DEFEATING POISON PILLS THROUGH ENACTMENT OF A STATE SHAREHOLDER PROTECTION STATUTE

BY ADDISON D. BRAENDEL*

ABSTRACT

In 1978 the Supreme Court held that state usury laws were preempted by the National Bank Act and that out-of-state banks could charge credit card interest rates as high as permitted by the state in which they were located. This caused a flood of bank relocations in the 1980's to Nevada and South Dakota to take advantage of usury laws more favorable to lenders. Given the absence of any substantive federal corporate regulation akin to the National Bank Act, there seems to be no reason why a single state shareholder protection statute, as described herein, could not protect resident shareholders from dilutive corporate practices by prohibiting selective and discriminatory stock purchase rights that accompany shareholder rights plans. Tender offerors could then relocate to that state before conducting a tender offer. If it is possible to enact such a law, and to sufficiently tailor it to withstand constitutional scrutiny, it could neutralize all poison pills.

TABLE OF CONTENTS

---

*Addison D. Braendel is a member of the Illinois Bar and practices corporate and securities law in Chicago, Illinois.

I. INTRODUCTION

This article proposes a novel method to unilaterally disable all poison pills, irrespective of the target corporation's state of incorporation. It requires enacting a single state law, a "Shareholder Protection Statute," that is broad enough in application to affect out-of-state corporations but narrowly tailored enough to survive constitutional challenge. After a brief background discussion of poison pills, the proposed Shareholder Protection Statute is described and its constitutionality is discussed.

In *Marquette National Bank of Minneapolis v. First of Omaha Service Corp.*,[1] the Supreme Court held that Minnesota's usury laws were preempted by the National Bank Act when a nationally-chartered Nebraska bank distributed credit cards to Minnesota residents and charged Nebraska interest rates, that were higher than Minnesota law allowed.[2] Implicit in this decision is the understanding that if the Nebraska bank had not been nationally-chartered, its interest rates could never have been exported because Minnesota's usury laws would have applied.[3] As a result of the decision, a flood of banks relocated in the 1980s to Nevada and South Dakota to take advantage of their lender friendly usury laws. This suggests that, given the absence of any substantive federal incorporation laws akin to the National Bank Act, there is good reason to think that a single state "blue sky" shareholder protection statute — the parallel of a state usury law — could protect resident shareholders from poison pills. This would prohibit out-of-state corporations from "exporting" their states' permissive use of poison pills to the detriment of in-state investors. Potential acquirors could relocate — just like the banks — to take advantage of the state statute favoring shareholders.

Generally, states are not permitted to regulate activity outside of their borders; however, states are permitted to regulate activities inside their

---

[1]439 U.S. 299 (1978).

[2]*Id.* See Smiley v. Citibank (S.D.), N.A., 517 U.S. 735 (1996), for a more recent articulation of this principle. Congress granted similar powers to state-chartered banks in 1980 under section 521 of the Depositary Institutions Deregulation and Monetary Control Act of 1980 (DIDA), Pub. L. No. 96-221, 94 Stat. 132 (1980). *See also* Greenwood Trust Co. v. Commonwealth of Mass., 971 F.2d 818, 831 (1st Cir. 1992) (holding that the Massachusetts statute section 14B was preempted by DIDA § 521).

[3]*See Marquette*, 439 U.S. at 299.

borders that have effects outside their borders. In this case, a state adopting the Shareholder Protection Statute would not be regulating in- or out-of-state corporations per se, it would regulate a corporate activity that takes place inside its borders (i.e., the exclusion of a state resident shareholder from an otherwise *pro rata* offering of securities). Other state laws that offer similar protections — usury laws, insurance laws,[4] tort laws,[5] "blue sky" laws, and most notably, certain provisions of the California Corporations Code[6] — are regularly enforced.

Any state could pass such a law, as it would not have to be passed in Delaware to have widespread applicability. It would affect any corporation, whether in-state or out-of-state, with securities held by a state resident shareholder. Just as banks migrated to South Dakota in the 1980s, tender offerors could migrate to a state that enacts the Shareholder Protection Statute. Although corporate opposition would undoubtedly be fierce, such

---

[4]*See* Gillen v. United Auto. Ass'n, 300 So. 2d 3, 6-7 (Fla. 1974) (holding that Florida's public policy against "other insurance" clauses in automobile liability policies will extend to a policy issued in another state, at least where the people insured are residents of Florida).

[5]*See, e.g.*, Litarowich v. Wiederkehr, 405 A.2d 874, 877 (N.J. Super. Ct. 1979) (holding that New Jersey's law of successor liability applied to a Delaware corporation for injury arising in New Jersey, notwithstanding Delaware's non-recognition of successor liability). *See also* Amanda Acquisition Corp. v. Universal Foods Corp., 877 F.2d 496, 506 (7th Cir. 1989), *cert. denied*, 493 U.S. 955 (1989) (holding that Wisconsin's antitakeover statute was neither preempted by the Williams Act nor unconstitutional under the dormant Commerce Clause). The court stated:

> Every state's regulation of domestic trade (potentially) affects those who live elsewhere but wish to sell their wares within the state. A law making suppliers of drugs absolutely liable for defects will affect the conduct (and wealth) of Eli Lilly & Co., an Indiana firm, and many other pharmaceutical houses, all located in other states, yet Wisconsin has no less power to set and change tort law than do states with domestic drug manufacturers.

Id.

[6]CAL. CORP. CODE § 2115(b) (West, WESTLAW through 1999 portion of 1999-2000 Reg. Sess. and 1st Ex. Sess.)) ("[T]he following chapters and sections of this division shall apply to a foreign corporation as defined in subdivision (a) (*to the exclusion of the law of the jurisdiction in which it is incorporated*) . . . .") (emphasis added). Section 2115 lists numerous sections, including director elections, inspection of books and records, distribution policy, and cumulative voting. While never considered by a federal court, California's Court of Appeals has upheld this provision against legal challenge, including dormant Commerce Clause challenges, on numerous occasions. *See* Havlicek v. Coast-to-Coast Analytical Serv., Inc., 39 Cal. App. 4th 1844, 1855-56 (Cal. Ct. App. 1995) (upholding California's directors' right to inspect laws against a Delaware corporation); Valtz v. Penta Inv. Corp., 139 Cal. App. 3d 803, 810 (Cal. Ct. App. 1983) (upholding California's shareholders' right to inspect laws against a Delaware corporation); Wilson v. Louisiana-Pacific Resources, Inc., 138 Cal. App. 3d 216, 232 (Cal. Ct. App. 1982) (upholding California's cumulative voting requirements against a Utah corporation). *See also* Western Air Lines, Inc. v. Sobieski, 191 Cal. App. 2d 399, 415 (Cal. Ct. App. 1961) (upholding California's cumulative voting requirements against a Delaware corporation).

a law should have a broad political base for support. Labor unions,[7] state pension boards,[8] institutional investors, and free marketers alike have become increasingly active to force companies to retire their poison pills. For the past several years, over fifty percent of the shareholder votes cast on poison pill initiatives voted *against* poison pills.[9] The difficulty, then, should not be so much in getting the Shareholder Protection Statute enacted, but in preventing it from being struck down in court.

It can be expected that the Shareholder Protection Statute would be vigorously attacked in court. The following four arguments are likely. First, opponents of the Shareholder Protection Statute may argue that it is preempted by federal law, either expressly by the National Securities Markets Improvement Act of 1996[10] or implicitly by the Williams Act. Second, opponents may argue that the Shareholder Protection Statute violates the Contracts Clause, Article I, Section 10 of the U.S. Constitution. Third, opponents may argue that the Shareholder Protection Statute is unconstitutional under the dormant Commerce Clause. A fourth and final argument pertains to conflict of laws (and the "internal affairs doctrine"), in which opponents may argue that the Shareholder Protection Statute should not be applied to out-of-state corporations because the laws of the state of incorporation most appropriately apply. This article discusses why each of these arguments should fail.

If the Shareholder Protection Statute is passed and upheld in court, a state resident tender offeror triggering a poison pill could sue in state court to force the target corporation to include it in the discounted stock offering being made to all the other shareholders. Any judgment in favor of the

---

[7]For a general discussion of labor union activity in matters of corporate governance, including the repeal of poison pills, see Georgeson & Company Inc., *Labor Unions and Grass-Roots Activists Dominate Governance-Related Proposals During the 1996 Annual Meeting Season*, Aug. 1996 News Release, *reprinted in* CHARLES E. SIMON & COMPANY, CORPORATE ANTI-TAKEOVER DEFENSES: THE POISON PILL DEVICE 5-2 (1997 ed.); John C. Coffee, Jr., *Bylaw Barricades: Unions and Shareholder Rights*, 217 N.Y. L.J. 58 (1997); Stewart J. Schwab & Randall S. Thomas, *Realigning Corporate Governance: Shareholder Activism by Labor Unions*, 96 MICH. L. REV. 1018 (Feb. 1998).

[8]*See, e.g.*, Holman W. Jenkins, Jr., *The Rise of Public Pension Funds*, WALL ST. J., Apr. 16, 1996, at A15 (discussing the rise of public pension funds and the involvement of pension chiefs in developing means to combat poison pills); Mark R. Wingerson & Christopher H. Dorn, *Institutional Investors in the U.S. and the Repeal of Poison Pills: A Practitioner's Perspective*, 2 COLUM. BUS. L. REV. 223 (1992) (discussing institutional investors attitudes and ideas about repealing poison pills).

[9]*See* Aug. 1996 News Release, *supra* note 7, at 5-3. The Georgeson Report notes that though the number of proposals has decreased since 1996, support for the proposals have increased. *Id.* Further, the report found that 40% of the shares outstanding voted in favor of poison pill proposals. *Id.*

[10]National Securities Markets Improvement Act of 1996, Pub. L. No. 104-290, 110 Stat. 3416 (1996) (codified in scattered sections of 15 U.S.C.).

tender offeror could of course be brought as an enforcement action under the Full Faith and Credit Clause in the home state of the target corporation. If the target corporation cannot exclude the tender offeror, the dilutive effects of the poison pill disappear, and the poison pill becomes irrelevant.

