Note

HOW DO PENNSYLVANIA DIRECTORS SPELL RELIEF? ACT 36

I. Introduction

Over the last sixty years, the corporate world has become increasingly active. One of the more visible and controversial areas of increased corporate activity has been corporate takeovers, where incumbent management is ousted from power.[1] Not coincidentally, the corporate world has seen a concurrent increase in federal regulation. In the 1930s, Congress enacted the Securities and Exchange Act (SEC Act), which granted the Securities and Exchange Commission (SEC or Commission) the power to enact regulations necessary for the protection of investors.[2] The regulations promulgated by the Commission require, *inter alia*, that corporate management provide disclosures to shareholders when they are asked to tender proxies or vote on corporate matters.[3] In the early 1960s, however, tender offers, as opposed to proxies, became the preferred method of effecting a corporate takeover. This presented a new problem because tender offers were not subject to the same disclosure re-

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1. There is evidence, however, that the number and frequency of takeovers is beginning to diminish. *See* Wayne, *Takeovers Face New Obstacles*, N.Y. Times, Apr. 19, 1990, § D, at 1, col. 3. This is, in part, a result of the enactment of state statutes designed to deter takeovers and the reduction in available financing.

2. The statute provides in relevant part:

> It shall be unlawful for any person, by the use of the mails or by any means or instrumentality of interstate commerce or of any facility of a national securities exchange or otherwise, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors, to solicit or to permit the use of his name to solicit any proxy or consent or authorization in respect of any security . . . .

15 U.S.C. § 78n(a) (1988). The rules enacted by the Commission, which apply directly to the regulation of proxies, are codified at 17 C.F.R. § 240.14a-1-11 (1990).

3. *See* 17 C.F.R. § 240.14a-1-11 (1990) (providing detailed requirements for the process of disclosing relevant information to shareholders and the substance of these disclosures).

quirements as proxies.[4] In response, Congress amended the SEC Act to include the Williams Act.[5] The Williams Act was primarily aimed at providing investors with the information necessary to assess the fairness of a tender offer.[6]

The most recent type of regulation, however, has not come from the federal government but from state governments. To date, no less than thirty-nine states have enacted some type of antitakeover statute regulating hostile takeovers within that state's jurisdiction.[7] These statutes, and hostile takeovers in general, have generated a wave of scholarly debate. On the economic front, the battle is waged over whether hostile takeovers and state antitakeover statutes are beneficial or detrimental to corporations, stockholders, and the economy. For every commentator in favor of an uninhibited takeover market, another feels that hostile takeovers are the cause of corporate America's ills.[8] Moreover, each side asserts that empirical evidence supports its position.[9]

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4. *See infra* notes 19-28 and accompanying text.

5. 15 U.S.C. §§ 78m(d)-(e), 78n(d)-(f) (1988).

6. *See infra* notes 29-33 and accompanying text. The essential requirements of the Williams Act are as follows:

(1) The offeror must disclose information to the shareholders upon commencement of the offer. Disclosure must be made by filing with the SEC and sending the information to the shareholders and the corporation. 15 U.S.C. § 78n(d)(1) (1988). The information must include information about the offeror's identity and background, the source of funds, the purpose of the purchase, and the extent of the offeror's holding in the corporation. 15 U.S.C. §§ 78m(d)(1), 78n(d)(1) (1988); 17 C.F.R. § 240.13d-1 (1990). The duty to disclose arises when the offeror either acquires or attempts to acquire more than five percent of the equity securities of the corporation. 15 U.S.C. § 78n(d)(1) (1988).

(2) Tendering shareholders must be allowed to withdraw their shares within 15 days of, and after 60 days from, the commencement of the offer. 15 U.S.C. § 78n(d)(1) (1988); 17 C.F.R. § 240.14d-7 (1990).

(3) If more shares are tendered than the offeror is willing to accept, then the offeror must purchase them on a pro rata basis. 15 U.S.C. § 78n(d)(6) (1988).

(4) If the offeror increases the share price, the same price must be given to those who have already tendered. 15 U.S.C. § 78n(d)(7) (1988).

7. *See* Marr, *Anti-Takeover Bill Threatens Shareholders*, PENSIONS & INVESTMENT AGE, Mar. 5, 1990, at 14 (commentary); Wagner, *State Anti-Takeover Legislation: Necessary Protection or Rationalization of Entrenchment?*, INSIGHTS, Feb. 1990, at 26 (No. 2) (Mergers & Acquisitions section) (setting forth a state-by-state analysis of the types of statutes enacted in each state).

8. *See* Easterbrook & Fischel, *Takeover Bids, Defensive Tactics, and Shareholders' Welfare*, 36 BUS. LAW. 1733 (1981) (supporting uninhibited hostile takeover activity); Proxmire, *What's Right and Wrong About Hostile Takeovers*, 1988 WIS. L. REV. 353 (espousing a particularly passionate stance against hostile takeovers).

9. *See infra* notes 85-95 and accompanying text.

State antitakeover statutes have also come under frequent constitutional attack. In both *Edgar v. MITE Corp.*[10] and *CTS Corp. v. Dynamics Corp. of America*,[11] the United States Supreme Court confronted the issue of whether a state antitakeover statute violated either the commerce clause or supremacy clause of the United States Constitution. In virtually every case challenging a state antitakeover statute, the plaintiffs aver that the statute places impermissible burdens on interstate commerce and, therefore, violates the commerce clause. Furthermore, it is often argued that because the state law seeks to regulate tender offers, it is preempted by the Williams Act.[12]

On April 27, 1990, however, when Pennsylvania Governor Robert Casey signed Act 36,[13] the seed for a new wave of legal and economic debate was planted. Act 36, which economic and legal commentators are calling the toughest antitakeover legislation in the country,[14] is a combination of provisions designed to severely curtail or completely halt hostile takeover activity in Pennsylvania.

Act 36 has three significant provisions. First, it expands the number and types of factors that corporate directors, as fiduciaries, may take into consideration when making any corporate decision.[15] Second, it restricts the voting rights of persons or groups whose voting power exceeds certain levels.[16] Finally, it requires disgorgement of profits realized from certain transactions involving the disposition of equity securities.[17] The most unique aspect of this Act is the disgorgement provision and the effect it may have on the use and

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10. 457 U.S. 624 (1982). *See infra* notes 47-60 and accompanying text (further discussing the case).

11. 481 U.S. 69 (1987). *See infra* notes 65-81 and accompanying text (further discussing the case).

12. *See, e.g.*, Amanda Acquisition Corp. v. Universal Foods Corp., 877 F.2d 496 (7th Cir. 1989) (discussing the Wisconsin statute's validity under both the Williams Act and the commerce clause); Hyde Park Partners, L.P. v. Connolly, 839 F.2d 837 (1st Cir. 1988) (holding the Massachusetts statute valid under the commerce clause but preempted by the Williams Act); RP Acquisition Corp. v. Staley Continental, Inc., 686 F. Supp. 476 (D. Del. 1988) (holding that the Delaware statute violated neither the commerce clause nor the supremacy clause).

