Â

BREATHING NEW LIFE INTO STATE TAKEOVER STATUTES

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I. Introduction

State regulation of tender offers began with a Virginia statute passed in 1968. See L. Loss, *Fundamentals of Securities Regulation* 601 (1983). The basis for the Virginia legislation was "[f]ear that established local concerns might be taken over by outside interests which in turn would close down plants and leave local residents jobless." E. Aranow & H. Einhorn, *Tender Offers for Corporate Control* 153 (1973). A substantial number of states followed the pattern set by Virginia, enacting so-called "first generation" takeover laws.

The role of the states in regulating hostile takeovers suffered a serious setback in 1982 when the Supreme Court's decision in *Edgar* v. *MITE Corp.* struck down the Illinois Business Take-Over Act, a first generation statute, as an unconstitutional burden on interstate commerce. Hostile acquisitions, most often undertaken by means of a tender offer for the target corporation's voting stock, have since been governed almost exclusively by the provisions of the 1968 Williams Act, 15 U.S.C. Â§ 78n(d), and the SEC rules and regulations promulgated thereunder, see *e.g.*, 17 C.F.R. Â§Â§ 240.13d-1, 240.14d-3. Although many states, following *MITE*, enacted laws designed to avoid the constitutional defects of the Illinois statute, many of those laws were struck down by federal courts which readily extended the *MITE* rationale. These courts in general held that the laws unduly interfered with interstate commerce and upset the equilibrium between bidder and target management that is at the heart of the Williams Act. So widely held was the view that most of the state anti-takeover statutes were unconstitutional that it became routine for bidders to file "preemptive" lawsuits in federal court when they commenced their offers, and for courts routinely to enjoin state officials from enforcing their statutes. The federal district court in Delaware went a step further, and stopped hearing those complaints altogether.

All that changed last April. The Supreme Court's decision in *CTS Corp.* v. *Dynamics Corp. of America* breathed new life into state takeover statutes by upholding the Indiana Control Share Acquisitions statute against the customary Commerce Clause and Supremacy Clause claims. In the process, the Court shifted the emphasis from uniform federal regulation to traditional state corporation law, and provided an analytical basis to support a substantial measure of state regulation of takeovers. It is still too early to tell what effect the *CTS* decision will have on the level of hostile takeover activity. It has, however, had a profound effect both on state legislatures, many of which scrambled to enact Indiana-type statutes following *CTS*, and on some companies, which have relocated to take advantage of them. But neither Delaware nor California has yet acted, so the practical importance of *CTS* may yet prove to be limited. Moreover, some commentators have questioned whether statutes like Indiana's actually deter takeovers, or whether under some circumstances they could facilitate them. The most important response to *CTS*, however, is yet to come: in the wake of the insider trading scandal, Congress is considering several bills that could be used as vehicles to preempt the states from regulating any aspect of takeover activity.

Much has been written about *MITE* and the so-called "second generation" of state takeover laws that were adopted in reaction to it. See, *e.g.*, L. Loss, *supra*, at 99-101 (Supp. 1986). This outline will review both *MITE* and *CTS* and will discuss the constitutional limits to state legislation in the area. The outline will then survey the various models of state statutes in the light of these constitutional principles. Finally, the outline will discuss the practical effects of *CTS* on hostile takeover activity and will note the various legislative initiatives that are pending in Congress.

II. The Supremacy of Federal Regulation: *Edgar* v. *MITE Corp.*

In *Edgar* v. *MITE Corp.*, 457 U.S. 624 (1982), the Supreme Court invalidated the Illinois Business Take-Over Act, Ill. Rev. Stat. ch. 121-1/2, Â¶ 137.57 *et seq.* (1979), as unconstitutional under the Commerce Clause, because it imposed burdens on interstate commerce that were excessive as compared to the state interests asserted in support of the statute.

The statute required any tender offer for a target company to be registered with the Illinois Secretary of State. A target company was defined as an issuer 10% of whose securities subject to the offer were held by Illinois shareholders, or in which any two of the following conditions were met:

(a) the corporation's principal executive office was in Illinois,

(b) the corporation was incorporated in Illinois, or

(c) 10% of the stated capital and paid-in surplus was represented in Illinois.

A tender offer automatically became registered 20 days after the filing of a registration statement with the Secretary of State unless the Secretary called for a hearing. The Secretary could call a hearing to adjudicate the substantive fairness of the offer if he believed it was necessary to protect the target's shareholders. In addition, the Act required that a hearing be held if requested by a majority of the target's outside directors or by Illinois shareholders owning at least 10% of the class of securities subject to the offer. The statute directed the Secretary, at the hearing, to deny registration of the offer if he found that it "fail[ed] to provide full and fair disclosure to the offerees of all material information concerning the take-over offer, or that the take-over offer [was] inequitable or [could] work or tend to work a fraud or deceit upon the offerees." *MITE*, 457 U.S. at 627.

A bare majority of the Court held that the Illinois Act was unconstitutional as a violation of the Commerce Clause. The Court applied the balancing approach of *Pike* v. *Bruce Church, Inc.*, 397 U.S.137 (1970): a state statute must be upheld if it "regulates evenhandedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental ... unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits." 397 U.S. at 142. The Court had no difficulty recognizing the "substantial" impact of the Illinois scheme on interstate commerce:

> "[s]hareholders are deprived of the opportunity to sell their shares at a premium. The reallocation of economic resources to their highest valued use, a process which can improve efficiency and competition, is hindered. The incentive the tender offer mechanism provides incumbent management to perform well so that stock prices remain high is reduced." 457 U.S. at 643.

In support of the Illinois statute, the Secretary argued that the state's interest was to protect resident shareholders and that the Act "merely regulates the internal affairs of companies incorporated under Illinois law." *MITE*, 457 U.S. at 644. As to the second asserted justification, the Secretary was wrong on the facts: the Illinois statute applied not only to companies incorporated in Illinois, but also to certain foreign corporations. Similarly, as to the first point, the Court observed that "[w]hile protecting local investors is plainly a legitimate state objective, the State has no legitimate interest in protecting non-resident shareholders. Insofar as the Illinois law burdens out-of-state transactions, there is nothing to be weighed in the balance to sustain the law." 457 U.S. at 644.

The Court was "also unconvinced that the Illinois Act substantially enhances the shareholders' position." *Ibid.* The statute purported to protect shareholders by requiring certain disclosures concerning the offer, by ensuring that shareholders had adequate time to decide whether to tender, and by providing for withdrawal and proration rights. Because the federal Williams Act provides the same protections, the Court saw no reason for Illinois to impose its own. And to the extent the Illinois statute imposed requirements that exceeded those of the Williams Act, the Court questioned whether they would "substantially enhance the shareholders' ability to make informed decisions." *Id.* at 645.

Although various members of the Court addressed the two other challenges to the Illinois statute â€" that it was a direct burden on interstate commerce and therefore unconstitutional without regard to the asserted State interest, and that it was preempted by the Williams Act â€" neither was able to command a majority of the Court. Indeed, in concurring opinions that are especially noteworthy in the light of *CTS*, Justices Powell and Stevens each recognized that there may be room for some State regulation of tender offers. Justice Stevens, for

instance, was "not persuaded ... that Congress' decision to follow a policy of neutrality in its own legislation [the Williams Act] is tantamount to a federal prohibition against state legislation designed to provide special protection for incumbent management." 457 U.S. at 655. Justice Powell went further, noting that state legislation concerning takeovers may â€" indeed, should â€" recognize the interests of employees, management personnel, and the communities they serve, in addition to those of the shareholders:

> "This period in our history is marked by conglomerate corporate formations essentially unrestricted by the antitrust laws. Often the offeror possesses resources, in terms of professional personnel experienced in takeovers as well as of capital, that vastly exceed those of the takeover target. This disparity in resources may seriously disadvantage a relatively small or regional target corporation. Inevitably there are certain adverse consequences in terms of general public interest when corporate headquarters are moved away from a city and State."

457 U.S. at 646 (Powell, J., concurring). In a footnote, Justice Powell explained:

> "The corporate headquarters of the great national and multinational corporations tend to be located in the large cities of a few States. When corporate headquarters are transferred out of a city and State into one of these metropolitan centers, the State and locality from which the transfer is made inevitably suffer significantly. Management personnel â€" many of whom have provided community leadership â€" may move to the new corporate headquarters. Contributions to cultural, charitable, and educational life â€" both in terms of leadership and financial support â€" also tend to diminish when there is a move of corporate headquarters." *Ibid.*

In the light of the Court's later decision in *CTS*, the majority opinion in *MITE* is especially interesting in two respects: the extent to which it relied upon assumptions regarding the behavior of the market largely based upon the Chicago - school law and economics approach, and its rejection of the internal affairs doctrine as a basis for upholding the statute. The lexicon of the majority opinion includes "incentives", "reallocation of economic resources to their highest valued use", and allowing shareholders the chance to get a "premium" for their shares. The Court cited with approval two leading proponents of the law and economics movement: Frank Easterbrook, now a judge on the Seventh Circuit, and Daniel Fischel, a professor at the University of Chicago Law School. *See* 457 U.S. at 643-44. In *CTS*, these assumptions are nowhere to be found, and, in fact, are disclaimed.