II. BACKGROUND OF POISON PILLS

Invented in the early 1980s and made famous by Martin Lipton of Wachtell, Lipton, Rosen and Katz, shareholder rights agreements, or poison pills, have been adopted by over 2,500 public U.S. companies.[11] A company can install a poison pill easily, and most importantly, without shareholder approval. Most often, the board of directors simply declares a dividend of share purchase rights and enters into a shareholder rights agreement with a rights agent, usually a bank. The share purchase rights attach to the company's common stock and remain inert until a shareholder acquires more than a fixed percentage of the company's outstanding stock — usually fifteen percent. At that point the rights detach and all the *other* shareholders can purchase newly issued shares of the company's stock at a significant discount, thereby diluting the acquiring shareholder's stock holdings. As a result, potential acquirors are forced to negotiate with the target's management before consummating an offer. Although some people consider this a positive thing,[12] others, fearing entrenchment, view it as a negative.[13] Economic studies reach conflicting results.[14]

---

[11]*See* Martin Lipton, *Poison Pill Update*, M&A LAW., Jul./Aug. 1997, at 3.

[12]For general background on the impropriety of managerial passivity, see Lucian A. Bebchuk, *The Case for Facilitating Competing Tender Offers*, 95 HARV. L. REV. 1028 (1982); Lucian Ayre Bebchuk, *Toward Undistorted Choice and Equal Treatment in Corporate Takeovers*, 98 HARV. L. REV. 1693 (1985); Leo Herzel et al., *Why Corporate Directors Have a Right to Resist Tender Offers*, 3 CORP. L. REV. 107 (1980); Martin Lipton, *Takeover Bids in the Target's Boardroom*, 35 BUS. LAW. 101 (1979).

[13]For general background on the propriety of managerial passivity, see Frank H. Easterbrook & Daniel R. Fischel, *Auctions and Sunk Costs in Tender Offers*, 35 STAN. L. REV. 1 (1982); Frank H. Easterbrook & Daniel R. Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161 (1981); Ronald J. Gilson, *Seeking Competitive Bids Versus Pure Passivity in Tender Offer Defense*, 35 STAN. L. REV. 51 (1982); Ronald J. Gilson, *A Structural Approach to Corporations: The Case Against Defensive Tactics in Tender Offers*, 33 STAN. L. REV. 819 (1981); Michael C. Jensen & Richard S. Ruback, *The Market for Corporate Control*, 11 J. FIN. ECON. 5 (1983); Michael C. Jensen & Jerold B. Warner, *The Distribution of Power Among Corporate Managers, Shareholders, and Directors*, 20 J. FIN. ECON. 3 (1988).

[14]*See generally* James A. Brickley et al., *Outside Directors and the Adoption of Poison Pills*, 35 J. FIN. ECON. 371, 371 (1994) (finding that "the average stock-market reaction to announcements of poison pills is positive when the board has a majority of outside directors and negative when it does not"); James F. Cotter et al., *Do Independent Directors Enhance Target Shareholder Wealth During Tender Offers?*, 43 J. FIN. ECON. 195, 195 (1997) (concluding that "independent outside directors enhance shareholder gains from tender offers, and that boards with

Regardless of whether poison pills are positive or negative, they are nearly impossible to defeat. The three most common methods employed to set aside poison pills — litigation, proxy fights and the "shareholder bylaw amendment" — are time-consuming and expensive. None of these methods operate effectively.

A potential acquiror can litigate a company's poison pill by asking a court to invalidate it.[15] In fact, this method first established the legality of the poison pill. The Supreme Court of Delaware in *Moran v. Household International, Inc.*[16] held that the adoption of a poison pill falls within the business judgment of a company's board of directors if the "defensive mechanism was 'reasonable in relation to the threat posed.'"[17] Following this proposition, successful acquirors appear to be in the minority.[18] For example, recent would-be acquirors who have lost in court include WHX Corporation, Union Pacific, Moore Corporation, Hilton Hotels, U.S. Surgical Corporation, Invacare Corporation, and AlliedSignal Inc.

Another strategy to get past a company's poison pill involves waging a proxy fight — replacing the company's board of directors with a slate nominated by the acquiror and then redeeming the pill with the new board of directors. Some companies have tried to preempt this route by including

---

a majority of independent directors are more likely to use resistance strategies to enhance shareholder wealth"); Sudip Datta & Mai Iskandar-Datta, *Takeover Defenses and Wealth Effects on Securityholders: The Case of Poison Pill Adoptions*, 20 J. BANKING & FIN. 1231, 1231 (1996) (presenting evidence that bondholders experience significant wealth losses at poison pill adoption announcements, while stockholders are unaffected); Jonathan M. Karpoff et al., *Corporate Governance and Shareholder Initiatives: Empirical Evidence*, 42 J. FIN. ECON. 365, 365 (1996) (finding that firms with poor performance prior to attracting governance proposals evidence little improvement in operating returns after proposals); Paul H. Malatesta & Ralph A. Walkling, *Poison Pill Securities: Stockholder Wealth, Profitability, and Ownership Structure*, 20 J. FIN. ECON. 347, 347 (1988) (finding that poison pill defenses reduce stockholder wealth, and that firms that adopt poison pill defenses "are statistically less profitable than the average firm in their industries during the year prior to adoption"); Robert Comment & G. William Schwert, *Poison Or Placebo? Evidence on the Deterrent and Wealth Effects of Modern Antitakeover Measures*, 39 J. FIN. ECON. 3, 3 (1995) (finding that poison pills do not deter takeovers and are associated with higher takeover premiums); OFFICE OF THE CHIEF ECONOMIST, SECURITIES AND EXCHANGE COMMISSION, THE EFFECTS OF POISON PILLS ON THE WEALTH OF TARGET SHAREHOLDERS 38-43 (1986) (finding that poison pills are harmful to shareholders).

[15]See Moran v. Household Int'l, Inc., 500 A.2d 1346, 1348-49 (Del. 1985).

[16]500 A.2d 1346 (Del. 1985).

[17]*Id.* at 1356 (quoting Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985)).

[18]*See* MARTIN LIPTON & ERICA H. STEINBERGER, TAKEOVERS & FREEZEOUTS § 6.03[4], at 6-72, 6-73 (1997) ("It appears that most courts will follow *Household* and there is relatively little doubt as to legality of the basic rights plan . . . ."). *See also* 11A SIMON M. LORNE & JOY MARLENE BRYAN, ACQUISITIONS AND MERGERS: NEGOTIATED AND CONTESTED TRANSACTIONS § 4.05(1)(d) (1996) (including cites of cases in which poison pills were held invalid).

a "dead-hand" provision in their poison pill.[19] A "dead-hand" provision permits only the incumbent directors who installed the pill, or their hand-picked successors, to redeem it.[20] Replacing the board of directors becomes irrelevant because the new directors are unable to remove the poison pill. A court in Georgia recently upheld such a provision.[21] Courts in New York and Delaware have not.[22] The Delaware ruling probably will limit the use of "dead-hand" provisions as a majority of publicly traded corporations are incorporated in Delaware. Regardless, a proxy contest is a costly and lengthy battle. Companies with classified, or staggered, boards of directors can prolong the fight for two or more years because only a limited number of directors, generally a third, come up for election in any given year.[23] Proxy fights are therefore viable, though not desirable, methods to acquire hostile targets.

A similar conclusion can be reached regarding the "shareholder bylaw amendment." The amendment can work to invalidate or otherwise limit a corporation's poison pill but it is time-consuming and expensive. Although shareholder bylaw amendments take different forms, most seek to curtail a board of directors' ability to either enact a pill or refuse redeeming a pill in certain "fair" tender offer situations.[24] Proposed through a company's proxy channels, the amendment can be voted upon at the company's annual meeting. As with replacing a company's board of directors, an amendment involves the time and expense of conducting a proxy solicitation, and can only be pursued on a company-by-company basis. The effectiveness of these bylaw amendments is a matter of state law; it is an open question whether

---

[19]*See generally* Carmody v. Toll Bros., 723 A.2d 1180, 1184 (Del. Ch. 1998) (describing the "dead hand" feature of the rights plan of Toll Brothers, Inc.).

[20]*See id.*

[21]*See* Invacare Corp. v. Healthdyne Techs., Inc., 968 F. Supp. 1578, 1582 (N.D. Ga. 1997) (holding that the bylaw proposed by the tender offeror, requiring removal of the poison pill, would violate a Georgia statute).

[22]*See* Bank of N.Y. v. Irving Bank Corp., 528 N.Y.S.2d 482, 486 (N.Y. Sup. Ct. 1988) (holding that continuing director provisions are an improper restriction on a board's power to manage a corporation). *See also Carmody*, 723 A.2d at 1191 (continuing director provision transgresses shareholders' statutory right to elect directors to manage corporation).

[23]*See* John C. Coffee, Jr., *The Bylaw Battlefield: Can Institutions Change the Outcome of Corporate Control Contests?*, 51 U. MIAMI L. REV. 605, 606 (1997) (discussing the viability of overcoming a poison pill via a proxy contest).

[24]One of the most visible proponents of the shareholder bylaw amendment is arbitrageur Guy P. Wyser-Pratte, who has introduced such proposals at Pennzoil Company and Telxon Corporation. *See* Patrick S. McGurn, *Corporate Governance in a Changing Market*, 12 INSIGHTS 4-5 (Dec. 1998). His latest creation is the "Shareholder Franchise Bylaw" which allows shareholders to call a meeting for the purpose of holding a referendum in the event of an acquisition proposal. *Id.* at 4. If the shareholders vote that the acquisition is in their best interest, the board of directors would be prohibited from using the poison pill to block the offer. *Id.*

the shareholder bylaw amendment would be binding on directors of a Delaware corporation.[25]

Potential acquirors of poorly performing publicly traded companies are therefore faced with a conundrum. Either negotiate with incumbent management who are likely part of the company's problem, or enter into a lengthy and expensive hostile acquisition without any assurance of success. Moreover, if successful, the acquiror only wins the right to *offer* to buy the shareholders' shares, and shareholders could still say no by refusing to tender. As a result, there appears to be a significant disincentive for market forces to correct poorly performing companies.[26]

III. THE SHAREHOLDER PROTECTION STATUTE

The Shareholder Protection Statute could be added to any state's "blue sky" laws. It would protect only state resident shareholders and would apply equally and even-handedly to in-state and out-of-state corporations with publicly-traded securities held by state resident shareholders. It would basically provide that:

> It shall be a fraudulent practice for any issuer to take any action to negate, dilute or otherwise limit a resident shareholder's rights to purchase, redeem, subscribe for or receive distributions or liquidations on any publicly-traded shares of capital stock or similar security that does not similarly negate, dilute or otherwise limit identical rights of all other shareholders of the same series or class of capital stock or similar security. This provision shall apply to any issuer,

---

[25]*See* Coffee, *supra* note 23, at 618-19. "[I]t remains highly questionable whether the shareholders can mandate the redemption of the poison pill under Delaware law.... However, they probably can prohibit the adoption of new defensive tactics if they are carefully defined...." *Id.*

[26]For a general discussion of the role of the market in correcting poorly performing companies, see Michael C. Jensen & Richard S. Ruback, *The Market for Corporate Control: The Scientific Evidence*, 11 J. FIN. ECON. 5 (1988) (finding that corporate takeovers benefit the shareholders, the bidding firm, and create positive gains), and Henry G. Manne, *Mergers and the Market for Corporate Control*, 73 J. POLITICAL ECON. 110 (1965) (noting a difficulty in devising statistical methods for distinguishing between the motivation behind a merger, be it the quest for monopoly profit or an effort to establish more efficient management in poorly run companies). Professors Bebchuk and Ferrell have recently published an interesting article in which they reassert the argument that states are engaged in a "race to the bottom" with respect to takeover regulation and the protection of incumbent management. Lucian A. Bebchuk & Allen Ferrell, *Federalism and Corporate Law: The Race to Protect Managers from Takeovers*, 99 COLUM. L. REV. 5, 1168 (June 1999). *See generally* William L. Cary, *Federalism and Corporate Law: Reflections upon Delaware*, 83 YALE L.J. 663 (1974) (analyzing the history of Delaware corporation laws and examining the future of the federal role in corporation standards).