13. S.B. 1310, 1989 Sess., Act. 36 (eff. Apr. 27, 1990). The independent sections will be codified as 15 PA. CONS. STAT. ANN. §§ 511, 512, 1721, 2502 (Purdon 1990) (amended 1990); 15 PA. CONS. STAT. ANN. §§ 2561-2567, 2571-2574, 2581-2583, 2585-88 (Purdon 1990).

14. Klein & Greenbaum, *Companies Cool Toward Anti-Takeover Law*, N.Y.L.J., Sept. 10, 1990, at 15; Wayne, *supra* note 1, § D, at 1, col. 3.

15. 15 PA. CONS. STAT. ANN. §§ 511, 1721 (Purdon 1990) (amended 1990).

16. 15 PA. CONS. STAT. ANN. §§ 2561-2567 (Purdon 1990).

17. *Id.* § 2571-2576.

solicitation of proxies. This provision may give rise to the first challenge of the SEC's authority to regulate proxy fights under the SEC Act.[18] Furthermore, it may strip shareholders of rights that were once thought sacred.

This note will first explore the legislative and judicial background that set the stage for the enactment of Act 36. It will then analyze the particular provisions of Act 36 relating to the restriction of voting rights and disgorgement of profits. Finally, it will assess the constitutional, economic, and public policy implications of Act 36, focusing primarily on the disgorgement provision.

II. BACKGROUND

To fully evaluate Act 36, one must examine the legal and economic developments leading up to the statute's enactment. The timing of this Act may play an important role in a court's recognition of the statute as a valid exercise of the state's power to regulate domestic corporations.

A. Federal Securities Regulation: Purposes and Objectives

In 1934, Congress enacted the Securities and Exchange Act of 1934,[19] which authorized the Commissioner of the SEC to enact regulations that are "necessary or appropriate in the public interest or for the protection of investors."[20] Under this authority, the Commission created federal regulations governing the use and solicitation of proxies.[21]

Recently, in *Business Roundtable v. SEC*,[22] the Court of Appeals for the District of Columbia Circuit had the opportunity to interpret the "purposes" of the federal proxy regulations.[23] The SEC claimed

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18. Donovan, *Anti-Takeover Laws Targeting Holder Rights; Latest Protective Efforts Would Prevent Owners From Firing Board in a Single Vote*, Investors Daily, Apr. 19, 1990, at 1.

19. 15 U.S.C. § 78l-n (1988).

20. *Id.* § 78n(a).

21. 17 C.F.R. §§ 240.14a-1 to -11 (1990).

22. 905 F.2d 406 (D.C. Cir. 1990).

23. The case involved a challenge to the validity of a federal regulation enacted by the Commissioner under the authority of § 19 of the Securities and Exchange Act of 1934. 15 U.S.C. § 78s (1988). The challenged regulation, Rule 19c-4, barred national securities exchanges from listing stock of any corporation that took any action reducing the per share voting rights of a share of stock from one vote per share. 17 C.F.R. § 240.19c-4 (1991). The question of the purposes of § 14 of the proxy regulations arose because the SEC relied primarily on § 14 of the SEC Act to demonstrate its power to enact such a regulation.

that the purpose of section 14(a) of the SEC Act was to ensure a well-informed shareholder vote.[24] This broad interpretation would allow the Commission great latitude in the exercise of power over various aspects of voting and proxies. The court, however, narrowed the scope of the Commission's broad interpretation of its authority by finding that the primary purpose of the proxy regulations was fair disclosure.[25] The court cited *J.I. Case Co. v. Borak*,[26] in which the United States Supreme Court held that "[t]he purpose of [section] 14(a) is to prevent management or others from obtaining authorization for corporate action by means of deceptive or inadequate disclosure in proxy solicitation."[27] In the final analysis, the Court held that the federal proxy regulations deal almost exclusively with disclosure and that matters dealing with the substance of proxies, such as how many votes are accorded to a share of stock, should be resolved by either Congress or the states.[28] Thus, while the *Business Roundtable* decision is only binding in the District of Columbia Circuit, it appears that it drew much of its authority from Supreme Court decisions. Therefore, it seems logical to conclude that if the Supreme Court is again asked to interpret the objectives of the federal proxy regulations in the context of evaluating a state antitakeover statute, it will rule similarly to the court of appeals in *Business Roundtable*.

The SEC Act also includes regulations concerning tender offers. The Williams Act[29] was enacted in 1968 as a response to the increasing number of tender offers in the early 1960s.[30] The drafters of the Williams Act noted that both tender offers and proxy contests are

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24. *Business Roundtable*, 905 F.2d at 410.

25. *Id.*

26. 377 U.S. 426 (1964). The Court also cited *Santa Fe Indus., Inc. v. Green*, which emphasized that "once full and fair disclosure has occurred, the fairness of the terms of the transaction is at most a tangential concern of the statute." 430 U.S. 462, 477-78 (1977).

27. *J.I. Case Co.*, 377 U.S. at 431.

28. *See Business Roundtable*, 905 F.2d at 411 (finding that regulations designed to provide shareholders with adequate information were procedural in nature and that other rules which affected shareholder choices were substantive in nature).

29. 15 U.S.C. §§ 78m(d)-(e), 78n(d)-(f) (1988).

30. *E.g.*, *MITE*, 457 U.S. at 632; Comment, *State Takeover Legislation After CTS: Does It Give States a Free Hand to Regulate Tender Offers?*, 13 DEL. J. CORP. L. 1029, 1032 (1988). The Court in *MITE* noted that the tender offer was a device that had "removed a substantial number of corporate control contests from the reach of existing disclosure requirements of the federal securities laws." *MITE*, 457 U.S. at 632 (quoting Piper v. Chris-Craft Indus., Inc., 430 U.S. 1, 22 (1977)).

devices used to oust incumbent management.[31] Furthermore, both devices require that shareholders choose between existing management and the challenger. The difference between the two was that federal regulations concerning proxies required specific disclosures in order to promote informed shareholder decisions, whereas tender offers were unregulated. By enacting the Williams Act, the drafters attempted to close the "significant gap in investor protection under the Federal securities laws"[32] by creating legislation that required disclosures to be provided to shareholders faced with a tender offer.[33]

In *Edgar v. MITE Corp.*,[34] and briefly in *CTS Corp. v. Dynamics Corp. of America*,[35] the Supreme Court interpreted the purposes of the Williams Act to determine whether a state antitakeover statute frustrated the objectives of that act in such a way that the state statute would be preempted under the supremacy clause.[36] In both cases, the Court found that Congress' intention was to protect investors.[37] The *MITE* Court also found that the express intention of the drafters was to ensure that management and the offeror were on equal footing so that neither could unfairly promote or inhibit the offer.[38] Because the Court has consistently endorsed these interpretations of the purposes of the Williams Act,[39] it is very likely that, if called on again, the Court will look to see if the statute frustrates the Williams Act's policy of investor protection and neutrality.