Equally significant, at least in hindsight, is the Court's response to the state's argument that the statute should be upheld under the internal affairs doctrine. Although the statute applied to non-Illinois companies, as to which application of the doctrine would make no sense ("Illinois has no interest in regulating the internal affairs of foreign corporations", 457 U.S. at 645-46), the Court appeared to suggest that the doctrine did not apply even to those companies incorporated in Illinois:

> "The internal affairs doctrine is a conflict of laws principle which recognizes that only one state should have the authority to regulate a corporation's internal affairs â€" matters peculiar to the relationships among or between the corporation and its current officers, directors, and shareholders â€" because otherwise a corporation could be faced with conflicting demands. That doctrine is of little use to the State in this context. *Tender offers contemplate transfers of stock by stockholders to a third party and do not themselves implicate the internal affairs of the target company*." *Id*. at 645 (citations omitted; emphasis added).

In *CTS*, this analysis was turned on its head.

III. The Legitimacy of State Regulation: *CTS Corp.* v. *Dynamics Corp. of America*

In response to *MITE*, a number of states enacted laws designed to provide the maximum available protection to domestic corporations and their shareholders while attempting to avoid the constitutional pitfalls of the Illinois statute.[1] In the years following *MITE*, these statutes were regularly challenged by hostile bidders and were usually struck down as unconstitutional under *MITE*. See, *e.g.*, *Fleet Aerospace Corp.* v. *Holderman*, 796 F.2d 135 (6th Cir. 1986), vacated, 107 S. Ct. 1623 (1987); *Gelco Corp.* v. *Coniston Partners*, 652 F. Supp. 829 (D. Minn.1986); *Terry* v. *Yamashita*, 643 F.Supp. 161 (D. Hawaii 1986); *APL Ltd. Partnership* v. *Van Dusen Air, Inc.*, 622 F. Supp. 1216 (D. Minn. 1985), vacated as moot, No. 85-5285 (8th Cir. Nov. 26, 1985); *Icahn* v. *Blunt*, 612 F.

Supp. 1400 (W.D. Mo. 1985). Although only three Justices in *MITE* had subscribed to the view that the Williams Act prevents states from adopting anti-takeover regulations, "this leap was taken by the Supreme Court plurality . . . in *MITE* and by every court to consider the question since." *Dynamics Corporation of America* v. *CTS Corp.*, 794 F.2d 250, 262 (7th Cir. 1986) (Posner, J.), *rev'd*, *CTS Corp.* v. *Dynamics Corp. of America*, 107 S. Ct. 1637 (1987) ("*CTS*"). It was therefore no surprise when the Seventh Circuit, affirming the District Court, struck down the Indiana Control Share Acquisitions Chapter of the Indiana Business Corporation Law as a violation of both the Commerce Clause and the Supremacy Clause.

Unlike the Illinois statute invalidated in *MITE*, the Indiana control share statute applies only to companies incorporated in Indiana. Moreover, the Indiana corporation must have at least 100 shareholders and certain additional contacts with the State: its principal place of business, principal office or substantial assets within Indiana, and either:

(i) more than 10% of its shareholders resident in Indiana; or

(ii) more than 10% of its shares owned by Indiana residents; or

(iii) 10,000 shareholders resident in Indiana.

Ind. Code Ann. Â§ 23-1-42-4(a) (Supp. 1986). A "control share acquisition" is an acquisition by virtue of which the acquirer, but for the operation of the statute, would cross one of three voting thresholds: 20%, 33-1/3%, or 50%. Thus, for example, a purchase of 8% of the company's shares by a 14% holder (or by a 43% holder) would be subject to the Act; a purchase of 19% by a person who until then had owned no stock would not. The shares acquired in the control share acquisition have voting rights only if they are granted by a majority vote of disinterested shares. If the acquirer files a disclosure statement (which the statute refers to as an "acquiring person statement") containing information about his intentions and financial capacity, management must hold a special shareholders' meeting â€" at the acquirer's expense â€" within 50 days to consider whether the acquirer will have voting rights. If the acquirer is denied voting rights, or if the acquiring person statement is not filed within 60 days, the corporation may (but need not) redeem the acquirer's shares "at the fair value thereof pursuant to the procedures adopted by the corporation." Ind. Code Ann. Â§ 23-1-42-10(a); *see* 794 F.2d at 261.

The Seventh Circuit had no difficulty concluding that the Indiana statute was both preempted by the Williams Act and created an unconstitutional burden on the interstate market for corporate control. With respect to preemption, the Seventh Circuit did not see much difference between the Illinois statute struck down in *MITE* and the Indiana control share statute: "The Illinois statute both imposed delay and put the acquirer at the mercy of the Illinois Secretary of State; the Indiana statute imposes slightly greater delay but puts the acquirer at the tenderer mercies of the disinterested shareholders. If we had to guess we would guess that the Indiana statute is less inimical to the tender offer, but that is unimportant. The Indiana statute is a lethal dose; the fact that the Illinois statute may have been two or three lethal doses has no practical significance. Very few tender offers could run the gauntlet that Indiana has set up." 794 F.2d at 262-63. Having decided that the statute was preempted, the court's Commerce Clause analysis was almost an afterthought: "if the statute is unenforceable by reason of the supremacy clause, it hardly matters, at least for this case, whether it is also unenforceable by reason of the commerce clause." *Ibid.* But the court, apparently using the balancing approach of *Pike*, nevertheless held the statute unconstitutional under the Commerce Clause as well.

Finally, the Seventh Circuit rejected the claim that the statute was saved by the internal affairs doctrine. Conceding that "Indiana has a broad latitude in regulating [the internal affairs of Indiana corporations], even when the consequence may be to make it harder to take over an Indiana corporation[,]" the court nevertheless held that the sweeping effect of the statute on hostile offers was "not merely the incidental effect of a general regulation of internal corporate governance. . . . Any other conclusion would invite facile evasions of the clause." 794 F.2d at 264.

The Supreme Court, however, did reach a different conclusion, and reversed. The Court held that the statute did not conflict with the Williams Act and, because it regulates an area of traditional and legitimate state concern â€" the internal affairs of its corporations â€" it also did not violate the Commerce Clause. In the process, the Court dramatically altered the terms of the analysis, emphasizing the state's traditional right to regulate the corporations it creates, even when those regulations substantially affect interstate commerce.

The *CTS* Commerce Clause holding is based upon two conclusions: that Indiana, in its control share statute, regulates attributes of property rights (shares of Indiana corporations) created by the state in the first place, and that, in so doing, Indiana does not discriminate against interstate commerce:

> "The very commodity that is traded in the securities market is one whose characteristics are defined by state law. Similarly, the very commodity that is traded in the 'market for corporate control' â€" the corporation â€" is one that owes its existence and attributes to state law. Indiana need not define these commodities as other States do; it need only provide that residents and nonresidents have equal access to them." *CTS*, 107 S.Ct. at 1652.

Furthermore, because the Indiana statute (unlike the Illinois Act) applies only to Indiana corporations â€" and even then only to those Indiana corporations with substantial local contacts â€" the state has not created an impermissible risk of inconsistent regulation: no state but Indiana would have a legitimate basis to regulate an Indiana corporation with substantial assets, employees and shareholders in the state.

In holding that the Indiana Act is not preempted by the Williams Act, the Court, without adopting the reasoning of the plurality opinion in *MITE* or its interpretation of the Williams Act, nevertheless held that the statute "passes muster even under the broad interpretation of the Williams Act articulated by Justice White in *MITE*." 107 S.Ct. at 1645. The MITE plurality had been principally concerned that the Illinois statute favored management over the bidder in any control contest, and thereby upset the balance between target's management and the bidder that is the purpose of the Williams Act.[(2)] In *CTS* the Court held that, in contrast to the Illinois statute, the Indiana control share acquisition law "protects the independent shareholder against both of the contending parties" (*id.*) by not giving either management or the offeror an advantage in communicating with the shareholders about the impending offer. It also does not impose an indefinite or unreasonable delay. Although a bidder must wait 50 days before finding out whether he can vote his shares (and is unlikely to want to purchase them beforehand), that delay, although longer than the approximately 30 days (20 business days) that a tender offer must remain open under the Williams Act, is not unreasonable, especially since it is within the maximum 60 day period that an offer may remain open under the Exchange Act. See Exchange Act Â§ 14(d)(5). "[N]othing in *MITE* suggested that *any* delay imposed by state regulations, however short, would create a conflict with the Williams Act." *Id.* at 1647 (emphasis in original).

The most significant aspect of *CTS* is not its holding as much as its deference to state regulation and its apparent rejection of the law and economics approach of *MITE*. For instance, where *MITE* embraced the view that the states have no business interfering with the interstate market for corporate control and that takeovers promote efficiency, *CTS* replies that "[t]he Constitution does not require the States to subscribe to any particular economic theory." 107 S.Ct. at 1651. The Court also seemed to take exception to the premise, implicit in *MITE*, that takeovers are ordinarily a good thing: "Indiana's concern with tender offers is not groundless. Indeed, the potentially coercive aspects of tender offers have been recognized by the Securities and Exchange Commission and by a number of scholarly commentators." *Id.* (citations omitted). Instead of assuming that state interference with the market for corporate control is invalid, the *CTS* Court upheld the law by looking to the source of the commodity that creates the market in the first place: state corporation law.