> whether incorporated in-state or out-of-state, notwithstanding anything in this State's conflict of laws statute to the contrary.

The Shareholder Protection Statute would require a company to *include* in-state residents in any share purchase rights, regardless of his or her share ownership level. As a result, it would not discriminate against any particular state(s) and would not regulate activity outside of the state's borders, though it would affect such activity.

If the Shareholder Protection Statute was passed, a potential acquiror could incorporate in the state, fund the entity and conduct a tender offer by filing a Form TO with the Securities Exchange Commission (SEC). The acquiror could then bring suit in state court seeking an injunction that would prohibit the target company from refusing to recognize the share purchase rights that all of the other shareholders enjoy. A judgment in favor of the acquiror could then be brought as an enforcement action under the Full Faith and Credit Clause of Article IV of the United States Constitution in the home state of the target corporation.

As already noted, four lines of attack against the Shareholder Protection Statute are likely: (1) federal preemption, (2) unconstitutionality pursuant to the Commerce Clause, (3) unconstitutionality pursuant to the Contracts Clause, and (4) conflict of laws. Federal preemption or unconstitutionality would seek to invalidate the law, while a conflict of laws opposition would seek to render the statute inapplicable to an out-of-state corporation.

IV. FEDERAL PREEMPTION

State laws can be preempted by federal law in one of two ways, express preemption and implied preemption because of conflicting federal regulation. Neither should apply to the Shareholder Protection Statute.

A. *Express Preemption*

Express preemption occurs when a federal law expressly states that a state law is to have no effect. The Supreme Court generally requires clear evidence of Congress' intent in the language of the statute.[27] Well-known examples of statutory preemption can be found in the Employee Retirement

---

[27] *See* Hillsborough County v. Automated Med. Lab., Inc., 471 U.S. 707, 715 (1985) (noting that "the historic police powers of the States were not to be superseded by [a] Federal Act unless that was the clear and manifest purpose of Congress") (quoting Jones v. Rath Packing Co., 430 U.S. 519, 525 (1977) (citations omitted)).

Income Security Act,[28] the Occupational Safety and Health Act,[29] Section 28(a) of the Securities Exchange Act of 1934,[30] and relevant in this instance, Section 18 of the Securities Act of 1933.[31]

Section 18 of the Securities Act of 1933 ('33 Act) was passed as part of the National Securities Markets Improvement Act of 1996.[32] Prior to passage, the sale of securities that were either registered under the federal securities laws or exempt from registration thereunder remained subject to a myriad of state "blue sky" registration and qualification laws including, in

---

[28]29 U.S.C. § 1144(a) (1994).

[29]29 U.S.C. § 667 (1994).

[30]15 U.S.C.A. § 78bb(a) (1997 & Supp. 1999). Section 28(a) reads in relevant part:

> Except as otherwise specifically provided in this chapter, nothing in this chapter shall affect the jurisdiction of the securities commission (or any agency or officer performing like functions) of any State over any security or any person insofar as it does not conflict with the provisions of this chapter or the rules and regulations thereunder.

[31]15 U.S.C.A. § 77r (West 1997). The text of Section 18 provides in part that:

> (a) Scope of exemption
>
> Except as otherwise provided in this section, no law, rule, regulation, or order, or other administrative action of any State or any political subdivision thereof—
>
> (1) requiring, or with respect to, registration or qualification of securities, or registration or qualification of securities transactions, shall directly or indirectly apply to a security that—
>
> (A) is a covered security; or
>
> (B) will be a covered security upon completion of the transaction;
>
> (2) shall directly or indirectly prohibit, limit, or impose any conditions upon the use of—
>
> (A) with respect to a covered security described in subsection (b) of this section any offering document that is prepared by or on behalf of the issuer; or
>
> (B) any proxy statement, report to shareholders, or other disclosure document relating to a covered security or the issuer thereof that is required to be and is filed with the Commission or any national securities organization registered under Section 780-3 of this title, except that this subparagraph does not apply to the laws, rules, regulations, or orders, or other administrative actions of the State of incorporation of the issuer; or
>
> (3) shall directly or indirectly prohibit, limit, or impose conditions, based on the merits of such offering or issuer, upon the offer or sale of any security described in paragraph (1).

These prohibitions are subject to the following preservation of authority provision:

> (c) Preservation of Authority.
>
> (1) Fraud Authority.
>
> Consistent with this section, the securities commission (or any agency or office performing like functions) of any State shall retain jurisdiction under the laws of such State to investigate and bring enforcement actions with respect to fraud or deceit, or unlawful conduct by a broker or dealer, in connection with securities or securities transactions.

15 U.S.C.A. § 77r(c).

[32]*See* H.R. REP. NO. 104-622, at 29 (1996).

some cases, "merit" review by the states' securities commissions.[33] Compliance with all the qualification laws was a time-consuming and troublesome task. In 1996, Congress amended Section 18 to expressly preempt these laws, summarily invalidating almost all notice and disclosure requirements for securities that satisfy '33 Act requirements.[34] Sections 18(a)(1) and 18(a)(2), relating to registration requirements and offering documents, respectively, clearly have no effect on the Shareholder Protection Statute, since it has no registration or qualification requirements with respect to securities or offering materials.[35]

One could argue that Section 18(a)(3), which forbids any state law to "directly or indirectly prohibit, limit, or impose conditions, based on the merits of such offering or issuer, upon the offer or sale of any [covered] security"[36] might be read broadly enough to preempt the Shareholder Protection Statute. Undoubtedly, share purchase rights would be deemed a "covered security" for purposes of the '33 Act. But the Shareholder Protection Statute is not intended to have any effect on any such offer or sale. A company, in-state or out-of-state, still could authorize and distribute share purchase rights without any difficulties, conditions or any other limitations under the Shareholder Protection Statute. The Shareholder Protection Statute would only prohibit a company's selective acceptance of share purchase rights tendered by certain (i.e., low percentage holding) shareholders.

Additionally, the sale of capital stock pursuant to the share purchase rights is itself an offering that the Shareholder Protection Statute may not "prohibit, limit, or impose conditions" upon, pursuant to Section 18(a)(3).[37] By forcing a company to include the acquiring shareholder in the rights redemption/stock offering, the state is imposing conditions on a securities offering. This argument would fail on two counts. First, the Shareholder Protection Statute does not pertain to "offerings" of securities within the meaning of Section 18(a)(3). It does not regulate either the initial offering of share purchase rights (by dividend) or the second offering of capital stock (once the poison pill is triggered). Rather, it regulates the *effect* of a security — the share purchase rights — by requiring that the company recognize the

---

[33]*See* North Star Int'l v. Arizona Corp. Comm'n, 720 F.2d 578, 582 (9th Cir. 1983). Decided before passage of the National Securities Markets Act of 1996, the Ninth Circuit held that Arizona's "merit" review, which empowered the state securities commission to deny the registration of a security if the offering appeared to be "inequitable" to investors, was neither preempted by the Securities Act of 1933 nor illegal under the Commerce Clause. *Id.* at 580-82.

[34]*See* H.R. REP. NO. 104-622, at 29 (1996).

[35]*See* 15 U.S.C.A. § 77r (West 1997).

[36]*Id.*

[37]*Id.*

acquiring shareholder's allocated share purchase rights. The company can do so by including the acquiring shareholder: in the offering to the other shareholders, in a separate registered transaction, in an exempt private transaction, or in any other manner it chooses. What it cannot do is ignore the acquiring shareholder. Second, the qualification language of Section 18(a)(3) does not pertain to the Shareholder Protection Statute. Section 18(a)(3) prohibits states from imposing conditions on offerings "based on the merits of such offering or issuer."[38] The Shareholder Protection Statute is not a "merit" review and does not grant any discretionary authority; it is a prohibition of fraudulent practices, which remains solidly within a state's purview.[39]

Finally, it is counter-intuitive that Section 18, passed in 1996, was intended by Congress to preempt a state law like the Shareholder Protection Statute that neither existed nor was contemplated at that time. Laws that *did* exist at the time — state laws expressly permitting poison pills — have not come under any such attack. It can, however, be argued with equal force that they implicitly impose conditions on securities offerings, insofar as they permit the exclusion of certain shareholders from securities offerings based on certain categorizations. They have not been preempted, just as the State Shareholder Protection Act would not likely be preempted, because Section 18 deals with an area of regulation wholly unrelated to the legality or illegality of poison pills.

B. *Implied Preemption*

Even if the Shareholder Protection Statute is not expressly preempted by Section 18 of the '33 Act, opponents might argue that the Williams Act, which regulates the conduct of tender offers, implicitly preempts the Shareholder Protection Statute.[40] The Williams Act sets forth certain timing, disclosure, proration and best-price rules that must be observed during a tender offer.[41] "It slows things down, allowing investors to evaluate the offer and management's response . . . . [It] ensure[s] that investors who decide at the end of the offer get the same treatment as those who decide immediately,

---

[38] *Id.*

[39] State police powers are traditionally accorded great deference. *See* Hall v. Geiger-Jones Co., 242 U.S. 539, 548 (1917). Additionally, Section 18(c) of the '33 Act explicitly preserves states' authority with respect to fraudulent practices.

[40] Passed in 1968, the Williams Act amended Sections 13(d)-(e) and 14(d)-(f) of the Securities Exchange Act of 1934, 15 U.S.C. §§ 78m(d)-(e), 78n(d)-(f) (1994).