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31. Johnson & Millon, *Misreading the Williams Act*, 87 MICH. L. REV. 1862, 1894 (1989).

32. 113 CONG. REC. 854 (1967) (remarks of Sen. Williams).

33. *See* Garfield, *State Competence to Regulate Corporate Takeovers: Lessons From State Takeover Statutes*, 17 HOFSTRA L. REV. 535, 540 (1989) (stating that the Williams Act is "for the most part" a disclosure statute requiring offerors to make disclosures concurrently with their offers).

34. 457 U.S. 624 (1982).

35. 481 U.S. 69 (1987).

36. *CTS*, 481 U.S. at 79-87; *MITE*, 457 U.S. at 632-39. The Court's preemption analyses will be examined further in a discussion of the cases themselves. *See infra* notes 47-81 and accompanying text.

37. *MITE*, 457 U.S. at 633. *See also CTS*, 481 U.S. at 82, 84 (finding that the Indiana antitakeover statute did not frustrate, but promoted, the objectives of the Williams Act by allowing shareholders to evaluate and approve a tender offer).

38. *MITE*, 457 U.S. at 633. "Congress disclaimed any 'intention to provide a weapon for management to discourage takeover bids,' and expressly embraced a policy of neutrality." *Id.* (citation omitted). The Court then cited Senator Williams, who stated, "We have taken extreme care to avoid tipping the scales either in favor of management or in favor of the person making the takeover bids." *Id.* at 633 (citing 113 CONG. REC. 24,664 (1967)).

39. *See CTS*, 481 U.S. at 82 (endorsing *MITE*'s interpretation of the Williams Act).

B. *State Antitakeover Legislation*

1. First-Generation Statutes and *MITE*

During the period between the enactment of the Williams Act and 1982, thirty-seven states enacted what are now known as first-generation state antitakeover statutes.[40] First-generation antitakeover statutes were state efforts to cope with the unknown effects of the new wave of takeovers. These statutes typically contained disclosure requirements very similar to those of the Williams Act.[41] Some of these statutes, however, had other, more stringent provisions. For example, the Illinois act that was invalidated by the Supreme Court in *MITE* had provisions requiring the filing of disclosure materials *before* the commencement of the tender offer,[42] whereas the Williams Act only required filing at the time of the commencement.[43] The Illinois act also authorized the Secretary of State to conduct hearings of potentially indefinite length in order to evaluate the adequacy of the disclosures and the fairness of the offer.[44] These provisions were typical of other first-generation statutes,[45] and, although they were enacted for shareholder protection, they were frequently challenged in lower federal courts[46] and, finally, the Supreme Court.

The first of two important Supreme Court decisions evaluating a state antitakeover statute was *Edgar v. MITE Corp.*,[47] where the Court, in a plurality opinion, found the Illinois Business Takeover

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40. Garfield, *supra* note 33, at 542.

41. *Id.*; Comment, *supra* note 30, at 1035.

42. ILL. REV. STAT. ch. 121 1/2, paras. 137.54E, .54B (1979) (repealed 1983).

43. 15 U.S.C. § 78n(d)(1) (1988); 17 C.F.R. § 240.14d-2 (1990).

44. ILL. REV. STAT. ch. 121 1/2, paras. 137.57A, .57B, .57E (1979) (repealed 1983). There are no such provisions in the Williams Act.

45. *See* Garfield, *supra* note 33, at 544 ("The Illinois statute at issue in *MITE* was a typical first[-]generation statute."). The statutes of the different states varied substantially, each with its own combination of provisions. The Illinois statute was typical of those because it contained most of the individual provisions that made up the varying state statutes of the time. *See* March, *Takeover Legislation After* CTS Corp. v. Dynamics Corp. of America: *The Acceptance of Control Share Regulation*, 30 ARIZ. L. REV. 927, 932-33 (1988) (stating the various types of provisions of first-generation statutes).

46. *E.g.*, Leroy v. Great W. United Corp., 443 U.S. 173 (1979) (invalidating the Idaho antitakeover statute); Dart Indus., Inc. v. Conrad, 462 F. Supp. 1 (S.D. Ind. 1978) (invalidating the Delaware antitakeover statute).

47. 457 U.S. 624 (1982).

Act[48] to be unconstitutional. The only argument accepted by a majority of the Court was that the statute placed an impermissible burden on interstate commerce.[49] Justice White, writing for the plurality, utilized the balancing test set forth in *Pike v. Bruce Church, Inc.*[50] and held that the burdens the statute placed on interstate commerce outweighed any state interests that it promoted.[51] Justice White found that the burdens of the statute included the denial of the shareholders' right to sell their shares at a premium,[52] the hindrance of efficient reallocation of economic resources,[53] and the reduction of incentives for incumbent management to maintain a high stock price.[54] Furthermore, he found that the purported benefits of the statute, which were protection of shareholder interests and promotion of the state's interest in regulating the internal affairs of its

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48. ILL. REV. STAT. ch. 121 1/2, paras. 137.51-.70 (1979) (repealed 1983). The statute applied to any takeover attempt where at least 10% of the target corporation's shareholders were Illinois residents. *Id.* para. 137.52-10(2). There was no requirement that the company be either headquartered or incorporated within the state of Illinois. Furthermore, it contained the following provisions: (1) a precommencement notice requirement whereby the offeror had to notify the Secretary of State 20 days prior to that offer, *id.* para. 137.54E, .54B; (2) a provision whereby the Secretary could call a hearing during the 20-day period in order to evaluate the fairness of the offer, *id.* para. 137.57A, .57B; and (3) a further provision allowing the Secretary to deny the tender offer registration if the offer is judged to be unfair or where disclosure is inadequate, *id.* para. 137.57E.

49. *MITE*, 457 U.S. at 646. Justice White also found that the statute directly burdened interstate commerce because it "purports to regulate directly and to interdict interstate commerce, including commerce wholly outside the State. . . ." *Id.* at 643. This theory, however, did not carry a majority vote of the Justices.

50. 397 U.S. 137, 142 (1970). The commerce clause test articulated in *Pike* states that "[w]here the 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." *Id.* at 142.

51. *MITE*, 457 U.S. at 646.

52. *Id.* at 643.