> "Every State in this country has enacted laws regulating corporate governance. By prohibiting certain transactions, and regulating others, such laws necessarily affect certain aspects of interstate commerce. This necessarily is true with respect to corporations with shareholders in States other than the state of incorporation. Large corporations that are listed on national exchanges . . . will have shareholders in many states and shares that are traded frequently. The markets that facilitate this national and international participation in ownership of corporations are essential for providing capital not only for new enterprises but also for established companies that need to expand their businesses. This beneficial free market system depends at its core upon the fact that a corporation â€" except in the rarest situations â€" is organized under, and governed by, the law of a single jurisdiction, traditionally the corporate law of the State of its incorporation."

107 S.Ct. at 1650. The Court noted that state regulations "of hitherto unquestioned validity" â€" such as those permitting staggered boards and cumulative voting, or those requiring a supermajority vote to approve a merger â€" affect many corporate transactions, in some cases making them more difficult to accomplish. But that does not make the laws unconstitutional: "[i]t . . . is an accepted part of the business landscape in this country for States to create corporations, to prescribe their powers, and to define the rights that are acquired by purchasing

their shares." *Id.* This makes sense, of course, only when the state law regulates those corporations created by that state: "Indiana has no interest in protecting nonresident shareholders *of nonresident corporations*." (*Id*. at 1651; emphasis in original).

CTS, then, stands for the proposition that states can continue their traditional function of "defining the attributes of shares in [their] corporations and in protecting shareholders," even if those laws affect interstate commerce to an undefined "limited extent." 107 S.Ct. at 1652. The Indiana Control Share Acquisitions statute "evenhandedly determines the voting rights of shares of Indiana corporations," a traditional state function. *Id*. As such, the Court held that it neither conflicts with the "provisions or purposes" of the Williams Act, nor does it impermissibly burden interstate commerce. *Id*.(3)

IV. Reasons For The Shift

The opinions in *MITE* and *CTS* read as if they were handed down by two different Courts. And in many respects they were. *MITE* was a kaleidoscope of different opinions. Five Justices (Chief Justice Burger and Justices White, Powell, Stevens, and O'Connor) joined in the narrowest branch of the Commerce Clause analysis, which concluded that the Illinois Act was unconstitutional because it placed a substantial burden on interstate commerce that outweighed any local benefits. Only four Justices joined the broader strain of Commerce Clause analysis, which concluded that the Illinois statute imposed a forbidden "direct" burden on commerce. Only three Justices found that the statute conflicted with the Williams Act and was therefore preempted; two Justices expressly rejected the preemption rationale. Three Justices believed that the case was moot and declined to address the merits at all.

The kaleidoscope shifted, of course, by the time of *CTS*. The three Justices who declined to express any opinion on the merits in *MITE* (Justices Brennan, Marshall, and Rehnquist) formed a liberal-conservative alliance that at once favored states' rights and business regulation, and which combined to approve the Indiana law. In addition, by the time *CTS* was decided, Chief Justice Burger, a strong supporter of preemption and the Commerce Clause analysis in *MITE*, had left the Court and its new member, Justice Scalia, was firmly committed to the camp of the states' rights proponents.

In addition to these shifts in personnel and newly expressed opinions, there were, of course, differences of substance in the two cases. *MITE* dealt with a statute that appeared to freeze the tender offer process in its tracks; *CTS*, by contrast, dealt with a law that regulated voting rights and did not overtly regulate tender offers at all. Refined legislative draftsmanship thus succeeded in shifting the judicial focus from obstructions of the national securities market to traditional governance of internal corporate affairs.

Other elements of the decision-making process shifted as well. The Department of Justice and the SEC are, of course, extremely influential advocates in any securities case in the Supreme Court. In *MITE*, the SEC and the Solicitor General, joined by the head of the Antitrust Division, filed a brief that vigorously argued both that the Illinois statute was preempted and that it ran afoul of the Commerce Clause. That brief made little reference to federalism or states' rights. This efficiency-based argument was accepted by the Supreme Court, which referred conspicuously to the "reallocation of economic resources to their highest valued use," the improvement of "competition and efficiency," and the preservation of managerial "incentive[s]." 457 U.S. at 643-644.

By the time of *CTS*, however, the Department of Justice had different â€” or at least additional â€” concerns. The government's brief argued half-heartedly that the Indiana statute violated the Commerce Clause, but it conceded that there was no inconsistency with the Williams Act. Most significantly, the government's brief also conceded that [t]he Constitution does not dictate that states, when acting within their proper spheres, act in accordance with any particular theory of economic efficiency, or that they pursue economic efficiency at all." Amicus Br. at 20. The government accused the Seventh Circuit of "second-guessing ... the Indiana legislature" on the issue of "where the best interests of shareholders lie." *Id.* at 28. These observations were reflected in the Supreme Court's declaration (107 S.Ct. at 1651) that "[t]he Constitution does not require the States to subscribe to any particular economic theory. We are not inclined to 'second guess' the empirical judgments of lawmakers."

One final ingredient deserves mention. Like the rest of us, the Justices read the newspapers. And their daily reading in the spring of 1987 focused on insider-trading scandals on Wall Street, many of which involved hostile tender offers. In this context, it was naturally tempting to draw back from a broad interpretation of the Commerce

Clause that would trivialize the regulatory power of the states in the field of tender offers. The Court was understandably moved to comment that "Indiana has a substantial interest in preventing the corporate form from becoming a shield for unfair business dealing." *Id*. at 1651-1652.

This blend of changes â€" involving a shift of personnel on the Supreme Court, an expression of new opinions from Justices not previously heard from, a more sophisticated regulatory strategy, a distinct change in advocacy from the SEC and the Department of Justice, and an enveloping climate of publicity that highlighted the seriousness of abuses in the tender offer field â€" prompted a reconsideration of Commerce Clause jurisprudence that is likely to have a lasting impact. The result of this shift is a more restrained concept of the judicial function in Commerce Clause cases, and less of a willingness to import judge-made economic conceptions. Justice Scalia's concurring opinion captured this thought as follows (107 S. Ct. at 1652):

> "having found . . . that the Indiana Control Share Acquisitions Chapter neither 'discriminates against interstate commerce,' . . . nor 'creates an impermissible risk of inconsistent regulation by different States' . . . I would conclude without further analysis that it is not invalid under the dormant Commerce Clause. While it has become standard practice at least since *Pike* v. *Bruce Church*, Inc. . . . to consider, in addition to these factors, whether the burden on commerce imposed by a state statute 'is clearly excessive in relation to the putative local benefits,' . . . such an inquiry is ill suited to the judicial function and should be undertaken rarely if at all."

This concurring 'opinion, coupled with the majority's expansive definition of internal corporate affairs and its recognition of the potentially coercive aspects of tender offers, constitute a broad invitation to the states to assume a regulatory function that was thought totally foreclosed after *MITE*. Just as the general rhetoric in *MITE* and its economic assumptions caused lower federal courts to condemn a variety of statutes that differed from the Illinois statute, so too the rhetoric favorable to state regulatory initiatives is certain to be extended beyond the statutory pattern explicitly reviewed in *CTS*. To appreciate the permissible scope and potential limits on these laws after *CTS*, it is necessary first to sketch the basic characteristics of so-called "second generation" takeover laws, that is, laws enacted in the wake of *MITE* which attempt to overcome the constitutional infirmities identified in that decision.

V. Second Generation Anti-Takeover Statutes

The various second generation statutes fall into six general categories: control share acquisition laws, fair price laws, heightened appraisal rights laws, five-year moratorium laws, expanded constituency laws, and heightened disclosure laws. A number of states have enacted anti-takeover statutes of more than one type. Bidders may thus frequently be confronted with several state law hurdles in a single offer.

A. Control Share Acquisition Laws

Twelve states[(4)] have enacted control share acquisition laws; the Indiana statute is typical. The Indiana statute applies to companies incorporated in Indiana which have 100 or more shareholders. In addition, the companies must have their principal place of business, principal office, or substantial assets within Indiana; and either more than 10% of their shareholders resident in Indiana; more than 10% of their shares owned by Indiana residents, or ten thousand shareholders resident in Indiana. Ind. Code Ann. Â§ 23-1-42-4(a)(Supp. 1986).

An entity acquires "control shares" whenever it acquires shares that, but for the operation of the act, would bring its voting power in the corporation to or above 20%, 33-1/3% or 50%. An entity that acquires control shares only acquires voting rights for those shares if granted at a shareholder meeting by a majority of all votes cast by each voting group, and by a majority of all votes cast by each voting group excluding the "interested shares".

In order to acquire voting rights, an acquirer must submit an "acquiring person statement" to the corporation. If the acquirer requests that the board of directors call a special meeting to consider the voting rights to be given his shares, the meeting must be held within 50 days, provided that the acquirer agrees to pay the expenses of the meeting. If no such request is made, the acquirer's voting rights are considered at the next special or annual shareholders' meeting.