[41] Amanda Acquisition Corp. v. Universal Foods Corp., 877 F.2d 496, 503 (7th Cir. 1989), *cert. denied*, 493 U.S. 955 (1989)

reducing pressure to leap before looking."[42] Federal courts held in a number of cases in the 1980's that the Williams Act preempted "first generation" state antitakeover statutes.[43] The states rebounded with "second generation" antitakeover statutes, mostly with success.[44]

In upholding Indiana's second generation antitakeover statute, the Supreme Court, in *CTS Corp. v. Dynamics Corp. of America*,[45] explained that,

> absent an explicit indication by Congress of an intent to pre-empt state law, a state statute is pre-empted only where compliance with both federal and state regulations is a physical impossibility or where the state law stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.[46]

Since compliance with the Shareholder Protection Statute and the Williams Act would not be a "physical impossibility,"[47] any argument for preemption would have to assert that the Shareholder Protection Statute "stands as an

---

[42]*Id.*

[43]These "first generation" antitakeover statutes were preempted because they conflicted with the timing and notice requirements of the Williams Act, generally by requiring precommencement notification by bidders and permitting independent state administrative review. *See* Edgar v. MITE Corp., 457 U.S. 624, 637 (1982) (holding that the Illinois Act hearing provisions frustrated "[c]ongressional purpose by introducing extended delay into the tender offer process"). *See also* L.P. Acquisition Co. v. Tyson, 772 F.2d 201, 209 (6th Cir. 1985) (holding that any hearing scheme devised by a state must operate within the confines of the intent of federal securities laws and regulations); Martin-Marietta Corp. v. Bendix Corp., 690 F.2d 558, 568 (6th Cir. 1982) (holding the state act unconstitutional due to its indirect burden on interstate commerce and contrary to the intentions of the Williams Act); Bendix Corp. v. Martin-Marietta Corp., 547 F. Supp. 522, 532 (D. Md. 1982) (finding that a 20-day advance notification requirement, a possibility of indefinite delay and an exemption given to qualifying tender offers "tips the scales toward the target company" and frustrates the goals of the Williams Act).

[44]"Second generation" state antitakeover statutes carefully avoided precommencement notice requirements and independent state administrative review. *See, e.g.*, CTS Corp. v. Dynamics Corp. of Am., 481 U.S. 69, 85-86 (1987) (upholding the Indiana Act since the possibility of imposing some additional delay would not be unreasonable); WLR Foods, Inc. v. Tyson Foods, Inc., 65 F.3d 1172, 1181 (4th Cir. 1995) (holding that defensive mechanisms for management during a takeover situation are not preempted by the Williams Act); *Amanda Acquisition Corp.*, 877 F.2d at 504-05 (upholding state law which inhibits bidders from profiting by making tender offers since the Williams Act fails to create such a right).

[45]481 U.S. 69 (1987).

[46]*CTS Corp.*, 481 U.S. at 78-79 (citations omitted).

[47]Or even a mild inconvenience, as the Shareholder Protection Statute would not interfere with the Williams Act in any manner. It has no timing, notice, disclosure or review requirements. Any bidder who conducted a tender offer would have to follow the procedures mandated by the Williams Act, neither more nor less.

obstacle to the accomplishment and execution of the full purposes and objectives of Congress"[48] by disrupting the balance Congress hoped to achieve between bidders and targets.

The plaintiff in *WLR Foods, Inc. v. Tyson Foods, Inc.*,[49] made just such an argument, suggesting that the Williams Act preempted Virginia's Poison Pill Statute[50] because the Virginia statute upset the balance that Congress intended to strike between bidders and targets.[51] The Fourth Circuit held otherwise, finding that the "balance" cited by plaintiff was merely incidental to the broader purpose of the Williams Act.[52] Since the Williams Act concerns the timing and conduct of tender offers, not who wins or loses, it does not apply to a state law that permits or prohibits poison pills.[53] It stands to reason that if the Virginia Poison Pill Statute can withstand Williams Act scrutiny, the Shareholder Protection Statute will render the same result.

V. *Dormant Commerce Clause*

As a preliminary matter, it should be noted that it is impossible to predict with any accuracy whether the Shareholder Protection Statute would withstand scrutiny under a dormant Commerce Clause analysis. Variously described by Supreme Court Justices as "hopelessly confused,"[54] making "no sense,"[55] a "quagmire,"[56] a "morass,"[57] or simply "not always . . . easy to

---

[48]*Edgar*, 457 U.S. at 631 (citations omitted).

[49]65 F.3d 1172 (4th Cir. 1995).

[50]VA. CODE ANN. § 13.1-646 (Michie 1993). This statute explicitly authorizes poison pills.

[51]*WLR Foods, Inc.*, 65 F.3d at 1177-78.

[52]*Id.* at 1179 (recognizing that state regulation over protection of management is incidental to the protection of investors within the Williams Act and is not a per se conflict).

[53]Along the same lines, the Seventh Circuit stated:

> There is a big difference between what Congress *enacts* and what it *supposes* will ensue. Expectations about the consequences of a law are not themselves law. To say that Congress wanted to be neutral between bidder and target—a conclusion reached in many of the Court's opinions, . . . is not to say that it also forbade the states to favor one of these sides . . . . Nothing in the Williams Act says that the federal compromise among bidders, targets' managers, and investors is the only permissible one.

Amanda Acquisition Corp. v. Universal Foods Corp., 877 F.2d 496, 503 (7th Cir. 1989), *cert. denied*, 493 U.S. 955 (1989) (citations omitted).

[54]Kassel v. Consolidated Freightways Corp., 450 U.S. 662, 706 (1981) (Rehnquist, J., dissenting).

[55]Tyler Pipe Indus. v. Washington State Dep't of Revenue, 483 U.S. 232, 260 (1987) (Scalia, J., dissenting).

[56]West Lynn Creamery, Inc. v. Healy, 512 U.S. 186, 210 (1994) (Scalia, J., concurring).

[57]Camps Newfound/Owatonna, Inc. v. Town of Harrison, 520 U.S. 564, 610 (1997) (Thomas, J., dissenting).

follow,"[58] dormant Commerce Clause jurisprudence has withstood the efforts by some of this country's best constitutional scholars to make much sense out of it.[59] Application of the Supreme Court's "balancing test" suggests a promising chance of survival for the Shareholder Protection Statute, mostly because the Shareholder Protection Statute does not exhibit the most serious defects of a state statute facing challenge; it is not discriminatory, on its face or otherwise, and it is not protectionist (no in-state industry is better off than an out-of-state industry for having it passed). More importantly, the Shareholder Protection Statute has some jurisprudence in its favor.[60] There is a long line of Supreme Court cases upholding states' "blue sky" laws,[61] and there are state statutes that *authorize* poison pills that have successfully withstood dormant Commerce Clause challenges.[62] Most importantly, however, is the current make-up of the Supreme Court and what seems to be a movement in its jurisprudence towards a greater deference to federalism.

---

[58]CTS Corp. v. Dynamics Corp. of Am., 481 U.S. 69, 87 (1987).

[59]*See generally* Julian N. Eule, *Laying the Dormant Commerce Clause to Rest*, 91 YALE L.J. 425, 479 (1982) ("It seems that the only thing consistently predictable about the Court is its continued unpredicability."); Michael A. Lawrence, *Toward a More Coherent Dormant Commerce Clause: A Proposed Unitary Framework*, 21 HARV. J.L. & PUB. POL'Y 395, 397 (1998) (citing LAWRENCE H. TRIBE, AMERICAN CONSTITUTIONAL LAW 440 (2d ed. 1988)) ("[T]he Court's dormant-commerce-clause jurisprudence consists of 'plainly manipulable and at times anachronistically metaphysical . . . doctrines,' with complex exceptions that are applied with only 'dubious consistency.'"). *See also* DAVID CURRIE, THE CONSTITUTION IN THE SUPREME COURT: THE FIRST HUNDRED YEARS 1789-1888, at 234 (1985) (describing the dormant Commerce Clause as "arbitrary, conclusory, and irreconcilable with the constitutional text"); Martin H. Redish & Shane V. Nugent, *The Dormant Commerce Clause and the Constitutional Balance of Federalism*, 1987 DUKE L.J. 569, 573 ("[N]ot only is there no textual basis [for it], the dormant Commerce Clause actually contradicts, and therefore directly undermines, the Constitution's carefully established textual structure for allocating power between federal and state sovereigns.").

"Many constitutional scholars try to achieve predictability by lumping cases into substantive categories, such as transportation cases, state quarantine and inspection law cases or limitation on personal mobility cases, for which the Court has shown some uniformity." *See* Lawrence, *supra*, at 414-15 (citing JOHN E. NOWAK & RONALD D. ROTUNDA, CONSTITUTIONAL LAW 284-302 (5th ed. 1995); LAWRENCE H. TRIBE, AMERICAN CONSTITUTIONAL LAW 413-36 (2d ed. 1988); WILLIAM COHEN & JONATHAN D. VARAT, CONSTITUTIONAL LAW 251-338 (10th ed. 1997)). This approach is not helpful for our purposes, as a statute similar to the State Shareholder Protection Statute (or anything quite like it) has never been tested.

[60]*But see* Edgar v. MITE Corp., 457 U.S. 624 (1982); Brown-Forman Distillers Corp. v. New York State Liquor Auth., 476 U.S. 573 (1986).

[61]Amanda Acquisition Corp. v. Universal Foods Corp., 877 F.2d 496, 506 (7th Cir. 1989), *cert. denied*, 493 U.S. 955 (1989) (citing Merrick v. N.W. Halsey & Co., 242 U.S. 568 (1917); Caldwell v. Sioux Falls Stock Yards Co., 242 U.S. 559 (1917); Hall v. Geiger-Jones Co., 242 U.S. 539 (1917)).

[62]*See* WLR Foods, Inc. v. Tyson Foods, Inc., 65 F.3d 1172, 1181-82 (4th Cir. 1995) (upholding a Virginia statute on two commerce clause challenges).