53. *Id.*

54. *Id.* at 643-44. To reach these conclusions, Justice White relied heavily on the views of Professors Easterbrook and Fischel, both of whom advocate an unimpeded takeover market. His heavy reliance on these commentators may indicate that Justice White was in favor of an uninhibited takeover market. Note that the *CTS* opinion, in which an antitakeover statute was upheld, is markedly different. The Court in 1987 was less activist than in 1982, which may help explain the apparent shuffling of views between the two cases because *CTS* involved a much less expansive reading of the commerce and supremacy clauses. *See infra* notes 65-81 and accompanying text.

corporations, were "for the most part speculative" because of the extraterritorial reach of the statute.[55]

Justice White, in that portion of the opinion not adopted by the majority, also determined that the Illinois statute was preempted by the Williams Act. After stating the purposes of the Williams Act, he found that the Illinois statute frustrated "the objectives of the Williams Act in some substantial way."[56] More specifically, Justice White believed that the statute impeded the Williams Act's goal of neutrality between management and the offeror in two ways: (1) the precommencement filing gave management the opportunity to thwart the offer by allowing them to communicate with the shareholders, whereas the offeror had no such access;[57] and (2) the hearing provisions frustrated Congress' intent because it disadvantaged the offeror by delaying the commencement of the offer for a potentially indefinite period.[58] This, Justice White postulated, gave management a powerful weapon for stymieing the offeror.[59] Although this view was not adopted by a majority of the Court, the rationale has been

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55. *Id.* at 644-46. Specifically, Justice White agreed with the determination of the court of appeals that, because the statute burdened interstate commerce, the State of Illinois had no interest in protecting out-of-state shareholders. More significantly, Justice White rejected the argument that the internal affairs doctrine was applicable in this situation because the act could apply to corporations which neither had their principal place of business in Illinois nor were incorporated in the state. The significance of this determination is that, in *CTS Corp. v. Dynamics Corp. of America*, that Court strongly embraced the internal affairs doctrine as a governing principle on the question of the state's interest in regulating takeovers. *CTS*, 481 U.S. at 91-93.

56. *MITE*, 457 U.S. at 632. Justice White relied on the test that finds a state statute void when it actually conflicts with a valid federal statute "or where the state 'law stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.'" *Id.* at 631 (quoting Ray v. Atlantic Richfield Co., 435 U.S. 151, 158 (1978)).

57. *Id.* at 634-36. The plurality noted that the drafters of the Williams Act had considered, but expressly rejected, a precommencement filing requirement. *Id.* at 635. The drafters eliminated such a requirement because it was not necessary "and might delay the offer when time was of the essence." *Id.* at 636 (quoting S. 510, 90th Cong., 1st Sess. (1967)). Furthermore, Justice White recognized that "[d]elay has been characterized as 'the most potent weapon in a tender-offer fight.'" *Id.* at 637 n.12 (quoting Langevoort, *State Tender-Offer Legislation: Interests, Effects, and Political Competency*, 62 CORNELL L. REV. 213, 238 (1977)).

58. Again, Justice White relied on an interpretation that the Williams Act was enacted with the recognition that delay in a tender-offer was undesirable. "Congress anticipated that investors and the takeover offeror would be free to go forward without unreasonable delay." *Id.* at 639.

59. *Id.* at 637.

used as a measuring stick by other courts to determine whether a particular statute is preempted.[60]

2. Second Generation Statutes and *CTS*

After *MITE*, numerous first-generation statutes similar to the Illinois statute were struck down by lower courts.[61] The *MITE* opinion did not set out a broad rule, however, and the states took advantage of this opportunity by enacting what is now called the "second-generation" state antitakeover statutes.[62] These statutes were designed to continue state interference with takeovers while simultaneously withstanding constitutional challenge.[63] Instead of regulating aspects of takeovers that were already provided for in federal law, the new breed of statute focused on regulating areas that were within the purview of traditional state corporate law.[64]

Five years after *MITE*, in *CTS Corp. v. Dynamics Corp. of America*,[65] the Supreme Court again addressed the constitutionality of a state antitakeover statute. In *CTS*, the Court upheld Indiana's second-generation control-share acquisition statute,[66] apparently signaling a broad endorsement of a state's right to regulate takeovers. The

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60. *See* CTS Corp. v. Dynamics Corp. of Am., 481 U.S. 69 (1987) (evaluating whether a state takeover statute would be preempted by determining whether the statute had provisions similar to the Illinois Act); Amanda Acquisition Corp. v. Universal Foods Corp., 877 F.2d 496 (7th Cir. 1989) (stating that a state antitakeover act can affect the benefits an acquiror receives but cannot hinder the tender offer process); Hyde Park Partners, L.P. v. Connolly, 839 F.2d 837 (1st Cir. 1988) (deciding whether the Massachusetts antitakeover statute was preempted by using the *MITE* interpretation of the William Act).

61. *See* Block, Barton & Roth, *State Takeover Statutes: The "Second Generation,"* 13 SEC. REG. L.J. 332, 337 (1987) (providing a comprehensive list of cases invalidating and validating first-generation statutes).

62. *See id.* at 332-33 (stating that "the Court failed to provide a clear standard against which other state laws could be measured"). Without clear guidelines for the constitutional limits of takeover statutes, states enacted at least six different types of statutes. *See* Garfield, *supra* note 33, at 548. *See also* Block, Barton & Roth, *supra* note 61 (discussing second-generation statutes).

63. *See* Kozyris, *Corporate Wars and Choice of Law*, 1985 DUKE L.J. 1, 76.

64. *See* Garfield, *supra* note 33, at 548 (noting that the new statutes resembled state corporate law statutes); Comment, *supra* note 30, at 1038 (stating that the new takeover statutes attempted to "couch" the statute in terms of state corporate law). Instead of directly regulating the tender offer process, which is done in the Williams Act, these statutes affected the target corporation, the offeror, or the nature of the securities, which are traditionally regulated by state corporate law. *See* March, *supra* note 45, at 933.

65. 481 U.S. 69 (1987).

66. IND. CODE ANN. § 23-1-42-1 to -11 (West 1989).

Indiana statute essentially provided that once an "acquiring person"[67] acquired an amount of voting rights in an Indiana corporation[68] that placed that person's total voting power above certain levels that could be voted in an election of directors, those "control shares"[69] would only entitle the holder to cast a vote if a resolution approved by shareholders extended that right.[70] Upon the acquiror's filing of an "acquiring person's statement," the shareholders would vote on this resolution within fifty days of the filing.[71]

Dynamics Corporation of America, which was involved in an attempt to acquire CTS Corporation, an Indiana corporation, challenged the statute on supremacy and commerce clause grounds. In a statement that set the tone for the opinion, the Court noted that it was not bound by Justice White's reasoning in *MITE* as it pertained to preemption because that portion of his opinion was not endorsed by a majority of the Court.[72] Nevertheless, the majority found that, even under Justice White's interpretation of the Williams Act in *MITE*, the Indiana statute still passed constitutional muster.[73]

Dynamics principally alleged that, by injecting a fifty day delay into the tender offer process, the statute favored management, thus violating the Williams Act. The Court rejected this argument, however, holding that the statute was consistent with the purposes of the Williams Act because it allowed shareholders to vote as a group. By giving the shareholders this veto power, the shareholders were

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67. An "acquiring person" is a person who proposes to make or has made a "control-share acquisition." *Id.* § 23-1-42-9. A "control-share acquisition" is the acquisition of voting rights in a corporation that places the acquiror's total voting power over 20%, 33%, or 50% of the total outstanding voting rights. *See id.* §§ 23-1-42-1, -42-2.