If the acquirer fails to file an "acquiring person statement", or if the other shareholders do not grant the control

shares voting rights, the corporation may redeem the acquirer's shares. Ind. Code Â§ 23-1-42-10(a). The price paid for the shares must be "not less than the highest price paid per share by the acquiring person in the control share acquisition." *Id.* Â§ 23-1-42-11(c). If the acquirer's shares are granted full voting rights and the acquirer accumulates more than 50% of the voting power, the other shareholders have dissenters' rights.

The Ohio control share acquisition statute differs from the Indiana Act in that shareholders must approve the control share acquisition itself, not just the grant of voting rights associated with the control share acquisition.[(5)]

The new North Carolina, Massachusetts, Florida and Arizona control share acquisition statutes are similar to the Indiana act with one important difference: they apply to foreign corporations which have close contacts with the state. The North Carolina law, for example, applies to foreign corporations that have more than 40% of their domestic fixed assets in North Carolina, more than 40% of their domestic employees in North Carolina, 500 or more shareholders, their principal place of business or principal office within North Carolina, and either 10% of their shareholders resident in North Carolina or more than 10% of their shares owned by North Carolina residents. In an interesting effort to avoid the constitutional problems raised by a state's regulating foreign corporations, the North Carolina law contains what might be regarded as a constitutional "savings clause": the law does not apply to a foreign corporation otherwise covered if the North Carolina law is expressly inconsistent with the laws of the company's state of incorporation. Massachusetts has a similar provision that applies only if the state of incorporation has adopted its own control share acquisition statute.

Wisconsin has adopted a variation of the Indiana statute that substantially dilutes, but does not eliminate, the acquirer's voting rights. For shares held in excess of a 20% interest, only 10% of the voting power can be exercised until shareholders approve full voting rights at a meeting to be held 30 to 50 days after the directors receive information from the bidder regarding his plans for the company. In other words, until a favorable vote, each share above the 20% threshold gets one-tenth of a vote.

B. Fair Price Laws

Thirteen states[(6)] have enacted fair price statutes. Maryland was the first state to adopt a fair price statute, which is typical of these laws. The statute requires that any business combination involving a resident corporation and a holder of ten percent or more of its stock must be recommended by the board of directors and approved by 80% of the outstanding shares and 2/3 of all shares not held by the interested shareholder, unless the compensation received by minority shareholders in the business combination satisfies the statute's fair price provision. The supermajority provisions do not apply if the board of directors approved the transaction before the bidder acquired the 10% stake. Md. Corps. & Ass'ns Code Ann. Â§ 3-603(c)(I)(ii). In very general terms, the fair price is one that equals or exceeds the highest price paid during the previous two years for the corporation's stock (including the price paid in the first step of the transaction). *Id.* Â§ 3-603(b).

Maryland's definition of "business combination" includes:

(1) mergers, consolidations, or share exchanges;

(2) the sale, lease, or transfer of 10% or more of the target's assets;

(3) the issuance or transfer by the target of equity securities that have an aggregate market value of at least five percent of the total market value of the outstanding shares;

(4) a liquidation or dissolution of the target in which the bidder receives anything other than cash; and

(5) reclassifications, recapitalizations, or other transactions which have the effect of increasing the proportionate ownership of the interested shareholder.

The definition of business combination does not include stock transfers to the interested shareholder from other shareholders. In order for there to be a business combination, however, the interested stockholder may not become the beneficial owner of any additional shares after the transaction that results in the interested

stockholder acquiring his 10% interest.

The North Carolina Act is similar to the Maryland law except that the potential acquirer must obtain 20% of the target's stock in order to trigger the requirements of the statute, and 95% shareholder approval is required unless the fair price provision is satisfied. More importantly, the North Carolina law applies to foreign corporations with substantial activities in North Carolina unless expressly inconsistent with the law of the state of incorporation.

C. Heightened Appraisal Rights Laws

Three states have adopted heightened appraisal rights statutes, which are frequently referred to as "control-share cash-out" laws.[(7)] The Pennsylvania statute, as an example, requires a person acquiring 30% or more of the stock of a company incorporated in Pennsylvania to notify the remaining shareholders. For an undefined "reasonable period" of time thereafter, any remaining shareholder may demand cash payment for his shares corresponding to fair value plus an "increment representing a proportion of any value payable for acquisition of control of the corporation". Â§ 1910E.

The Maine law is similar, except that the cash-out trigger is 25% and Maine specifies the time periods for notification and disclosure which Pennsylvania leaves open. In the Utah law heightened appraisal rights are not granted in cases in which the transaction receives the prior approval of a majority of the continuing directors.

D. Five-Year Moratorium Laws

Nine states[(8)] currently have five-year moratorium laws. The provisions of the New York statute are typical. It applies to New York corporations which maintain their principal executive offices in New York and have holders of at least 10% of their stock residing in New York.

Any person who acquires 20% or more of the voting stock becomes an "interested shareholder." An interested shareholder is prohibited from engaging in a business combination with the company for five years unless the company's board has approved (i) the particular business combination or (ii) the stock purchase that put the interested shareholder over the 20% threshold. Board approval must be obtained before the acquirer becomes an interested shareholder. BCL Â§ 912(c)(1). New York defines "business combination" in substantially the same way as Maryland does for purposes of its fair price statute (see section V.B., *supra*), except that New York includes as a business combination any proposal for liquidation or dissolution of the target made by the interested shareholder or any of his affiliates or associates. The definition does not include stock transfers to the interested shareholder from other shareholders. BCL Â§ 912(a)(5).

After five years have elapsed, the interested shareholder may engage in a business combination only if (i) a majority of the disinterested shareholders approve or (ii) the consideration paid by the interested shareholder satisfies fair price criteria. BCL Â§ 912(c)(3).

A New York company may choose not to be covered by the statute with the approval of a majority of the disinterested shareholders. The opt out, however, does not become effective until 18 months after the successful vote.

The Arizona, Kentucky, New Jersey, Washington, Wisconsin and Indiana laws are similar, except that a person becomes an interested shareholder when he acquires 10% or more (as opposed to 20%) of a resident corporation's voting power. The Wisconsin statute has a three (instead of five) year moratorium on business combinations. The Washington law regulates corporations that are not incorporated in Washington but which have close contacts with the state.

E. Expanded Constituency Laws

A number of states permit directors to consider the interests of constituents other than the corporation's shareholders.[(9)] The Illinois statute is representative and provides that:

"In discharging the duties of their respective positions, the board of directors, committees of the

> board, individual directors and individual officers may, in considering the best interests of the corporation, consider the effects of any action upon employees, suppliers and customers of the corporation, communities in which offices or other establishments of the corporation are located and all other pertinent factors.[(10)]

Although most of these laws are permissive and are not, strictly speaking, anti-takeover devices, they reflect the concern with hostile takeovers expressed in *CTS*, and could be used to justify defensive tactics to resist hostile takeovers.

At least one state, however, has taken a different approach. The new Arizona statute includes a requirement that "[i]n discharging the duties of the position of director, a director, in considering the best interests of the corporation, *shall consider* the long-term as well as the short-term interests of the corporation and its shareholders including the possibility that these interests may be best served by the continued independence of the corporation." Ariz. Rev. Stat. Â§ 10-1202 (as added by H.B. 2002, July 23, 1987) (emphasis added). By requiring the directors to consider long-term interests, the statute creates a hornet's nest of problems: How would the directors go about considering the long term in the light of cases like *Smith* v. *Van Gorkom* [(11)]? The directors would not be likely to get a fairness opinion from an investment banker that the proposed transaction is fair over the long-term. How, then, would the courts evaluate a board decision to reject a higher price now in favor of a speculative higher value in the future? As someone once quipped, "in the long run, we're dead."

Problems may also arise in connection with the permissive statutes. They could, for example, be read to give an employee standing to sue the directors if, as a result of a sale of the company, a plant is closed and the employee loses his job. The uncertainties created by these statutes may make life harder for directors.

F. Heightened Disclosure Statutes

At least nine states[(12)] have heightened disclosure statutes which, in many cases, are revisions of pre-*MITE* disclosure statutes. Some of these statutes apply only with respect to corporations with substantial contacts with the state; others apply, like the Blue Sky laws, if an offer is made to a certain number of residents of the state. These laws are sometimes referred to as "third generation" takeover laws, reflecting the legislatures' effort to minimize constitutional objections to "second generation" statutes.

The Minnesota statute is a good example of these laws. It applies "only when at least twenty percent of the target's shareholders are Minnesota residents and the target has 'substantial assets' in the state." *Cardiff Acquisitions, Inc.* v. *Hatch*, 751 F.2d 906, 911 (8th Cir. 1984). Under the statute,

> "[a]n offer becomes effective when the offeror files with the commissioner a registration statement disclosing the information prescribed in section 80B.03(2) & (6). The Commissioner may suspend the tender offer in Minnesota within three days if the registration materials fail to apprise local investors fairly of the information required by 80B.03(2) & (6). 1984 Minn. Sess. Law Serv., ch. 488, Â§ 80B.03(4a) (West). The suspension may be lifted once the offeror discloses the information specified in section 80B.03(2) & (6). A hearing on the suspension must be convened within ten days and a decision rendered within three days. 1984 Minn. Sess. Law Serv., ch. 488, Â§ 80B.03(5) (West). The Minnesota Act does not contain a provision like the one in the Illinois Act [in *MITE*] which required the Commissioner to convene a hearing at the request of the target corporation. In sum, there is no delay under the Minnesota Act as there was under the Illinois Act because the Commissioner must complete the process within nineteen calendar days, 1984 Minn. Sess. Law Serv., ch. 488, Â§ 80B.03(5) (West), which is prior to the expiration of the twenty business-day minimum offering period specified by federal law . . . . 17 C.F.R. Â§Â§ 240.14d-7 and 240.14e-1 (1984)."