A. *Facial Discrimination*

Prior to employing a balancing test, the Supreme Court has held that state laws that facially discriminate against interstate commerce are "virtually *per se* invalid."[63] It appears to be an open question whether evidence of a discriminatory *purpose* or discriminatory *effect* triggers an equally difficult hurdle.[64] For purposes of the Shareholder Protection Statute it does not matter, as it is not facially discriminatory, in either purpose or effect. The Shareholder Protection Statute applies equally to in-state and out-of-state corporations and provides no special benefit to in-state enterprises. As the Supreme Court stated while upholding the Indiana antitakeover statute, "[N]othing in the Indiana Act imposes a greater *burden* on out-of-state offerors than it does on similarly situated Indiana offerors, we reject the contention that the Act discriminates against interstate commerce."[65] As with the Indiana Act, nothing in the Shareholder Protection Statute imposes a greater burden on out-of-state corporations than it does on similarly situated in-state corporations. As a result, the Shareholder Protection Statute would proceed to the second step of a dormant Commerce Clause analysis, the balancing test.[66]

---

[63]Fulton Corp. v. Faulkner, 516 U.S. 325, 331, 346 (1996) (quoting Oregon Waste Sys. Inc. v. Department of Envtl. Quality, 511 U.S. 93, 99 (1994)) (striking down a North Carolina "intangibles tax" that provided a deduction for shareholdings of corporations doing business in North Carolina).

[64]*See, e.g.*, Maine v. Taylor, 477 U.S. 131, 138 (1986) ("[O]nce a state law is shown to discriminate against interstate commerce 'either on its face or in practical effect,' the burden falls on the State to demonstrate . . . that the statute 'serves a legitimate local purpose . . . .") (quoting Hughes v. Oklahoma, 441 U.S. 322, 336 (1979)); Minnesota v. Clover Leaf Creamery Co., 449 U.S. 456, 471 n.15 (1981) ("A court may find that a state law constitutes 'economic protectionism' on proof either of discriminatory effect . . . or of discriminatory purpose")). *See also* Donald H. Regan, *The Supreme Court and State Protectionism: Making Sense of the Dormant Commerce Clause*, 84 MICH. L. REV. 1091, 1095 (1986) (stating that the Court should be concerned with discriminatory purpose); Winkfield F. Twyman, Jr., *Beyond Purpose: Addressing State Discrimination in Interstate Commerce*, 46 S.C. L. REV. 381, 438 (1995) (claiming that the Supreme Court should be concerned with discriminatory effect).

[65]CTS Corp. v. Dynamics Corp. of Am., 481 U.S. 69, 88 (1987) (emphasis added).

[66]Originally, the Supreme Court's dormant Commerce Clause jurisprudence attempted to distinguish cases on whether the state law in question dealt with matters that were "local" or "national." *See* Cooley v. Board of Wardens of the Port of Phila., 53 U.S. (12 How.) 299, 319 (1851). By the early twentieth century, the Supreme Court was examining whether the state law had a "direct" or "indirect" affect on interstate commerce. *See* DiSanto v. Pennsylvania, 273 U.S. 34, 37 (1927). It is not clear how pertinent the direct/indirect distinction remains. It was cited with approval in *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142 (1970) ("[M]ore frequently [the Court] has spoken in terms of 'direct' and 'indirect' effects and burdens.") and used in the Court's analysis in *Edgar v. MITE Corp.*, 457 U.S. 624, 641 (1982) ("The Illinois Act differs substantially from state blue-sky laws in that it *directly* regulates transactions which take place across state line, even if wholly outside the State of Illinois.") (emphasis added), and *Brown-Forman Distillers Corp. v. New York State Liquor Auth.*, 476 U.S. 573, 582 (1986) (holding that New York's liquor fair-pricing

B. *The Balancing Test*

In *Pike v. Bruce Church, Inc.*, the Supreme Court articulated the Dormant Commerce Clause balancing test as follows: "Where [a state] statute regulates evenhandedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits."[67] The Shareholder Protection Statute easily meets the first part of the balancing test. It "regulates evenhandedly," by treating in-state and out-of-state corporations equally[68] "to effectuate a legitimate local public interest,"[69] of protecting resident shareholders from fraudulent practices. The second part of the test will be discussed in detail to determine if the burden the Shareholder Protection Statute will place on commerce is "clearly excessive in relation to the putative local benefits."[70]

The "putative local benefits" of the Shareholder Protection Statute are clear and significant. The proposed statute would seek to protect the property interests of resident shareholders who own significant interests[71] in publicly traded companies. Furthermore, the Shareholder Protection Statute will also indirectly seek to protect the property interests of resident shareholders who own much less, but suffer price depression because companies adopt poison pills. Studies examining this last issue have expressed mixed results.[72] There are, however, a significant number of studies reflecting a strong backing for the idea, and thus, a state could make a strong argument on this point.[73]

---

statute directly regulates interstate commerce"), but otherwise seems to have fallen into general disuse. It seems most likely that a court reviewing the constitutionality of the Shareholder Protection Statute would employ the balancing test. If it did not, the Shareholder Protection Statute would probably fare better under a direct/indirect burden analysis. The Shareholder Protection Statute has no effect until a state resident triggers the poison pill and applies *only* to transactions where the state has a significant and legitimate interest. Similarly, the Shareholder Protection Statute will have no effect on any transactions occurring wholly outside the state (e.g., where a shareholder in State X tries to sell shares to a shareholder in State Y, and State Z has adopted the statute).

[67]397 U.S. 137, 142 (1970).

[68]*Id.*

[69]*Id.*

[70]*Id.*

[71]Significant interests refers to owning 15% or greater.

[72]*See, e.g.*, Datta & Iskandar-Datta, *supra* note 14, at 1231-50; Malatesta & Walkling, *supra* note 14, at 347-76; Michael Ryngaert, *The Effect of Poison Pill Securities on Shareholder Wealth*, 20 J. FIN. ECON. 377, 377 (1988); OFFICE OF THE CHIEF ECONOMIST, *supra* note 14.

[73]It should be noted that if a state made this argument, the reasons need not be right; they simply must be legitimate: "[A] law can be both economic folly and constitutional." CTS Corp. v. Dynamics Corp. of Am., 481 U.S. 69, 96-97 (1987) (Scalia, J., concurring).

Once a putative local benefit is established, a court must determine whether "the burden imposed on such commerce is clearly excessive" to the local benefit.[74] When weighing the burden against the benefit, "the extent of the burden that will be tolerated will of course depend on the nature of the local interest involved, and on whether it could be promoted as well with a lesser impact on interstate activities."[75] Opponents of the Shareholder Protection Statute may argue that, notwithstanding its putative local benefits, it imposes a significant burden on interstate commerce. As a result, poison pills which have effectively become the law of the land will become obsolete solely because one state refuses to recognize them and provides a judicial remedy to negate their effects.

There are two problems with this argument. First, any burden resulting from the Shareholder Protection Statute is less onerous than the burden from state laws that *permit* poison pills. Poison pills excessively burden interstate commerce by restricting the ability of shareholders to transfer their shares to each other, whether inside the target corporation's state of incorporation or outside. A poison pill's *raison d'être* is to prohibit the transfer of shares from a current shareholder to a tender offeror. In this light, the Shareholder Protection Statute actually facilitates interstate commerce, as it permits otherwise prohibited commercial transactions.

Second, once a state has made a legislative determination that poison pills are harmful to its residents, the Shareholder Protection Statute is the least burdensome way to protect its residents. A *more* burdensome law would declare all poison pills illegal, or prohibit in-state sales of out-of-state securities where the securities originate from a state that permits poison pills. The Shareholder Protection Statute does neither, having a legal effect only when a resident shareholder is being denied participation in a securities offering permitted to every other shareholder.

C. *Inconsistent Regulation*

Alternatively, opponents may argue that the burden is not only excessive because it limits interstate commerce, but also because it subjects

---

[74]Minnesota v. Clover Leaf Creamery Co., 449 U.S. 456, 471 (1981) (quoting Pike v. ruce Church, Inc., 397 U.S. 137, 142 (1970)).

[75]*Id.* Some valid local interests include a state's police power (Hall v. Geiger Jones Co., 242 U.S. 539, 548 (1917)), the regulation of safety (Raymond Motor Transp., Inc. v. Rice, 434 U.S. 429, 443 (1978)), environmental conservation (*Clover Leaf Creamery Co.*, 449 U.S. at 473), corporate governance (*CTS Corp.*, 481 U.S. at 91), and protecting local investors (*Edgar*, 457 U.S. at 644).

out-of-state corporations to inconsistent regulation.[76] More simply, opponents might claim a state is using the Shareholder Protection Statute to "project" its legislation onto other states. This kind of activity was forbidden by the Supreme Court in *Brown-Forman Distillers Corp. v. New York State Liquor Authority*.[77] In *Brown-Forman*, the Supreme Court struck down a New York law that required liquor distributors to post a monthly price schedule of all liquor products sold within the state and to agree not to sell any products outside of the state for a lesser amount.[78] The Court struck down the law holding, "New York may regulate the sale of liquor within its borders . . . [but] it may not 'project its legislation into [other states].'"[79] Similarly, in *Edgar v. MITE Corp.*, a plurality of the Court struck down an Illinois statute that granted the Illinois Secretary of State the authority to substantively review tender offers for target corporations that exhibit a nexus to the state.[80] The Court explained that "if Illinois may impose such regulations, so may other States; and interstate commerce in securities transactions generated by tender offers would be thoroughly stifled."[81] Under this line of reasoning, the Shareholder Protection Statute creates an impermissible burden because it has the practical effect of neutralizing any other state law that permits poison pills. Any tender offeror, wherever located, could incorporate in the state which had adopted the Shareholder Protection Statute and rely on its protection for conducting a tender offer.

Without question, a court reviewing the Shareholder Protection Statute could stop at this point in the analysis, correctly surmise that the Shareholder Protection Statute effectively "projects" legislation onto other states, and hold it unconstitutional. This holding would be incorrect for three reasons: first, the mere presence of "projection" of legislation is not in and of itself illegal; second, the harmful burdens the Court sought to avoid in *Brown-Forman* and *Edgar v. MITE Corp.* are not present under the Shareholder Protection Statute; and third, for reasons to be explained, both *Brown-Forman* and *Edgar v. MITE Corp.* have limited precedential value,

---

[76]*See* Brown-Forman Distillers Corp. v. New York State Liquor Auth., 476 U.S. 573, 583-84 (1986) (striking down a New York liquor fair-pricing statute for forcing "other states to alter their own regulatory schemes"). *Compare CTS Corp.*, 481 U.S. at 88 (upholding an Indiana antitakeover statute), *with Edgar*, 457 U.S. at 642 (striking down an Illinois antitakeover statute); *and Kassel*, 450 U.S. at 671 (striking down an Iowa truck-length statute).

[77]476 U.S. 573 (1986). See also the related decisions *Healy v. Beer Inst., Inc.*, 491 U.S. 324, 343 (1989) (striking down a Connecticut beer pricing affirmation statute), and *United States Brewers Ass'n v. Healy*, 692 F.2d 275 (2d Cir. 1982), *summarily aff'd*, 464 U.S. 909 (1983) (striking down a Connecticut liquor pricing statute for burdening out-of-state transactions).