68. The act applies only to corporations in Indiana that have: (1) 100 or more shareholders; (2) their principal place of business, their principal office, or substantial assets in Indiana; and (3) either (a) more than 10% of their shareholders residing in Indiana, (b) more than 10% of their shares owned by Indiana residents, or (c) 10,000 shareholders residing in Indiana. *Id.* § 23-1-42-4.

69. "Control shares" are those shares which place the acquiror over the levels of voting power that make the acquisition a control-share acquisition. IND. CODE ANN. § 23-1-42-1 (West 1989).

70. *Id.* § 23-1-42-9.

71. *Id.* §§ 23-1-42-6 to -7.

72. *CTS*, 481 U.S. at 81. The language of the Court does not indicate whether it adopted or rejected the *MITE* findings. This leaves open the question of whether the *MITE* rationale is still useful or whether *CTS* should provide the standards by which future statutes are judged.

73. *Id.*

granted protection from the coercive effects of tender offers.[74] Furthermore, it found that not every delay of the tender offer process would conflict with the Williams Act.[75] In reaching this conclusion, the Court deferred to state law by recognizing that "[t]he longstanding prevalence of state regulation in this area suggests that, if Congress had intended to pre-empt all state laws that delay the acquisition of voting control following a tender offer, it would have said so explicitly."[76] This conclusion is apparently in conflict with Justice White's opinion that merely disadvantaging the offeror was impermissible.[77] The Court concluded that the regulation imposed by the state was consistent with the purposes of the Williams Act, and, therefore, the Indiana statute did not violate the supremacy clause.[78]

The Court also rejected Dynamics' commerce clause arguments. It first found that the statute applied to both in-state and out-of-state offerors equally and, therefore, did not discriminate against interstate commerce.[79] Then, without mentioning the *Pike* balancing test relied on in *MITE*, which was the only part of the plurality to gain a majority vote, the Court apparently performed a balancing test by weighing the burdens on commerce imposed by the statute against the state's interests in regulating takeovers and corporations.[80] While acknowledging that regulation such as the Indiana statute may affect interstate commerce, the Court nonetheless found that Indiana's right to regulate its corporations outweighed any burden on interstate commerce, as long as the state legislation was nondiscriminatory.[81]

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74. *Id.* at 82-83. The use of the word "coercive" indicates the Court's negative sentiment towards the utility of hostile takeovers. This sentiment may be a contributing factor to the final decision that the statute, which would impede takeovers, is constitutional.

75. *Id.* at 85.

76. *Id.* at 86. The Court noted that "a variety of state corporate laws of hitherto unquestioned validity . . . may limit or delay the free exercise of power after a successful tender offer." *Id.* at 85. For example, state laws frequently permit corporations to stagger the terms of directors. This could delay the offeror's election of personal directors until the staggered elections arise. *See id.*

77. *Supra* note 58 and accompanying text.

78. *Id.* at 86-87.

79. *Id.* at 87-88.

80. *See id.* at 89. Although no reference was made to *Pike* or the balancing test, the Court focused on the fact that states traditionally have had the power to regulate their corporations. This implies that the Court found the state's interest to be paramount, thereby satisfying the second part of the balancing test.

81. More specifically, the Court stated:

It thus is an accepted part of the business landscape in this country for

Accordingly, the Court held that the statute did not violate the commerce clause and, therefore, was constitutional.

After *CTS*, many questions remain. Is *MITE* still reliable law? Is there any validity to its findings, or did *CTS* limit *MITE* to its facts? Does *CTS* mean that state legislation is constitutional as long as it does not contain provisions that the drafters of the Williams Act either expressly included or excluded? Do states have a free hand to regulate takeovers because corporations are created by state law? These are questions that lower courts are presently resolving in challenges to current antitakeover statutes,[82] and they may not be

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> States to create corporations, to prescribe their powers, and to define the rights that are acquired by purchasing their shares. A state has an interest in promoting stable relationships among parties involved in the corporations it charters, as well as in ensuring that investors in such corporations have an effective voice in corporate affairs.

Id. at 91.

The Court went on to state that, because "[t]he very commodity that is traded [in interstate commerce] in the securities market is one whose characteristics are defined by state law," the commerce clause is not implicated because every state "need not define these commodities as other States do." *Id.* at 94.

82. *See supra* note 12. The cited cases were all decided after *CTS*. One of the questions facing each court is how far *CTS* is intended to be taken in terms of its broad endorsement of the state's right to freely regulate its domestic corporations. In Amanda Acquisition Corp. v. Universal Foods Corp., 877 F.2d 496 (7th Cir. 1989), *CTS* was carried to its extreme. Ironically, the author of the opinion, Judge Easterbrook, is none other than Professor Easterbrook, one of the most noted opponents of antitakeover laws. After spending two full pages of the opinion on the positive aspects of hostile takeovers, Judge Easterbrook sums up the opinion in one paragraph:

> Skepticism about the wisdom of a state's law does not lead to the conclusion that the law is beyond the state's power . . . . We have not been elected custodians of investors' wealth. States need not treat investors' welfare as their summum bonum. Perhaps they choose to protect managers' welfare instead, or believe that the current economic literature reaches an incorrect conclusion and that despite appearances takeovers injure investors in the long run. *Unless a federal statute or the Constitution bars the way, Wisconsin's choice must be respected.*

Id. at 502 (emphasis added).

Then, in determining whether the state statute stood in the way of the Williams Act, Judge Easterbrook appeared to reject Justice White's conclusions in *MITE*. While recognizing that many courts have found that the drafters of the Williams Act wanted management to be on an equal footing with investors, he found that such a conclusion did not forbid states to favor one side over the other. *Id.* at 503. Judge Easterbrook found the statute valid by endorsing the state's right to regulate the internal affairs of its corporations. Where the Illinois statute in *MITE* interrupted the tender offer process during the time the Williams Act regulated the offer, the act under review by Judge Easterbrook allowed the Williams Act to function before its provisions had to be satisfied. This, Judge Easterbrook found, was a permissible

finally resolved until the Supreme Court hands down more definite guidelines or Congress enacts further legislation.

Nevertheless, the debate over the utility of takeovers and state antitakeover regulation rages on. Another question in this debate is whether current statutes effectively realize their purported objectives. As Justice Scalia noted in his *CTS* concurrence, "a law can be both economic folly and constitutional."[83] Are these statutes folly? This question is probably less settled than constitutional questions,[84] and may be just as important.