Id. at 910 (emphasis in original). Any suspension of the offer applies only to Minnesota residents, *id.* at 911, Minn. Stat. Ann. Â§Â§ 80B.01(8), 80B.03(4a), although it is possible that the inability of a bidder to purchase shares from Minnesota residents could result in the failure of the minimum condition of the offer.

VI. Potential Constitutional Challenges to Second Generation Statutes

Constitutional challenges to these second generation laws â€” whether enacted before or after *CTS* â€" can be expected to focus on whether they are more like laws governing corporate functions which have traditionally been left to the states, or instead like the Illinois statute, which allowed a local official to enjoin a nationwide offer for shares of a company that was not even incorporated in Illinois.

A. Control Share Acquisition Statutes

Given the Supreme Court's strong endorsement of the Indiana approach, it will be difficult to mount a sweeping attack on these statutes. Nevertheless, there are two areas in which the statutes may still be vulnerable. First, several recently-enacted statutes (Arizona, North Carolina and Massachusetts, for instance) apply to foreign corporations. In some cases, the statutes were drafted with particular companies in mind: for example, Burlington Industries in North Carolina. Although Burlington is North Carolina's largest employer by far, and has other significant contacts with the state, it is not a creature of that state. Thus, the premise of both *MITE* and *CTS* â€" that the state that creates a corporation is the only state entitled to regulate it â€" does not justify North Carolina's regulation of Burlington. To the contrary, as a Delaware corporation, Burlington is subject, as to corporate law matters, to the Delaware General Corporation Law.

But Arizona, North Carolina and Massachusetts undoubtedly have a great interest â€" greater, perhaps, than Delaware â€" in protecting the employees, shareholders and customers of their important corporate constituents, even if not incorporated in those states. Justice Powell recognized in *MITE* the importance of corporations to their local communities, especially in states where a single corporation may be very important to the state's economy and fiscal health.

Notwithstanding the appealing arguments that can be made to support the state's interest in the well-being of resident foreign corporations, a substantial argument can also be made that the Arizona, North Carolina and Massachusetts statutes (along with others that apply to foreign corporations) are unconstitutional, even after *CTS*, since they purport to regulate a property interest that is created by another state. No one would seriously question that Delaware real estate law should govern the transfer of a parcel of land located in Wilmington, even if the owner resides in North Carolina and has not seen the property for years. Any other rule could result in uncertainty and frequent litigation, especially in the case of a company with substantial operations in more than one state. Like Delaware real estate, the attributes of shares of corporations â€" another form of property â€" are created by the state of incorporation.[(13)] It has long been recognized that interests in those "artificial beings" should be governed by the laws of the state of incorporation alone. See *Trustees of Dartmouth College* v. *Woodward*, 4 Wheat. 518, 636 (1819), cited with approval in *CTS*, 107 S.Ct. at 1649-50. Although a constitutional rule granting sole regulatory power to the state of incorporation may not be perfect, it at least has the virtue of certainty. The alternative would be to subject bidders to conflicting and inconsistent regulations, which both *CTS* and *MITE* recognized as a basis for invalidating state laws under the Commerce Clause.

Whatever arguments might be made to support them, it appears clear that statutes that apply to foreign corporations cannot be justified by the internal affairs doctrine as expressed in *CTS*. That, of course, does not automatically invalidate the statutes, but it does distinguish them from *CTS*. Beyond this, many of these post-*CTS* statutes are "one company" laws, custom-tailored to protect a particular corporation from a hostile bidder. As to these statutes in particular it would seem that a substantial argument could be made that they impermissibly interfere with interstate commerce, and perhaps also violate the uniformity provisions of applicable state constitutions.

A related problem, which has not yet been tested, is whether incorporation â€" without any other contacts â€" provides a sufficient constitutional nexus to permit a state to adopt a control share acquisition law. The problem is acute for Delaware: although over half of the Fortune 500 companies and more than 40% of the New York Stock Exchange-listed companies are incorporated in Delaware, they have few â€" if any â€" other contacts with the state. *CTS*, as well as parts of *MITE*, refer to the traditional role of states in regulating the attributes (such as voting rights) of the corporations they create. ("No principle of corporation law and practice is more firmly established than a State's authority to regulate domestic corporations, including the authority to define the voting rights of shareholders." *CTS*, 107 S.Ct. at 1649.) Yet *CTS* also recognized that the Indiana statute does not apply to all Indiana corporations, but only to those with substantial local contacts. ("Moreover, unlike the Illinois statute invalidated in *MITE*, the Indiana Act applies only to corporations that have a substantial number of shareholders in Indiana. Thus, every application of the Indiana Act will affect a substantial number of Indiana residents, whom Indiana indisputably has an interest in protecting." *Id*. at 1652.) It does not appear that the

requirement of local contacts was essential to the Court's holding in *CTS*, but it might nevertheless provide some basis for attacking a Delaware version of the Indiana statute.

A second potential challenge to the control share statutes can be levelled against the Ohio model statute, which requires shareholder approval not of voting rights after the share purchase is made, but of the purchase itself. As a result, it could be argued that the Ohio statute does not govern the internal functioning of domestic corporations, but rather directly regulates the interstate securities market, since an out-of-state investor cannot even purchase control shares in an Ohio company without shareholder approval. This feature distinguishes the Ohio model from *CTS*, in which the Court observed that "the [Indiana] Act does not impose an absolute 50-day delay on tender offers, nor does it preclude an offeror from purchasing shares as soon as federal law permits." 107 S.Ct. at 1647. The Ohio statute does have that effect. It is unclear whether this is a sufficient basis on which to invalidate the Ohio statute, especially since the practical effect of the Indiana statute is the same: although permitted to do so, no bidder will purchase shares until the shareholders have approved voting rights, so in effect the vote of the shareholders under the Indiana law is a referendum on the purchase itself.

B. Five-Year Moratorium Laws (New York)

Like the Indiana control share acquisitions statute, five-year moratorium statutes such as section 912 of the New York Business Corporation Law do not directly regulate the purchase of shares. Instead, they require board approval before certain major corporate transactions can be undertaken by certain major stockholders. The practical effect of the New York statute is to force potential bidders to negotiate with a company's board of directors before commencing the hostile offer. This could be considered part of the state's traditional function of regulating the internal affairs of its corporations. It is not very different in form from charter provisions (like staggered boards) that can delay major transactions following the purchase of a controlling block of stock. For a bidder unable to negotiate a deal with the board, a solution could be to wage a proxy fight before buying the 20% stake, in the hope that the new board would approve the purchase.[(14)] That New York, like Indiana, requires substantial contacts with the state before the statute applies would help it survive a constitutional challenge.

But the New York statute plainly increases the costs of tender offers, because, for instance, it makes it difficult for the bidder to arrange financing that will later be repaid using the proceeds of a sale of the acquired company's assets. As a result, the statute could, as a practical matter, eliminate bidders who need to borrow large sums in order to launch an attack. In their place would be cash-rich companies, possibly the same foreign buyers who have helped fuel the recent bull market on Wall Street. The resulting decrease in competition could result in lower prices overall in corporate control transactions for New York companies. These considerations did not, of course, greatly trouble the Supreme Court in *CTS*, which upheld the Indiana law despite its deterrent impact on tender offers. But, as discussed above with respect to the control share statutes, a law (like Washington's) that applies to foreign corporations may be subject to attack even after *CTS*. For a more detailed discussion of possible constitutional challenges to the New York type statutes, see Note, *The Constitutionality of State Business Combination Legislation*, 8 Cardozo L. Rev. 1025 (1987) and Cherno, *Supreme Court's Decision Substantially Changes the Balance Between Bidders and Target Companies*, 1 Insights 3, 6 (1987).

C. Fair Price Laws and Heightened Appraisal Rights Laws

The fair price laws have no direct effect on the purchase of shares in a tender offer; they simply preclude the front-end loaded offers that once were common, but which have been used far less frequently of late. Although these statutes can make certain offers more expensive, the statutes operate in essentially the same way as fair price charter provisions. After *CTS*, which relied heavily on the potentially "coercive" impact of tender offers and the sovereign power of the state to prevent "unfair business dealing," it seems unlikely that these laws will be invalidated.

The Pennsylvania-model control share cash-out statute operates as a mandatory fair price provision: a person who acquires 30% or more of the stock of a Pennsylvania corporation may have to buy the remaining shares of the company at a price that reflects fair value plus a control premium, if applicable. (This feature resembles the English takeover bid law.) Like the fair price statutes, the heightened appraisal rights laws may make purchases of a control block of shares more expensive, but they do not prohibit them, and even require them in certain cases.