[78]*Brown-Forman Distillers Corp.*, 476 U.S. at 585.

[79]*Id.* at 582-83 (citing Baldwin v. G.A.F. Seelig, Inc., 294 U.S. 511, 521 (1935)).

[80]*Edgar*, 457 U.S. at 627.

[81]*Id.* at 642.

that would not likely be expanded on given the present make-up of the Supreme Court.

1. "Projecting" Legislation

"Projecting" one's legislation onto other states is not illegal under the Commerce Clause, unless it creates an excessive burden on interstate commerce in relation to the local benefits.[82] As a result, passing a usury law that permits a significantly higher rate of interest than a neighbor state is permissible under the dormant Commerce Clause.[83] As is passing a law expressly permitting poison pills, despite such laws "impos[ing] some incidental burden on interstate commerce."[84] For this reason, states have legally passed a host of laws, including insurance and annuity laws,[85] strict liability tort laws,[86] "blue sky" laws, the previously-mentioned California Corporations Code, etc., each of which, to a greater or lesser extent, "project" their host state's legislation onto economic actors in other states. Similarly, the "projection" of the Shareholder Protection Statute onto out-of-state corporations is not alone sufficient to invalidate it under the dormant Commerce Clause without a concurrent finding of an excessive burden.

2. Excessive Burdens

The effects of the Shareholder Protection Statute on interstate commerce distinguish it from the statutes struck down in *Brown-Forman* and *Edgar v. MITE Corp.* In these cases, the individual statutes had an overreaching effect on other states, placing an excessive burden on interstate commerce by causing conflict with states' current laws, in turn curtailing the economic activity that they sought to regulate. In *Brown-Forman*, the Supreme Court struck down New York's "affirmation statute" requiring distillers to offer lowest-price guarantees.[87] The Supreme Court found that by New York "defining the 'effective price' of liquor differently from other States, New York can effectively force [distillers] to abandon [their] promotional [allowances] in States in which that program is legal, or force those other States to alter their own regulatory schemes."[88] As a result, New

---

[82]*Pike*, 394 U.S. at 142.

[83]*See* Marquette Nat'l Bank of Minneapolis v. First of Omaha Serv. Corp., 439 U.S. 299 (1978).

[84]WLR Foods, Inc. v. Tyson Foods, Inc., 65 F.3d 1172, 1182 (4th Cir. 1995).

[85]*See* Gillen v. United States Auto. Ass'n, 300 So. 2d 3, 4 (Fla. 1974).

[86]*See* Litarowich v. Wiederkehr, 405 A.2d 874, 874 (N.J. Super. Ct. 1979).

[87]*Brown-Forman Distillers Corp.*, 476 U.S. at 585.

[88]*Id.* at 583-84.

York's statute conflicted with the affirmation statutes held in twenty other states,[89] and eighteen control states,[90] therein "directly regulat[ing] interstate commerce."[91] Similarly in *Edgar v. MITE Corp.*, an Illinois antitakeover statute permitted the Illinois Secretary of State to substantively pass on the merit of a takeover offer, refusing to register it if it appeared inequitable.[92] This statute was struck down for its clear "sweeping extraterritorial effect" on interstate commerce.[93] Much like *Brown-Forman*, the Illinois statute at issue provided for a broad base of power, allowing the Illinois Secretary of State to call a hearing on a tender offer and review it for an indefinite amount of time[94] in cases that "would not affect a single Illinois shareholder," and was held to be too "stif[ling]" of interstate commerce.[95]

In contrast, the Shareholder Protection Statute should present no such dilemma for anyone, whether in-state or out-of-state. If State B permits poison pills (and a State B company adopts one) but State A does not permit poison pills, no conflict frustrates the State B company from conducting its business. The State B company is perfectly free to adopt its poison pill and even to exercise the poison pill in accordance with its terms if it does not implicate a State A resident. If a State A resident triggers the poison pill, the State B company must include the State A resident in any offering of its securities. The State B company will have no difficulty ascertaining its obligations, or performing them. This remains true even if every state enacts a poison pill statute, either permitting or prohibiting them. The company with a poison pill will need to include or exclude acquiring shareholders, as state law provides, in any exercise of the share purchase rights. While this may confound the company's purpose in driving away hostile acquirors, it will not make compliance with numerous state laws impossible nor difficult. As a result, unlike the statutes in *Brown-Forman* and *Edgar v. MITE Corp.*, the burden imposed by the Shareholder Protection Statute would be only incidental.

---

[89] *Id.* at 576.

[90] *Id.* at 576 n.1.

[91] *Brown-Forman Distillers Corp.*, 476 U.S. at 582.

[92] Edgar v. MITE Corp., 457 U.S. 624, 627 (1982). The statute in *Edgar v. MITE Corp.*, applied to every corporation that (1) had ten percent or more of its capital stock owned by Illinois residents or (2) met two of the following conditions: the corporation had its principal executive office in Illinois, was organized under Illinois law, or had at least ten percent of its stated capital and paid-in surplus represented in Illinois. *Id.*

[93] *Id.* at 642.

[94] *Id.* at 637.

[95] *Id.* at 642.

3. Inapplicability of Contrary Supreme Court Precedent

In the event that a court determined that the effects of the Shareholder Protection Statute could not be distinguished from *Brown-Forman* and *Edgar v. MITE Corp.*, there is good reason to believe that the Supreme Court would. Three Justices in *Brown-Forman* dissented, arguing that not only was the record insufficient to show that the New York law raised prices in other states, but the New York law was the opposite of the economic protectionist laws that the dormant Commerce Clause is intended to combat.[96] Two of the dissenting Justices remain on the bench, Justice Stevens and Chief Justice Rehnquist. Like the New York law, the Shareholder Protection Statute is meant to benefit consumers, not protect incumbent state interests. Unlike the New York law, the Shareholder Protection Statute does not lead to a potential welter of conflicting state regulations that would curtail interstate economic activity.

The decision in *Edgar v. MITE Corp.* was a plurality opinion, from which Chief Justice Rehnquist dissented.[97] While it remains good law, the Supreme Court's decision five years later in *CTS Corp. v. Dynamics Corp. of America*,[98] upholding Indiana's antitakeover statute, effectively limited *Edgar*'s reach. The question remains whether the Supreme Court would view the Shareholder Protection Statute, a pro-takeover law, as a valid exercise of state power per *CTS*, or an invalid exercise of state power per *Edgar*.

The Supreme Court would likely give the Shareholder Protection Statute a *CTS* reading for the three reasons that follow: First, the current make-up of the Supreme Court suggests that the Shareholder Protection Statute would get a sympathetic hearing. Three Justices (Rehnquist, Scalia, and Thomas) strongly oppose expanding the Court's dormant Commerce Clause jurisprudence.[99] Four other Justices are swing votes: Justices O'Connor and Kennedy generally favor states' rights, Justice Breyer has free

---

[96]Brown-Forman Distillers Corp. v. New York State Liquor Auth., 476 U.S. 573, 588 (1986).

[97]*See Edgar*, 457 U.S. at 664-67.

[98]481 U.S. 69 (1987). One aspect of the *CTS* decision that appears unfavorable to the Shareholder Protection Statute is the Supreme Court's finding that the Indiana statute did not create a risk of inconsistent regulation. Finding it only applied to corporations incorporated in Indiana and "[n]o principle of corporation law and practice is more firmly established than a State's authority to regulate domestic corporations" such that "[s]o long as each State regulates voting rights only in the corporations it has created, each corporation will be subject to the law of only one State." *Id.* at 89. This should not foreclose the Shareholder Protection Statute though, because it does not have any affect on voting rights and, as has already been shown, any burden from the risk of conflicting regulation is incidental.

[99]*See infra* text accompanying notes 104-07.

market sympathies and Justice Stevens was a dissenter from the holding in *Brown-Forman*.[100] Thus, three Justices are almost certain to approve the Shareholder Protection Statute and four others quite possibly would. As the Shareholder Protection Statute needs only five Justices suppport to pass muster, it stands an excellent chance of survival.

Second, the Shareholder Protection Statute is more like the Indiana antitakeover statute upheld in *CTS*. It creates only a minimal risk of inconsistent regulation between the states, unlike the law struck down in *Edgar* that gave broad discretionary powers over out-of-state corporations. Third, by invalidating the Shareholder Protection Statute the Supreme Court risks creating a *de facto* rule that prohibits states from passing laws that purport to regulate other states' corporations. This is unlikely considering California has been regulating other states' corporations for years.[101]

D. *Supporting Precedent*

The Shareholder Protection Statute should survive the *Pike v. Bruce Church, Inc.* balancing test. It is distinguishable from *Brown-Forman* and *Edgar v. MITE Corp.*, and is also supported by ample Supreme Court and Appellate Court precedent. Most importantly, the Shareholder Protection Statute and the various state laws permitting poison pills do not present an irreconcilable conflict. As a result, it should be left to Congress, and not the courts, to preempt the Shareholder Protection Statute should it be viewed as state over-reaching. As Justice Brandeis stated in his dissent in *New State Ice Co. v. Liebmann*:

> To stay experimentation in things social and economic is a grave responsibility. Denial of the right to experiment may be fraught with serious consequences to the Nation. It is one of the happy incidents of the federal system that a single courageous State may, if its citizens choose, serve as a laboratory . . . .[102]

To this end, the Supreme Court has stated that it is Congress' responsibility, and not the Court's, to determine when "local interests should be required to

---

[100]*See Brown-Forman Distillers Corp.*, 476 U.S. at 586-92.

[101]CAL. CORP. CODE § 2115(b) (West, WESTLAW through 1999 portion of 1999-2000 Reg. Sess. and 1st Ex. Sess).