3. The Value of Hostile Takeovers and Antitakeover Laws

The pros and cons of takeovers have been thoroughly examined by economic and legal scholars. The proponents of an unimpeded hostile takeover market argue that takeovers promote efficient management. The threat of a hostile takeover is seen as an incentive for management to constantly strive for the best results lest they be ousted by a raider who proposes to run the company more efficiently.[85] Studies show that share prices of target companies decline for months before the offer and then rise at the time of the offer.[86] This demonstrates that inefficient companies are usually the targets.[87] The tender offer, whether completed or not, restores the price to normal.[88] Also cited as an advantage is the so-called "takeover premium" paid to the stockholders of target companies.[89] Proponents of takeovers cite empirical data which indicates that takeover premiums average fifty percent over the market rate in the 1980s.[90]

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exercise of the state's rights because it did not interfere with the procedures of the Williams Act. *Id.* at 504.

83. *CTS*, 481 U.S. at 96-97 (Scalia, J., concurring).

84. *See* Langevoort, *The Supreme Court and the Politics of Corporate Takeovers: A Comment on* CTS Corp. v. Dynamics Corp. of America, 101 HARV. L. REV. 96 (1987) (noting that both sides of the argument on the utility of takeovers have merit and support).

85. *See* Easterbrook & Fischel, *supra* note 8, at 1736-37 (stating that the tender offeror serves as a monitor of the corporate manager).

86. *Id.* at 1739.

87. *Id.*

88. *Id.* at 1739-40.

89. A takeover premium is the price above market rate that is paid to stockholders as a result of a takeover of the corporation. *See* Stout, *Are Takeover Premiums Really Premiums? Market Price, Fair Value, and Corporate Law*, 99 YALE L.J. 1235, 1235 n.1 (1990).

90. *See* Black, *Bidder Overpayment in Takeovers*, 41 STAN. L. REV. 597, 601 (1989).

They also argue that takeovers create synergies in which the resources of two companies are combined to produce an overall more efficient single unit.[91]

Opponents of hostile takeovers, however, are just as prepared as their counterparts. These commentators assert that corporate raiders do not prey on inefficient companies, as their counterparts would assert, but instead set their sights on the prospering companies.[92] Opponents aver that financing a hostile takeover requires the corporate raider to borrow heavily. Once control is attained, the acquiring corporation uses the acquired company's equity and good credit as collateral to refinance the debt.[93] In order to pay the new debt-service, research and development is cut, and the jobs of otherwise productive employees are eliminated.[94] This, opponents say, leads to short-term gains but, in the end, leads to the demise of the corporation and its community. In addition to sacrificing workers, communities, and corporations in the pursuit of shareholder wealth, these commentators also allege that hostile takeovers are coercive in nature, forcing shareholders to tender their shares to the offeror for fear of being "squeezed out" after control is obtained.[95]

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91. *See Amanda Acquisition Corp.*, 877 F.2d at 500 (Easterbrook, J., opinion) (synergies are one way in which managers can realize gains for shareholders through business combinations).

92. *See* Proxmire, *supra* note 8. *See also* Lipton, *Takeover Bids in the Target's Boardroom*, 35 BUS. LAW. 101 (1979) (describing the harmful effects of hostile takeovers).

This reasoning is in direct conflict with the proponents who claim that only inefficient corporations are targets of a raider. There has been empirical data amassed recently which does, however, support the view that efficient companies are classic targets. A study done by Professor Louis Lowenstein, in which several thousand mergers and acquisitions were analyzed, found that the average return on target firms prior to such acquisitions was 16% compared to an 11% return on all firms during the same period. *Impact of Corporate Takeovers: Hearings Before the Subcomm. on Securities of the Senate Comm. on Banking, Housing and Urban Affairs*, 99th Cong., 1st Sess. 108 (1985) (statement of Louis Lowenstein, professor of law, Columbia Law School).

93. Professor Proxmire states that the scenario is the same even when the takeover bid is not consummated. The incumbent management issues new debt to raise capital in order to fight the offeror. This places the corporation in the same position, highly leveraged and looking for ways to pay the debt. Proxmire, *supra* note 8, at 358-59.

94. The AFL-CIO argues that takeovers have caused the loss of 80,000 union jobs and 500,000 non-union jobs. *Hostile Takeovers: Hearings Before the Senate Comm. on Banking, Housing and Urban Affairs*, 100th Cong., 1st Sess. 262 (1987) (statement of Thomas P. Donahue, secretary-treasurer, AFL-CIO).

95. *See* Langevoort, *supra* note 84, at 96 (criticizing takeovers for coercing

With scholars disagreeing so sharply, and with empirical evidence supporting both sides, probably the safest statement to make is that, while some takeovers promote efficient management, shareholder wealth, and efficient allocation of resources, some are coercive, destroy jobs and companies, create excessive debt, and reduce productivity. Thus, the best legislation would promote the good and deter the bad. Whether legislators are motivated by these concerns is debatable.[96] Nevertheless, the Pennsylvania legislature enacted Act 36 in 1990, an action that has been confronted with some serious questions.

4. What Prompted Act 36?

Like many other antitakeover acts, the enactment of Act 36 was at least partially connected to a threatened takeover of a large Pennsylvania corporation.[97] First City Diversified, a company of the Canadian Belzberg family, was engaged in a long and hotly contested attempt to take over Pennsylvania's Armstrong World Industries, Inc.[98] Armstrong lobbied the Pennsylvania legislature to enact legislation that would help defeat the attempt.[99] Armstrong argued that the proposed takeover would result in lost jobs and plant closings.[100] Despite intense lobbying against the legislation before the state Congress, Act 36 passed by a vote of 227-14.[101] The passage of the Act resulted in over fifty Pennsylvania public companies opting to remain exempt from certain provisions of Act 36.[102]

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shareholders). This situation is common in the "two-tiered tender offer" where the acquiror announces an offer to pay a high price to those who tender their shares in the front end of the offer, while simultaneously threatening to pay a below market price to those who do not tender in the front end of the offer. This situation is thought to coerce shareholders to sell in fear of losing out in the back-end of the transaction.

96. Some may suggest that legislators are truly representing the concerns of their constituents. Others allege that the motives are purely protectionist. *See* Garfield, *supra* note 33, at 539. Whatever the motives are, the answer is probably as elusive as determining the utility of takeovers.

97. *See id.* at 560 (citing the protectionist motives behind the enactment of many state antitakeover acts).

98. Klein & Greenbaum, *supra* note 14, and accompanying text.

99. *Id.*

100. *Id.*

101. Wayne, *supra* note 1, § D, at 7, col. 1. The debate included many letters from prominent business, law, and economics scholars in opposition to the bill; criticism from SEC Chairman Richard Breeden; and threats from large institutional investors to withdraw investments in Pennsylvania companies. *Id.*

102. Klein & Greenbaum, *supra* note 14, at 15.

III. THE PROVISIONS OF ACT 36[103]

Both the control-share acquisition and the disgorgement sections of Act 36 are extremely complicated, and, therefore, a piece-by-piece examination is needed to fully understand their meaning and implication.