D. Heightened Disclosure Statutes

For the most part, these laws mirror the disclosure requirements of the Williams Act, and to that extent they do not raise difficult constitutional questions. But many of these laws also impose certain additional disclosure requirements, most frequently relating to the potential impact of the proposed tender offer on the particular state. (*See*, *e.g.*, section 1603(a)(9) and (10) of the New York Business Corporation Law, which requires disclosure of, among other things, proposed plant closings, relocation of offices, the bidder's employee benefit plans, and any other matters likely to affect New York residents.) Although it is not difficult to see why the state has an interest in these matters, allowing state officials to suspend an offer for failure to comply with the disclosure requirements permits them to directly interfere with a national tender offer, even if the suspension is limited to the particular state. This is an important distinction between the heightened disclosure statutes and the control share acquisition laws: In Minnesota, unlike Indiana, the shareholders may never get the chance to vote on an offer because a state official decides that the disclosures are inadequate. See generally *Martin-Marietta Corp.* v. *Bendix Corp.*, 690 F.2d 558, 567 (6th Cir. 1982) (enjoining enforcement of Michigan Take-Over Offers Act because "[i]t prevents Michigan shareholders from participating in the nationwide tender offer. . . . This is an indirect burden on interstate commerce in that it has the effect of defeating the tender offers of residents from other states where the tendered shares owned by Michigan residents are needed to provide sufficient tendered shares to satisfy the offer").

The manner in which the disclosure laws operate could, therefore, subject them to attack under the Supremacy Clause. Arguably, they tip the balance in favor of management by giving a state official the power to enjoin the offer because disclosures beyond those required by the Williams Act are not made. The Williams Act reflects Congress' best judgment regarding the appropriate level of disclosure to be made by bidders in tender offers. Allowing states to adopt their own requirements could result in shareholders being buried in "an avalanche of trivial information" that would inhibit, rather than promote, informed shareholder decisions. See *TSC* v. *Northway*, 426 U.S. 438, 448-49 (1976). *But see Cardiff Acquisitions, Inc.* v. *Hatch*, 751 F.2d 906, 912 (8th Cir. 1985) (upholding the Minnesota heightened disclosure statute because "the additional disclosures required by the Minnesota Act will aid Minnesota shareholders in appraising the value of a tender offer and will not result in the shareholders receiving a mass of irrelevant information that will serve to confuse rather than enlighten.").

Moreover, these laws, which often go substantially beyond general antifraud provisions, arguably do not regulate an area of traditional and legitimate state concern and therefore the internal affairs doctrine, central to the holding of *CTS*, cannot be invoked to shield these statutes from Commerce Clause review. The Commerce Clause analysis would depend upon a number of factors, including the following: Does the act impose a waiting period before the offer becomes effective? Is the act limited to offers made to residents of that state? Does the act have the potential to cause indefinite delays by not specifying the time limits within which disclosures must be made? Most importantly, are the grounds on which the state official may suspend the offer narrowly drawn and specifically related to the adequacy of the disclosures, rather than the substantive terms of the offer? To the extent the disclosure requirements are used as a means of allowing states to regulate the substantive fairness of tender offers, they are likely to be deemed invalid under *MITE* and *CTS*.

But if the statutes are designed and enforced only to insure that full disclosure is made to residents of the state, the only basis for complaint would ordinarily be that a bidder might have to comply with a number of different disclosure requirements for a single offer. In the age of the word processor, that may not be unduly onerous. And since companies must already comply with Blue Sky laws in connection with routine securities offerings, it would not appear that the heightened disclosure laws would constitute an unreasonable burden on interstate commerce. See generally Comment, *Beyond CTS: A Limited Defense of State Tender Offer Disclosure Requirements*, 54 U. Chi. L. Rev. 657, 677-79 (1987); Note, *The Continuing Validity of State Takeover Statutes â€" A Limited Third Generation*, 62 Notre Dame L. Rev. 412, 431-32 (1987).

VII. Legislative Trends

In the months following *CTS*, a number of states rushed to enact anti-takeover statutes, frequently at the behest of a particular corporate constituent. For example, the new Massachusetts control share acquisitions law was sought by Boston-based Gillette Company, the target of a bid by Revlon; Boeing persuaded Washington to adopt a moratorium law that applies only to Boeing, even though it is a Delaware corporation; North Carolina passed a control share law for Burlington Industries, also a Delaware corporation; and Greyhound successfully lobbied Arizona to pass protective legislation for its benefit. In all, eleven states have passed new anti-takeover laws, or

amended existing ones, since *CTS* was decided in April.

Some of these laws were proposed in the midst of intense takeover battles and were pushed through the legislature in a matter of hours. In Minnesota, for instance, Dayton Hudson Corp., under attack by Dart Group Corp., persuaded the Governor to call a special session of the legislature, which immediately passed protective legislation. Not only was the law passed quickly, but it was custom-designed for Dayton Hudson. The five-year moratorium component of the law prevents an acquirer from quickly selling off assets to pay for the acquisition. (Dart would have needed to borrow heavily to finance the bid.) In addition, the effective date of the statute's prohibition on greenmail was delayed until March 1988, to allow Dayton Hudson time to purchase Dart Group's stake at a premium if necessary to end the assault. (For a discussion of recent legislative developments, see Pamepinto and Heard, "New State Regulation of Corporate Takeovers," *National Law Journal*, at p. 26. (9/21/87)).

But if *CTS* had a domino effect on some state legislatures, that is only part of the story. Delaware and California have not yet acted, and the outcome in those states may well determine whether state takeover laws are an important factor in future hostile bids or only measures of limited application. (For a discussion of the reasons Delaware chose not to proceed with an anti-takeover statute at this time, see section VIII below.)

An even more important issue is the effect pending federal legislation could have on state regulation of takeovers. Many observers have noted that the recent flurry of activity in the states, combined with the insider trading scandal, have made federal takeover legislation almost inevitable. A number of bills are pending in Congress that would increase the tender offer period from 20 business days (30 calendar days) to 40 or even 60 calendar days. Section 3(a) of the Dingell-Markey proposal (H.R. 2172) would require a one-share, one-vote standard for all shares traded on a national exchange. The SEC, moreover, is considering whether to prohibit exchange or NASDAQ listing of common stock if the issuer takes any action that would adversely affect the voting rights of existing, publicly-traded shares. See SEC proposed Rule 19c-4, Rel. No. 34-24623 (June 22, 1987). Either of these proposals, if adopted, might effectively preempt the control share acquisition laws, which work by denying a shareholder his voting rights.[(15)] Other pending legislation â€" including proposals to limit a company's repurchases of its own stock at a premium ("greenmail") and to restrict a board's defensive activities during a tender offer â€" could also have a preemptive effect. *See*, *e.g.*, H.R. 2172 (Dingell), S. 227 (D'Amato), S. 521 (Simon). In contrast, Section 12 of Senator Proxmire's bill (S.1323) expressly disclaims any effort to preempt state law: "the internal affairs or governance of corporations shall be subject to regulation by the laws of the state under which such corporation is organized" and shall not be preempted by federal law "except where compliance with such law would preclude compliance with the filings, disclosure, procedural or antifraud requirements" of federal law.

CTS has thus cast a long shadow over federal legislative efforts. Although the preemption issue has come to the fore in committee hearings, it is far from clear how the issue will be resolved â€" if it is resolved â€" in an election year. See Mendelsohn and Berg, "Tender Offer Battles In Legislative Arena Shift To Preemption," *Legal Times*, p. 26 (9/14/87). There is massive disagreement among the contending forces, including the securities industry (which generally favors preemption), the corporate community (which dislikes preemption but is far from united on the point), organized labor (which favors more federal regulation coupled with preemption of state law) and the Administration (which, based on the recent testimony of its officials, is divided). Add to this mixture the views of the new SEC chairman, David Ruder, favoring preemption, and you have a recipe for legislative confusion. See generally DER No. 132 (BNA), pp. A-11 to A-12 (7/13/87), summarizing the views of various legislators on the need for preemptive federal law. See also the Sept. 17, 1987 testimony of Chairman Ruder before the House Subcommittee on Telecommunications and Finance, p. 69:

> "Limitations on the free transferability of securities directly and primarily implicate issues of national concern regarding the efficiency, depth, and liquidity of the Nation's securities markets. Accordingly, I believe that federal law should control in that area by preempting state statutes that unduly interfere with the nationwide, free transferability of securities. I reach this conclusion cautiously, in full recognition of the Commission's more general position that internal corporate affairs should be regulated by the states. Nevertheless, preemption is needed when the states unduly interfere with the national markets. State laws couched as affecting matters of internal corporate governance may in reality have their primary effect not within the state, or within the corporation, but in the larger, nationwide market for the corporation's shares. Just as it would be imprudent for Congress to use tender offer regulation as a guise for federal regulation of internal

> corporate governance, it is imprudent for the states to use their authority over matters of internal governance as a guise for regulating the interstate market for tender offers. I recognize the difficult policy questions raised by a legislative effort to draw the line between the federal and state areas. Nonetheless, I do not agree with those who urge Congress to defer resolution of this issue. Delay would only increase the potential for the creation of a Gordian knot of overlapping regulation that could take the judiciary years to unravel."

The Chairman of the Federal Reserve Board has supported this view. See *Wall Street Journal*, p. 24, Col. 3 (9/22/87).