[102]New State Ice Co. v. Liebmann, 285 U.S. 262, 311 (1932). Justice Brandeis further added that "[t]here must be power in the states and the nation to remould, through experimentation, our economic practices and institutions to meet changing social and economic needs." *Id.*

yield to the national authority and interest... [because] Courts do not sit as legislatures."[103]

Several current Justices seem to agree on this point. Chief Justice Rehnquist has stated:

> The Commerce Clause is, after all, a grant of authority to Congress, not to the courts. Although the Court when it interprets the "dormant" aspect of the Commerce Clause will invalidate unwarranted state intrusion, such action is a far cry from simply undertaking to regulate when Congress has not because we believe such regulation would facilitate interstate commerce.[104]

Justice Scalia has added that "it is for Congress to make the judgment that interstate commerce must be immunized from certain sorts of nondiscriminatory state action."[105] And Justice Thomas' antipathy towards the dormant Commerce Clause is clear:

> The negative Commerce Clause has no basis in the text of the Constitution, makes little sense, and has proved virtually unworkable in application. In one fashion or another, every Member of the current Court and a goodly number of our predecessors have at least recognized these problems, if not been troubled by them. Because the expansion effected by today's holding [that a Maine property tax exemption facially discriminated against out-of-state interests] further undermines the delicate balance in what we have termed "Our Federalism," I think it worth revisiting justifications for our involvement in the negative aspects of the Commerce Clause, and the compelling arguments demonstrating why those justifications are illusory.[106]

In this atmosphere of judicial reluctance to legislate where Congress has chosen not to, the Shareholder Protection Statute should fare well. As noted above, the Supreme Court has long recognized the states' authority to

---

[103]South Carolina State Highway Dep't v. Barnwell Bros., 303 U.S. 177, 190 (1938).

[104]Kassel v. Consolidated Freightways Corp., 450 U.S. 662, 690 (1981) (Rehnquist, J., dissenting).

[105]Oklahoma Tax Comm'n v. Jefferson Lines, Inc., 514 U.S. 175, 201 (1995) (Scalia, J., concurring).

[106]Camps Newfound/Owatonna, Inc. v. Town of Harrison, 520 U.S. 564, 610-12 (1997) (Thomas, J., dissenting; Rehnquist, C.J., and Scalia, J. joining).

enact "blue sky" laws that regulate securities within their borders.[107] Additionally, the Fourth Circuit recently held that Virginia's poison pill enabling statute did not run afoul of the dormant Commerce Clause, even though it effectively projected its legislation onto other states.[108] Separately, the Second Circuit held in 1991 that a New York shareholder may inspect the books and records of a Maryland corporation in accordance with the New York Business Corporation Law, despite the fact that the inspection was not permitted under the Maryland General Corporation Law.[109] Although state court decisions carry less precedential weight, there is a line of unchallenged California Court of Appeals' cases upholding California's authority to regulate out-of-state corporations.[110] The courts in each of these cases considered, and rejected, dormant Commerce Clause arguments. Collectively, these factors support a favorable ruling on the Shareholder Protection Statute.

VI. CONTRACTS CLAUSE

Article I, Section 10 of the U.S. Constitution provides that "[n]o state shall . . . pass any . . . Law impairing the Obligation of Contracts."[111] As every shareholder rights plan is evidenced by a shareholder rights agreement, an opponent of the Shareholder Protection Statute could plausibly argue that

---

[107]*See* Merrick v. N.W. Halsey & Co., 242 U.S. 568 (1917); Caldwell v. Sioux Falls Stock Yards Co., 242 U.S. 559 (1917); and Hall v. Geiger-Jones Co., 242 U.S. 539 (1917).

[108]WLR Foods, Inc. v. Tyson Foods, Inc., 65 F.3d 1172, 1181 (4th Cir. 1995).

> Although the laws that states enact to regulate their corporations necessarily affect interstate commerce, . . . [w]e conclude that the Virginia statutes at issue do not violate the Commerce Clause, because they do not discriminate against interstate commerce, and to the extent that they burden interstate commerce, the burden is justified by the legitimate interest of the Commonwealth in regulating its corporations.

Id. at 1182. It should be recalled that the Supreme Court has stated that "protecting local investors is plainly a legitimate state objective." *Edgar*, 457 U.S. at 644.

[109]Sadler v. NCR Corp., 928 F.2d 48, 55 (2d Cir. 1991) (stating that absent "irreconcilable conflict," Maryland cannot expect "constitutional insulation for the particular arrangements it adopted"). *See also* Jefferson Indus. Bank v. First Golden Bank, 762 P.2d 768, 769 (Colo. Ct. App. 1988) (holding that Colorado's right to inspect law may be applied to a Delaware corporation); RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 304, cmt. d (1971).

[110]*See* Havlicek v. Coast to Coast Analytical Servs., Inc., 39 Cal. App. 4th 1844, 1856 (Cal. Ct. App. 1995) (upholding California's directors' right to inspect laws against Delaware corporation); Valtz v. Penta Inv. Corp., 139 Cal. App. 3d 803, 803 (Cal. Ct. App. 1998) (upholding California's shareholders' right to inspect laws against Delaware corporation); Wilson v. Louisiana-Pacific Resources, Inc., 138 Cal. App. 3d 216, 216 (Cal. Ct. App. 1983) (upholding California's cumulative voting requirements against a Utah corporation); *see also* Western Air Lines, Inc. v. Sobieski, 191 Cal. App. 2d 399, 399 (Cal. Ct. App. 1961) (upholding California's cumulative voting requirements against a Delaware corporation).

[111]U.S. CONST. art. I, § 10, cl. 1.

it would impair those contracts and is therefore unconstitutional by virtue of the Contracts Clause. A literal reading of the Contracts Clause certainly supports such a conclusion, however, it is well established that literal readings of the Contracts Clause have been abandoned for over 150 years.[112]

In *Exxon Corp. v. Eagerton*,[113] the Supreme Court stated, "This Court has long recognized that a statute does not violate the Contracts Clause simply because it has the effect of restricting, or even barring altogether, the performance of duties created by contracts entered into prior to its enactment."[114] This interpretation is necessary; to hold otherwise would permit people to contract themselves out of reach of the law. As the Supreme Court stated, "[O]ne would be able to obtain immunity from state regulation by making private contractual arrangements."[115] Justice Holmes said as much stating: "One whose rights, such as they are, are subject to state restriction, cannot remove them from the power of the State by making a contract about them. The contract will carry with it the infirmity of the subject matter."[116] The background of the Contracts Clause requires such a reading. The framers of the Constitution were addressing a pervasive problem of states passing laws to relieve certain debtors of their obligations:

> The context in which the Contracts Clause is found, the historical setting in which it was adopted, and our cases construing the Clause, indicate that its primary focus was upon legislation that was designed to repudiate or adjust pre-existing debtor-creditor relationships that obligors were unable to satisfy.[117]

As a result, the Supreme Court in its modern Contracts Clause jurisprudence has developed two separate standards of review. The standard

---

[112]*See generally* Chrysler Corp. v. Kolosso Auto Sales, Inc., 148 F.3d 892, 894 (7th Cir. 1998) (Posner, C.J.) ("It has been a long time, however, since the contracts clause was interpreted literally.").

[113]462 U.S. 176 (1983).

[114]*Id.* at 190.

[115]United State Trust Co. v. New Jersey, 431 U.S. 1, 22 (1977).

[116]Hudson Co. v. McCarter, 209 U.S. 349, 357 (1908).

[117]Keystone Bituminous Coal Ass'n v. DeBenedictis, 480 U.S. 470, 502-03 (1987). *See also* Home Bldg. & Loan Ass'n v. Blaisdell, 290 U.S. 398, 455 (1934) (Sutherland, J., dissenting). Sutherland stated:

> Bonds of men whose ability to pay their debts was unquestionable could not be negotiated except at a discount of thirty, forty or fifty per cent. Real property could be sold only at a ruinous loss. Debtors, instead of seeking to meet their obligations by painful effort, by industry and economy, began to rest their hopes entirely upon legislative interference.

Id.

depends on whether the state law impairs the state's own obligations, in which the state law is afforded less deference, or whether the state law impairs private contracts, in which the state law receives greater deference.[118] Since the Shareholder Protection Statute does not pertain to any state obligation, the private contract standard of review will apply.

When the state law affects private contracts, as opposed to state obligations, the Supreme Court asks "whether the change in state law has 'operated as a substantial impairment of a contractual relationship.'"[119] "This inquiry has three components: whether there is a contractual relationship, whether a change in law impairs that contractual relationship, and whether the impairment is substantial."[120] In *General Motors Corp. v. Romein*, the most recent Supreme Court case addressing the Contracts Clause, General Motors challenged a Michigan workers' compensation law that required employers to refund any payments previously withheld from disabled workers who had other sources of income.[121] General Motors argued that implicit in the terms of the collective bargaining agreement with its employees was the workers' compensation scheme as then permitted by state law.[122] Enforcement of the new law would cause General Motors to have to refund nearly $25 million in previously withheld benefits.[123] The Supreme Court found that no contractual relationship existed, as the terms of the collective bargaining agreement were silent on the issue of disability payments.[124] Rather, the parties had relied on a mutual understanding of state law, which did not rise to the level of a "contract."[125] As there was no contract, there could be no impairment, and General Motors' Contracts Clause argument was dismissed.

Similarly, a court could find that no contract exists with respect to an acquiring shareholder and a company with a poison pill. Most shareholder rights agreements state that "by accepting" the dividended purchase rights, shareholders agree to be bound by the terms of the agreement.[126] It is

---

[118]*See United States Trust Co.*, 431 U.S. at 25-26.

[119]General Motors Corp. v. Romein, 503 U.S. 181, 186 (1992) (citations omitted).

[120]*Id.*

[121]*See id.* at 181. Withholding payments from disabled workers who had another source of income had been proper under an earlier repealed Michigan law.

[122]*See id.* at 187.

[123]*See General Motors*, 503 U.S. at 186.

[124]*See id.* at 181.

[125]*Id.*

[126]*See, e.g.*, Rights Agreement, Section 16, dated March 29, 1996, of Ralston Purina Company, filed as an exhibit to a Form 8-A, dated March 29, 1996 (on file with the Securities and Exchange Commission).

questionable whether that unilateral activity by the company would be deemed a contract for purposes of a Contracts Clause analysis.[127]

Even if the court found that a contract existed, the Shareholder Protection Statute would survive. The next step in a Contracts Clause analysis involves a determination of whether the state law operated as a "substantial impairment."[128] The Seventh Circuit recently addressed this issue in *Chrysler Corp. v. Kolosso Auto Sales, Inc.*[129] In this case, Chrysler sought to invalidate a Wisconsin law that permitted a franchisee to relocate its franchised business, notwithstanding a contractual prohibition in the franchise agreement.[130] Chrysler (the franchisor) had a contract (pre-dating the Wisconsin law) with the auto dealership Kolosso that included a provision prohibiting Kolosso from relocating without Chrysler's prior written permission.[131] Kolosso invoked the Wisconsin law, relocated its business, and Chrysler sued.[132] On appeal, Chief Judge Posner upheld the Wisconsin law, holding that the "foreseeability" of the challenged law by the contracting parties controls whether it imposes a burden substantial enough to violate the Contracts Clause.[133] While nothing in the Chrysler/Kolosso contract accounted for a change in the law, the court held that heavily regulated businesses are on notice of potential legislative changes.[134] If the expectations of the parties can be shown to have taken into account (or even that they *should* have taken into account) a change in the law, then the state law cannot be said to impair the contractual relationship: "[A] contractual obligation is not impaired within the meaning that the modern cases impress

---

[127]Even the "contract" between the rights agent and the company is of dubious quality. Rather than the typical arm's-length agreement in which two parties negotiate for something of value, it contains what one pro-Contracts Clause scholar has termed "abusive transactions — as when two parties [the company and the rights agent] make an agreement to violate the rights of a third [the acquiring shareholder]." Richard Epstein, *Toward a Revitalization of the Contract Clause*, 51 U. CHI. L. REV. 703, 732 (1984). After all, the only exchange of value in a shareholder rights agreement is the payment of a fee to the rights agent in exchange for its agreement to unilaterally exclude some future shareholder from a securities offering. Professor Epstein has allowed that in the case of abusive transactions, the state can appropriately employ its police powers, notwithstanding a Contracts Clause challenge. *See id.*

[128]*General Motors*, 503 U.S. at 186.