A. *The Control-Share Acquisitions Act*

The Pennsylvania control-share acquisitions subchapter (Subchapter G)[104] of Act 36 is very similar, but not identical, to the Indiana Control-Share Act validated in *CTS*.

Subchapter G applies to every Pennsylvania corporation registered under the Securities and Exchange Act of 1934 having a class of equity securities entitled to vote in an election of its board of directors.[105] As opposed to Indiana, however, there are no further requirements linking the corporation or its shareholders to the state.[106] Affected corporations may, however, "opt out" of protection by the statute. In order to opt out, the corporation must have amended its bylaws on or before July 26, 1990, to expressly exempt themselves.[107] For new corporations, the original articles of incorporation must indicate the corporation's desire to be exempt.[108] Subchapter G also provides a laundry list of transactions that are not affected by its provisions.[109] The most significant of these exempt transactions are

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103. Act 36 is a compilation of amendments and additions to existing chapters of Pennsylvania's corporate law. Only the Control-Share Acquisitions Act and the disgorgement provisions are discussed in this note because they most directly affect the decisions of a person attempting to acquire control of a corporation.

104. 15 PA. CONS. STAT. ANN. §§ 2561-2567 (Purdon 1990) [hereinafter Subchapter G].

105. *Id.* §§ 2561(a), (b)(1). *See* 15 PA. CONS. STAT. ANN. § 2502 (Purdon 1990) (amended 1990) (describing what constitutes registered corporations).

106. *See supra* note 68 and accompanying text.

107. 15 PA. CONS. STAT. ANN. § 2561(b)(2)(i) (Purdon 1990).

108. *Id.* § 2561(b)(2)(iii).

109. The transactions excepted from the effects of Subchapter G include those that are:

(3) Consummated before October 17, 1989.

(4) Consummated pursuant to contractual rights or obligations existing before:

(i) October 17, 1989, in the case of a corporation which was a registered corporation described in section 2502(1)(i) on that date; or

(ii) in any other case, the date this subchapter becomes applicable to the corporation.

(5) Consummated:

those consummated by the corporation or its subsidiaries.[110] The statute does not specify, however, whether transactions effected by directors acting independently of the corporation may be considered to be transactions effected by the corporation.[111]

As to corporations and transactions that are not exempted by the statute, a general rule is set forth. The statute provides that when an "acquiring person"[112] acquires a quantity of voting rights

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(i) Pursuant to a gift, devise, bequest, or otherwise through the laws of inheritance or descent.
(ii) By a settlor to a trustee under the terms of a family, testamentary or charitable trust.
(iii) By a trustee to a trust beneficiary or a trustee to a successor trustee under the terms of, or the addition, withdrawal or demise of a beneficiary or beneficiaries of, a family, testamentary or charitable trust.
(iv) Pursuant to the appointment of a guardian or custodian.
(v) Pursuant to a transfer from one spouse to another by reason of separation or divorce or pursuant to community property laws or other similar laws of any jurisdiction.
(vi) Pursuant to the satisfaction of a pledge or other security interest created in good faith and not for the purpose of circumventing this subchapter.
(vii) Pursuant to a merger, consolidation or plan of share exchange effected in compliance with the provisions of this chapter if the corporation is a party to the agreement of merger, consolidation or plan of share exchange.
(viii) Pursuant to a transfer from a person who beneficially owns voting shares of the corporation that would entitle the holder thereof to cast at least 20% of the votes that all shareholders would be entitled to cast in an election of directors of the corporation and who acquired beneficial ownership of such shares prior to October 17, 1989.
(ix) By the corporation or any of its subsidiaries.
(x) By any savings, stock ownership, stock option or other benefit plan of the corporation or any of its subsidiaries, or by any fiduciary with respect to any such plan when acting in such capacity.

Id. § 2561(b)(3)-(5).

110. *Id.* § 2561(b)(5)(ix).

111. This is relevant to whether the statute impermissibly favors management in violation of the Williams Act's mandate of neutrality between the offeror and management. *See infra* notes 191-92 and accompanying text.

112. An "acquiring person" is defined as:

A person who makes or proposes to make a control-share acquisition. Two or more persons acting in concert, whether or not pursuant to an express agreement, arrangement, relationship or understanding, including as a partnership, limited partnership, syndicate, or through any means of affiliation whether or not formally organized, for the purpose of acquiring, holding, voting or disposing of shares of a registered corporation, shall also constitute a person for the purposes of this subchapter. A person, together with its affiliates and associates, shall constitute a person for the

in a protected corporation that would, when added to all the voting power already held by the acquiring person, allow that person to vote in an election of directors (1) at least twenty percent but less than thirty-three percent, (2) at least thirty-three percent but less than fifty percent, or (3) more than fifty percent of the outstanding voting shares of the corporation,[113] the voting rights that are acquired placing the person above one of these thresholds will not empower that person to cast a vote at an election of directors unless a resolution approved by the shareholders gives the control shares[114] the same power to vote as any other voting shares.[115] It is important to note that this provision is triggered not only by the acquisition of shares of stock but also by the mere acquisition of voting rights, as in a proxy situation.

As stated above, the voting rights of control shares will be reinstated only by resolution of the shareholders. Such resolution must be approved by a vote of the shareholders at an annual or special meeting.[116] The acquiring person may demand a special meeting of the shareholders to consider restoration of control-share voting rights if that person (1) files a "fully conforming" information statement pursuant to the act,[117] (2) makes a written request for a special meeting at the time of the filing of said statement,[118] (3) acquires or makes a bona fide offer to acquire the voting rights necessary to

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purposes of this subchapter.

15 PA. CONS. STAT. ANN. § 2562 (Purdon 1990).

113. This process of exceeding these voting-rights ownership thresholds is defined as a "control-share acquisition." *Id.*

114. The voting shares which exceed these threshold levels of ownership are defined as "control shares." In addition,

> [v]oting shares beneficially owned by an acquiring person shall also be deemed to be control shares where such beneficial ownership was acquired by the acquiring person:
>
> (1) within 180 days of the day the person makes a control-share acquisition; or
>
> (2) with the intention of making a control-share acquisition.

Id. Shares "beneficially owned" are those that a person owns indirectly or those over which the person has the right to vote or acquire. *See* 15 PA. CONS. STAT. ANN. § 2552 (Purdon 1990).

115. *Id.* § 2564.

116. *See id.* § 2565 (describing the procedure for establishing voting rights of control shares).

117. *Id.* § 2565(a)(1). The provisions detailing what constitutes a fully conforming information statement are contained in § 2565. Nothing in either section, however, designates a person or party to determine whether the statement is conforming or what constitutes "fully."