Perhaps, as was recently suggested, the "question will prove so difficult to resolve that there will be no tender offer reform legislation this year. Alternatively, Congress may adopt a tender offer package that contains no explicit provision on pre-emption, leaving it to the courts to apply the *CTS* decision to other state statutes." Pamepinto and Heard, *supra*, at 28. A "compromise" provision preempting some state statutes, but leaving intact control share acquisition laws of the kind approved in *CTS*, also is under consideration in Congress. See DER, No. 182 (BNA), p. A-1 (9/22/87).

VIII. Practical Considerations

When all is said and done, the most interesting question is not whether these statutes (and especially the control share laws) will survive judicial scrutiny, but whether they will have a significant effect on hostile takeover activity in the meantime. It is probably too early to tell whether shareholders are better or worse off with these statutes, although some studies have been done. See, for example, the March 1987 report of the Federal Trade Commission entitled *State Regulation of Takeovers and Shareholder Wealth: The Effects of New York's 1985 Takeover Statutes*, which concluded that shareholders of the 94 New York companies surveyed experienced a decline in the value of their investment shortly after announcement of the bill in 1985:

> "The announcement of this statute resulted in a highly significant decline in the average value of the sample firms. This decline of just under 1% indicates a capital loss to the shareholders of these firms of just under $1.2 billion. Thus, despite the political rhetoric advocating the regulation of takeovers on behalf of stockholders, the evidence presented here indicates that on average this very strong statute does not protect shareholders; rather, the law protects managers at the expense of shareholders. Moreover, the decline in the average value of the firms affected by these regulations does not merely reflect a reallocation of wealth from shareholders to managers. By deterring takeovers, regulations such as the ones passed in New York may promote the inefficient management of society's assets by lessening the ability of capital markets to efficiently reallocate assets. Consequently, the real cost of the goods and services produced by the firms affected by these regulations may increase, injuring consumers as well as shareholders."

The Office of the Chief Economist at the SEC reached a similar conclusion in a May 18, 1987 report entitled *Shareholder Wealth Effects of Ohio Legislation Affecting Takeovers*. Other recent empirical studies have reached different conclusions. See "New Jersey Antitakeover Law Seen Having Little Impact on Stock Prices," BNA Sec. Reg. & Law Rept., Vol. 19, p. 1411 (9/18/87) (concluding that companies subject to the New Jersey Shareholder Protection Act "outperformed the market during most of the period studied"); see also Wallman and Ranard, "State Takeover Laws Work Well," *Legal Times*, p. 22 (9/21/87) (summarizing economic arguments in favor of state takeover laws). But whatever the short-term effects of the statutes may be on stock prices, an equally important question is whether they can achieve their objectives, and on that there is considerable debate.

Delaware, for example, has decided, at least for the moment, not to adopt a control share statute based on the Indiana model. One reason the proposal was not recommended to the legislature is practical: it is difficult to adopt controversial and complicated legislation quickly. But another reason is that some commentators concluded that control share statutes actually work to the raider's advantage. A raider could put a company "into play" simply by announcing an intention to cross one of the stock ownership thresholds and calling for a shareholder vote: nothing in the Indiana law requires that the purchase be consummated before the acquirer can call for the meeting. Without having spent money to acquire a control block, he would have announced to the world that the company is for sale.[(16)] A vote in favor of the control share acquisition would probably result in a bidding war: certainly a windfall for the shareholders, but not at all what the statute's draftsmen had in mind. And it would seem that a favorable vote would be likely: shareholders (and especially institutions, which are the dominant

shareholders today) would generally vote for a short-term profit, so that any bidder offering a premium for the stock could reasonably expect a favorable outcome.

Another reason these statutes might not work as intended is that they have the potential to handcuff the board of directors. It is the board that has traditionally been the mechanism for erecting takeover defenses (such as restructurings and shareholder rights plans known as "poison pills"). If the raider is forced to go to the stockholders for a referendum on the offer, what reason is there to suppose that the result of the vote will be any different from the result of the offer itself? And as for the frequently expressed view that the 50-day delay helps management, it is far from clear that defensive measures designed to prevent or influence the shareholder vote would be sustained in litigation. Courts could conclude that the statute, having directed the question to the shareholders, thereby removed it from the board. For a summary of the considerations that led Delaware to abstain, at least for now, see Herzel and Shepro, "Delaware: No Hostility To Takeovers," *Financial Times* (7/9/87). For a fascinating inside view of the legislative process in Delaware, see Black, "Why Delaware Is Wary of Anti-Takeover Law," *Wall Street Journal* (7/10/87):

"The committee finally concluded unanimously to hold off on action for several reasons:

It seriously questioned whether the Indiana statute would even do what it is intended to do. The statute's principal deterrent to hostile offers is the requirement of a shareholder vote in 50 days on whether control shares will have voting rights. Since it is likely that tender offers would be conditioned on a favorable vote, this would, indeed, lengthen the duration of tender offers to 50 calendar days from the 20 business days required under the Williams Act.

But wouldn't the result be a stockholder plebiscite on every offer, and wouldn't the stockholder vote always favor the bidder or any new bidder that offered a greater premium? It did not seem to the committee to matter that the Indiana law precluded the bidder (as well as management) from voting. It seemed likely that institutions would vote for a short-term profit. So would arbitragers who could acquire shares before the record date for the stockholders meeting or purchase shares with proxies attached.

It is argued that 50 days would give a target management more time to take defensive action or to find a white knight. But it is unclear that courts would permit defensive action during the proxy solicitation mandated by the statute. Courts might well prohibit either side from taking any action to prejudice a fair vote, including adoption of shareholder-rights plans, sales of stock, corporate restructurings and other devices used to defend against unwanted takeovers. And, since every control-share acquisition would now involve a proxy contest, it was not clear what the position of the SEC would be on action by either side that might affect the vote or require changes in proxy materials.

The Delaware committee was also skeptical of the claim that the mere existence of a 50-day wait would deter tender offers. The market's usual creativity in connection with takeovers has extended to financing matters as well, not only with junk bonds but with investment bankers providing bridge loans to finance takeovers.

In addition, the committee was impressed by those who counseled that the Indiana statute affords a ready means to put companies into play. Almost anyone who wants to do that, or even to harass management, could simply notify the company of his intention to make a control-share acquisition and trigger the statutory stockholder plebiscite. The ensuing meeting notice and other publicity provide a cheap means to publicize the company's availability for sale.

Others noted that Indiana-type legislation might have a particularly short shelf life. A number of bills pending in Congress would extend the time tender offers must remain open under the Williams Act. One by Reps. John Dingell (D., Mich.) and Edward Markey (D., Mass.) would extend the time to 60 days. One commentator on the proposed Delaware law said that its incidental extension of tender offers to 50 days was a poor trade for the stockholder plebiscite the law required, and a net loss if Congress extended the time for tender offers to 60 days, anyway.

Other activity at the federal level also has the potential to make Indiana-type statutes an anachronism. The Dingell and Markey legislation would impose a one-share, one-vote standard on all shares listed on national exchanges or quoted on NASDAQ, and the SEC has proposed a rule to prohibit corporate action that would

disproportionately reduce the voting power of shares. Such provisions might preempt the provisions of the Indiana law that limit the voting rights of control shares.

A host of other problems emerged in the drafting process. Some Indiana provisions seem to permit greenmail, and their viability was called into question in light of legislation pending in Congress that would prohibit greenmail. Technical problems abounded. It appeared that the Indiana statute does not grandfather certain existing control-share positions. Would Delaware's adoption of such a statute inadvertently confiscate the control premium attached to existing blocks? Should the statute cover all corporations, or should stockholders or directors be permitted to opt in or opt out? Should an effort be made to preclude the decision on every tender offer from turning on the votes of arbitragers?

In the end, it was decided that these questions could not be resolved responsibly in time, and that court tests to come may yet alter the picture. Study will continue up to the reconvening of the Legislature."

As a result of Delaware's delay, an important unresolved issue is whether Delaware companies will reincorporate to take advantage of anti-takeover statutes adopted by other states. This appears unlikely. The new statutes have not all been carefully drafted, and no one can know for certain how they will work. An even more important consideration is the ability of companies to adopt their own anti-takeover provisions by charter amendment. Although that requires shareholder approval, so does reincorporation. And many companies have had fair price provisions and staggered boards for years. Except for possible limitations that may be imposed by the exchanges or by state corporation law, the company could also adopt an amendment that requires shareholder approval of a purchase of a block of stock of a certain size, or that conditions voting rights on a favorable vote of a majority of the outstanding shares. It is easy to see why a company would prefer to make its own law rather than take a chance on untested legislation.

Whatever the eventual outcome of this debate may be, the takeover industry will survive and will probably continue to flourish. Although a few companies may relocate to take advantage of the new laws (as Singer Company recently did in its move from Connecticut to New Jersey), the number of companies to which they apply is still limited. And even if some hostile takeovers do become more expensive, that is no reason to assume that there will be a dramatic decline in takeover activity. Unless Delaware acts, the new state laws are likely to be of relatively minor importance to the takeover industry as a whole. To be sure, some states may test the post-*CTS* waters with ever more aggressive statutes; the limits of *CTS* will then be defined in further litigation.