[129]148 F.3d 892 (7th Cir. 1998).

[130]*Id.* at 893.

[131]*Id.*

[132]*See id.*

[133]*Chrysler Corp.*, 148 F.3d at 894.

[134]*See id.* at 895. "The automobile dealership relationship has been heavily regulated in Wisconsin as in other states for many years — in Wisconsin for more than sixty years .... [The] degree to which the activity to which the contract pertains ... [is] regulated when the contract was made [provides evidence of foreseeability.]" *Id.*

upon the Constitution if at the time the contract was made the parties *should have foreseen* the new regulation challenged under the clause."[135]

Under this standard, a Contracts Clause challenge to the Shareholder Protection Statute cannot possibly survive. Apart from the fact that the distribution of securities is one of the most heavily regulated of all commercial activities, almost every shareholder rights agreement *by its own terms* contemplates a change in law. For instance, as the Ralston Purina Rights Agreement provides in part:

> notwithstanding anything in this Rights Agreement to the contrary, neither the Company nor the Rights Agent shall have any liability to any holder of a Right . . . by reason of any . . . statute, rule, regulation or executive order promulgated or enacted by any governmental authority, prohibiting or otherwise restraining performance of such obligation . . . .[136]

This type of provision is boilerplate, and probably exists in every shareholder rights agreement on file with the Securities and Exchange Commission. Companies know that poison pills are questionable devices, and their lawyers include language to protect them from liability in the event they are found to be illegal, are enjoined, or are otherwise without effect. These clauses provide clear evidence that the parties understand that enforcement of shareholder rights agreements remains subject to prevailing law. As such, none of them would be "substantially impaired" within the meaning of Contracts Clause jurisprudence in the event that the prevailing law changes.

Historical precedent amply supports this reading. State police powers will not be prescribed by application of the Contract Clause where the state statute in question is designed to advance "a broad societal interest."[137] In particular cases, the Supreme Court has held that a state prohibition law may be applied to contracts for the sale of beer that were valid when entered into,[138] that a law barring lotteries may be applied to lottery tickets that were valid when issued,[139] and that a law prohibiting the issuance of notes by unincorporated banking associations is effective, despite the existence of

---

[135]*Id. at* 897 (emphasis added).

[136]Rights Agreement, *supra* note 126.

[137]Allied Structural Steel Co. v. Spannaus, 438 U.S. 234, 249 (1978).

[138]*See* Beer Co. v. Massachusetts, 97 U.S. 25 (1878).

[139]*See* Stone v. Mississippi, 101 U.S. 814 (1880).

contracts by association members providing for the opposite.[140] It is almost certain that the Shareholder Protection Statute would similarly survive a Contracts Clause challenge.[141]

VII. CONFLICT OF LAWS

It may be argued that even if the Shareholder Protection Statute is constitutional, it is simply inapplicable to out-of-state corporations. When determining questions of corporate law, and the issue arises as to the appropriate state law to apply, courts often apply the "internal affairs doctrine."[142] 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 — matters peculiar to the relationships among or between the corporation and its current officers, directors, and shareholders — because otherwise a corporation could be faced with conflicting demands."[143]

The internal affairs doctrine is, however, only "presumptively applicable" in the absence of statutory direction.[144] As the Supreme Court has explained, "Where . . . it is clear that the legislature has actually addressed itself to the choice of law problem, the courts, subject to the limit of constitutionality, must give effect to its intentions."[145] Courts may only

---

[140]*See* Myers v. Irwin, 2 S. & R. (Pa.) 368 (1816).

> [I]t is said that the members had formed a contract *between themselves*, which would be dissolved by the stoppage of their business. And what then? Is that such a violation of contracts as is prohibited by the constitution of the *United States*? Consider to what such a construction would lead. Let us suppose, that in one of the states there is no law against gaming, cock-fighting, horse-racing, or public masquerades, and that companies should be formed for the purpose of carrying on these practices. And suppose, that the legislature of that state, being convinced of the pernicious effect of these institutions, should venture to interdict them: will it be seriously contended, that the constitution of the *United States* has been violated?

Id. at 372.

[141]Even if it did not survive, it would only delay effectiveness of the state statute for a number of years. Contracts Clause challenges pertain only to "existing contractual relationships." *Allied Structural Steel*, 438 U.S. at 242. *See also* JOHN E. NOWAK & RONALD D. ROTUNDA, CONSTITUTIONAL LAW § 11.8, at 405 (4th ed. 1991) (concluding that a law operating prospectively on a contract is not an impairment within the meaning of the Contracts Clause). Since virtually all shareholder rights agreements have terms of 10 or fewer years, it would only be a matter of time before the state statute would have universal applicability.

[142]Atherton v. Federal Deposit Ins. Corp., 519 U.S. 213, 223-24 (1997).

[143]Edgar v. MITE Corp., 457 U.S. 624, 645 (1982).

[144]Resolution Trust Corp. v. Chapman, 29 F.3d 1120, 1122 (7th Cir. 1994).

[145]Lauritzen v. Larsen, 345 U.S. 571, 579 n.7 (1953) (quoting Elliot E. Cheatham & Willis L.M. Reese, *Choice of the Applicable Law*, 52 COLUM. L. REV. 959, 961 (1952)).

resort to the "internal affairs doctrine" (and the related "significant relationship" test)[146] when there is no clear statutory guidance as to which state's laws to apply. As a result, the baseline for any conflict of laws analysis is the statute giving rise to the right being enforced. This principle is also stated in Section 6 of the *Restatement (Second) of Conflict of Laws* — "[a] court, subject to constitutional restrictions, will follow a statutory directive of its own state on choice of law"[147] — and has been cited with approval by nearly every circuit.[148] As the reader will recall, the Shareholder Protection Statute is applicable by its terms: "This provision shall apply to any issuer, whether incorporated in-state or out-of-state, notwithstanding anything in this State's conflict of laws statute to the contrary."[149]

As a result, assuming that the Shareholder Protection Statute is indeed constitutional, the statutory language requiring that it apply to any "issuer" notwithstanding its state of incorporation will be controlling. This concept should not be controversial; California has been foisting its General Corporation Law on foreign corporations for decades.[150]

VIII. CONCLUSION

Poison pills are a fairly recent phenomenon, are incredibly pervasive, and are considered to be the most significant recent development in takeover defense. They are also almost impossible to overcome, as the directors of Wallace Computer Services, Inc. and any number of other independent corporations can readily attest. This result occurs despite an overwhelming majority of shareholders who would like to sell their shares. It is not

---

[146]*See* RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 188 (1971); Diesel Serv. Co. v. AMBAC Int'l Corp., 961 F.2d 635, 640 (7th Cir. 1992).

[147]The commentary to this section is even more forceful: "A court, subject to constitutional limitations, *must* follow the directions of its legislature. The court *must* apply a local statutory provision directed to choice of law provided that it would be constitutional to do so." RESTATEMENT (SECOND) OF CONFLICT OF LAWS, Comment on § 6(1) (1971) (emphasis added).

[148]*See generally* MacDonald v. General Motors Corp., 110 F.3d 337 (6th Cir. 1997); Trumpet Vine Inv., N.V. v. Union Capital Partners I, Inc., 95 F.3d 1110 (11th Cir. 1996); Gann v. Fruehauf Corp., 52 F.3d 1320 (5th Cir. 1995); TPLC, Inc. v. United Nat'l Ins. Co., 44 F.3d 1484 (10th Cir. 1995); Henson v. GTE Prods. Corp., No. 93-1862, 1994 U.S. App. LEXIS 23870 (4th Cir. Sept. 1, 1994); Oil Shipping (Bunkering) B.V. v. Sonmez Denizcilik Ve Ticaret A.S., 10 F.3d 1015, 1019 (3d Cir. 1993); Diesel Serv. Co. v. AMBAC Int'l, 961 F.2d 635, 640 (7th Cir. 1992); Barclays Discount Bank Ltd. v. Levy, 743 F.2d 722, 725 (9th Cir. 1984); Mason v. Southern New England Conference Ass'n of Seventh-Day Adventists, 696 F.2d 135 (1st Cir. 1982); *In re* Parkwood, Inc., 461 F.2d 158 (D.C. Cir. 1971).

[149]*See supra* Part III.

[150]*See* Nagy v. Riblet Prods. Corp., 79 F.3d 572, 576-77 (7th Cir. 1996) ("California has been the most aggressive in asserting control over the internal affairs of foreign corporations located in that state; California subjects them to a list of rules selected from its domestic corporate statute.").

unreasonable for a state to determine that poison pills are an unfair, unilateral destruction of shareholders' property rights. Given that determination, it should not be beyond a state's power to fix the situation, at least where its residents are concerned. A statute akin to the Shareholder Protection Statute could be one possible option. For those inclined to support it, it would be an appropriate exercise of state police power to protect a legitimate state interest, carefully tailored to minimize its impact on purely out-of-state transactions.

Some states — Illinois which has fourteen corporations with poison pills, New Hampshire which has twenty corporations with poison pills, or maybe six Alaska where no corporations have poison pills could probably pass a law like the Shareholder Protection Statute.[151] It then would be left to the courts to determine its scope and constitutionality. As this article has attempted to show, the validity of such a law is, if not assured, at least a good possibility.

---

[151]CHARLES E. SIMON & CO., CORPORATE ANTI-TAKEOVER DEFENSES: THE POISON PILL DEVICE app. C-1 to C-56 (Joy Marlene Bryan ed., 2000).