APPENDIX

I. Control Share Acquisition Laws (CSA)

Arizona
Florida
Indiana
Louisiana
Massachusetts
Minnesota
Missouri
North Carolina
Ohio
Oregon
Wisconsin

II. Fair Price Laws (FP)

Connecticut
Florida
Georgia
Illinois
Kentucky
Louisiana
Maryland

Michigan
Mississippi
North Carolina
Virginia
Washington
Wisconsin

III. Heightened Appraisal Rights Laws (HAR)

Maine
Pennsylvania
Utah

IV. Five Year Moratorium (FYM)

Arizona
Kentucky
Minnesota
Missouri
New Jersey
New York
Washington
Wisconsin

V. Expanded Constituency (EC)

Arizona
Illinois
Maine
Minnesota
Ohio

VI. Heightened Disclosure (HD)

Idaho
Hawaii
Minnesota
Nebraska
New York
Oklahoma
Tennessee
Utah
Wisconsin

1. Arizona CSA, FYM, EC
2. Connecticut FP
3. Florida CSA, FP
4. Georgia FP
5. Hawaii HD
6. Idaho HD
7. Illinois FP, EC
8. Indiana CSA, FYM
9. Kentucky EP, FYM
10. Louisiana CSA, FP
11. Maine HAR, EC
12. Maryland FP
13. Massachusetts CSA
14. Michigan FP
15. Minnesota CSA, FYM, EC, HD

16. Mississippi FP
17. Missouri CSA, FYM
18. Nebraska HD
19. New Jersey FYM
20. New York FYM, HD
21. North Carolina CSA, FP
22. Ohio CSA, EC
23. Oklahoma HD
24. Oregon CSA
25. Pennsylvania HAR
26. Tennessee HD
27. Utah HAR, HD
28. Virginia FP
29. Washington FP, FYM
30. Wisconsin CSA, FP, HD, FYM

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1. These statutes are discussed in Section V, *infra*.
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2. For instance, the Illinois statute provided for a 20-day pre-commencement period, during which management could lobby the company's shareholders, but the bidder could not do likewise. In addition, the Illinois statute provided for a fairness hearing, but established no deadline for it, so that the offer could be delayed indefinitely. Finally, the ultimate arbiter of the fairness of the offer was not the shareholders, but the Illinois Secretary of State. This feature allowed the Secretary to block as unfair an offer from, say, an Ohio bidder to a Minnesota shareholder of a Delaware corporation that happened to have its principal executive office, and 10% of its capital, in Illinois. See *CTS*, 107 S.Ct. at 1645
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3. One of the noteworthy aspects of *CTS* is that the Court does not appear to undertake the balancing approach of *Pike* v. *Bruce Church, Inc.* Having concluded that the Indiana statute fell within the realm of traditional state regulation, the Court did not attempt to balance the federal policy against the asserted state interest.
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4. See Ariz. Rev. Stat., tit. 10, ch. 6, Â§ 10-1201, added by HB 2002, ch. 3 (7/22/87); Fla. Stat. Â§ 607.109 (HB 358, 1987); Haw. Rev. Stat. Â§Â§ 416-171 to 172 (1985); Ind. Code Ann. Â§ 23-1-42 (Burns Supp. 1986); La. Rev. Stat. 12:135-140.2 (SB 595, 1987); Mass. Stat. ch. 110D (H 5869, 7/21/87); Minn. Stat. Â§ 302A.011, as amended by H.F. 1 (1987); Mo. Stat. Ann. Â§ 351.015 (HB 349, 1987); 1987 N.C. Sess. Laws SB 687, HB 973; Ohio Rev. Code Ann. Â§ 1701.831 (Anderson 1985); Oregon S.B. 641, reported in 19 Sec. Reg. & Law Rep. 1339 (BNA)(8/28/87); Wis. Stat. Ann. Â§ 180.25(9). The Hawaii statute was invalidated in *Terry* v. *Yamashita*, 643 F.Supp. 161 (D. Hawaii 1986).
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5. In June 1986, the Sixth Circuit affirmed a district court ruling invalidating the Ohio statute. *Fleet Aerospace Corp.* v. *Holderman*, 796 F.2d 135 (6th Cir. 1986). The Supreme Court has vacated that judgment and remanded the case for reconsideration in light of the *CTS* decision. *State of Ohio* v. *Fleet Aerospace Corp.*, 107 S.Ct. 1623 (1987)
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6. Conn. Gen. Stat. Ann. Â§ 33-374a to 374c (West Supp. 1987); Fla. Stat. Â§ 607.108 (HB 358, 1987); Ga. Code Ann. Â§Â§ 14-2-232 to 234 (Supp. 1986); Ill. Ann. Stat., ch. 32, Â§ 7.85 (Supp. 1987); Ky. Rev. Stat. Ann. Â§ 271A.396 (Michie Replacement 1986); La. Rev. Stat. Ann. Â§Â§ 12:132 to 134 (West Supp. 1987); Md. Corps. & Ass'ns Code Ann. Â§Â§ 3-601 to 603 (1985 & Supp. 1986); Mich. Comp. Laws Ann. Â§Â§ 450.1776 to 1784 (West Supp. 1987); Miss. Code Ann. Â§Â§ 79-25-1 to 7 (Supp. 1986); 1987 N.C. Sess. Laws SB 687, HB

631; Va. Code Ann. Â§Â§ 13.1-726 to 728 (Michie Replacement 1985); Rev. Code of Wash. Ann. Â§ 23A.08.425 (Supp. 1987); Wis. Stat. Ann. Â§ 180.725 (West Supp. 1986). The Louisiana Legislative Library reports that the Louisiana Legislature recently repealed Louisiana's fair price law (Act No. 820, SB 779).
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7. Me. Rev. Stat. Ann. tit. 13-A, Â§ 910 (Supp. 1986); Pa. Stat. Ann. tit. 15, Â§ 1910 (Purdon Supp. 1987); Utah Code Ann. Â§ 16-10-76.5 (Supp. 1986).
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8. Ariz. Rev. Stat. tit. 10, ch. 6 Â§ 10-1201 (H.B. 2002, July 23, 1987); Ind. Code Â§ 23-1-43 (Burns Supp. 1986); Ky. Rev. Stat. Â§Â§ 271A.396 to 398 (Baldwin Supp. 1986); Minn. Statutes Â§ 302A-011, amended by H.F.1 (1987); Mo. Rev. Stat. Â§ 351.459 (Supp. 1987); N.J. Stat. Ann. Â§ 10A-1 (West Supp. 1987); New York Bus. Corp. Law Â§ 912 (McKinney 1986); Wash. Laws SB 6084 (August 10, 1987); Wis. Stat. Ann. Â§ 180.726 (added by Assembly Bill 2, September 1987).
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9. See, *e.g.*, 1987 Ariz. Sess. Laws HB 2002; 111. Ann. Stat. ch. 32, Â§ 8.85 (Smith-Hurd Supp. 1986); Me. Rev. Stat. Ann. tit. 13-A, Â§Â§ 716-717 (Supp. 1986); Minn. Laws H.F. 1 (1987); Ohio Rev. Code Ann. Â§Â§ 1701.59 [E] (Anderson 1985).
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10. Ill. Ann. Stat. ch. 32,&8.85 (Smith-Hurd Supp. 1986).
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11. 488 A.2d 858 (Del. 1985).
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12. Haw. Rev. Stat. Â§ 417E-1 to E-11 (1985); Idaho Code Ann. ch. 15, Â§Â§ 30-1501 to 1513 (Supp. 1987); Minn. Stat. Ann. Â§Â§ 80B.01 to .13 (West 1985); Neb. Rev. Stat. Â§Â§ 21-2418 to 2430 (1983); New York Bus. Corp. Law Â§Â§ 1600 to 1613 (McKinney 1986); Okla. Stat. Ann. tit. 71, Â§Â§ 451 to 462 (West 1985); Tenn. Code Ann. ch. 5, Â§Â§ 48-5-101 to 114 (1984); Utah Code Ann. Â§ 61-5-3 (Supp. 1986); Wis. Stat. Ann. Â§ 552.03 (West Supp. 1986).
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13. Of course, real estate arguably has a closer nexus to the state, since it is physically located there. Shares of stock, by contrast, are frequently located outside the state and are traded on national exchanges. But the shares exist only because the state of incorporation created them, and that state should be the only one to regulate what it created.
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14. The fact that a bidder who purchased, say, 80% of the stock could later appoint his own board would not help him avoid the restrictions of the statute, since the board approval that exempts the transaction must precede the purchase of the control shares.
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15. The proposed SEC Rule might not have this effect in every case. It extends protection only to *existing* shareholders. If a bidder were to condition his purchase of shares on a favorable vote, he would not be an existing holder at the time he is denied voting rights, and the rule might not apply. Moreover, it is not clear that the rule would apply to voting disparities imposed by state law rather than adopted by corporate action. And if the rule were construed to apply to such state laws, there is some question whether the SEC would have authority to adopt it pursuant to existing federal legislation.
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16. What is more likely, of course, is that the bidder would actually buy shares, so that if the company were put into play but he failed to acquire it, he could still profit by selling his shares to the successful bidder.
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