118. *Id.* § 2565(a)(2).

complete a control-share acquisition,[119] and (4) promises to pay the corporation for the expense of calling a special meeting.[120] After such request, the corporation must hold the special meeting within fifty days after the receipt of the information statement.[121] If the acquiring person does not make a written request for a special meeting or does not undertake to pay the expenses of such a meeting, but does make or offer to make a control-share acquisition and files an information statement, the issue of reinstating voting rights will be submitted to the shareholders at the next annual meeting.[122] Furthermore, if the acquiring person does not submit the information statement and evidence indicating that the person has entered into financing agreements in order to finance such a transaction, the corporation is not required to submit the restoration issue to the shareholders at any time.[123]

The information statement, which appears to be extremely critical to obtaining voting rights, requires that the acquiring person disclose, *inter alia*, (1) the identity of the acquiring person or group,[124] (2) the number of shares or voting rights acquired or proposed to be acquired in the control-share acquisition,[125] (3) the terms of the acquisition,[126] (4) the plans or proposals of how the acquiring person will direct the future of the corporation,[127] and (5) any other material

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119. *Id.* § 2565(a)(3). Again, there is no further clarification as to who determines what is a bona fide written offer. It is conceivable that, if this decision is left to the directors, this process could go on indefinitely if management intends to stall the transaction.

120. *Id.* § 2565(a)(4).

121. *Id.* § 2565(a). In addition, the acquiring person may request at the time the information statement is submitted that the special meeting not be held within 30 days after submission of the statement.

122. *Id.* § 2565(b).

123. *Id.* § 2565(d).

124. *Id.* § 2566(a)(1).

125. *Id.* § 2566(a)(4). The acquiror must specify the amount of shares that it believes in good faith will be available to be cast in an election of the directors as a result of the control-share acquisition.

126. A statement of the terms must include the source of money for the transaction. It must also disclose the material terms of such financing and the acquiror's plans for meeting its debt-service. *Id.* § 2566(a)(5)(i). Also, the terms must reveal the identity of any pension fund or corporation which is providing the funds and the amount of money which has or will be used. *Id.* § 2566(a)(5)(ii).

127. *Id.* § 2566(a)(6). This provision would seem to be of great importance to whether a shareholder will accord the control shares the power to vote. This section requires disclosure of plans to:

(i) Enter into a business combination or combinations involving the

facts that would affect a shareholder's decision whether to approve or deny the restoration of voting rights.[128] In addition to submitting this information statement, the target corporation must submit to its shareholders a statement disclosing whether the board of directors recommends or disapproves the transaction or has any other opinion as to how the shareholders should vote on the restoration of voting rights.[129] The combination of these two provisions demonstrates the Pennsylvania legislature's clear intent to make shareholders fully aware of any negative effects, including those on the community, the corporation, the corporation's employees, or the corporation's suppliers, that could possibly result from the proposed control-share acquisition.[130]

If and when the special or annual meeting is held, the resolution to accord the control shares voting power must be approved by a

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corporation.

(ii) Liquidate or dissolve the corporation.

(iii) Permanently or temporarily shut down any plant, facility or establishment . . . of the corporation, or sell any such plant, facility or establishment . . . to any other person.

(iv) Otherwise sell all or a material part of the assets of, or merge, consolidate, divide or exchange the shares of the corporation to or with any other person.

(v) Transfer a material portion of the work, operations or business activities of any plant, facility or establishment of the corporation to a different location . . . .

(vi) Change materially the management or policies of employment of the corporation or the policies of the corporation with respect to labor relations matters . . . .

(vii) Change materially the charitable or community involvement or contributions or policies, programs or practices relating thereto of the corporation.

(viii) Change materially the relationship with suppliers or customers of, or the communities in which there are operations of, the corporation.

(ix) Make any other material change in the business, corporate structure, management or personnel of the corporation.

15 PA. CONS. STAT. ANN. § 2566(a)(6)(i)-(ix) (Purdon 1990). Presumably, a misrepresentation of these facts would be a per se violation of the requirement of full disclosure of material facts. *See* TSC Indus. v. Northway, Inc., 426 U.S. 438 (1976) (defining the materiality standard for disclosures).

128. *Id.* § 2566(a)(8).

129. In making its recommendation, the directors are required to specifically consider "the effects of according voting rights to control shares upon the interests of employees and of communities in which offices or other establishments of the corporation are located." *Id.* § 2565(c)(3). This emphasizes the legislature's belief that hostile takeovers can have serious adverse effects on communities as well as corporations.

130. *See id.* §§ 2565(c)(3), 2566(a)(6) (mandating consideration and disclosure of factors that may cause harm to various noncorporate entities).

majority vote of the following two separate groups: (1) all of the "disinterested shares,"[131] and (2) all of the voting shares of the corporation.[132] Thus, if either category does not approve the resolution, the control shares' voting rights will be denied.

This is not, however, the end of the game. The Act gives the corporation a number of cards to play after the approval or rejection of the voting rights. If the control shares' voting rights have been approved, but the proposed control-share acquisition is not consummated within ninety days, the voting rights will lapse and, therefore, be lost.[133] On the other hand, if the voting rights are not accorded by the shareholders, the control shares can regain their voting power if the acquiror transfers them to a person with whom he has no affiliation.[134] Finally, there are special situations in which the corporation may redeem the control shares from the acquiring person.[135] All of these provisions appear to allow the target corporation to "get back to normal" or rid themselves of the influence of the acquiring person after a control-share acquisition has either failed or been stalled.

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131. *Id.* § 2564(a)(1). "Disinterested shares" are shares continuously held by persons, not including the acquiror or any affiliates of the acquiror, for specified periods of time prior to the control-share acquisition. Making these shares a separate category creates a "pure breed" of voters. This pure breed is intended to be a class of shareholders that is undiluted by the influence of shares held by the acquiror prior to the control-share acquisition. Presumably, this is to allow those with somewhat long-term interests in the corporation to veto the transaction if they feel it is repugnant to their goals.

Disinterested shares are those that have been owned continuously during a period ending on the record date (the date of the meeting at which accordance of voting rights is considered), *id.* § 2564(c), and beginning on the last of the following to occur: (1) one year prior to the record date; (2) five days prior to the date on which it is first publicly disclosed that someone has acquired, or intends to acquire, shares with the intent to make a control-share acquisition; or (3) October 17, 1989, for corporations that were registered as of that date, or the date that Act 36 became applicable to the corporation. *Id.* § 2562.

132. *Id.* § 2564(a)(2).

133. *Id.* § 2564(b).

134. *Id.* § 2564(c). As will be seen, this provision may trigger the disgorgement provision. *See infra* note 146 and accompanying text.

135. Unless the target corporation's articles of incorporation prohibit redemption, the corporation has the right to redeem all of the control shares from the acquiring person at an average of the high and low trading prices of similar securities at the following times: (1) within two years after consummation of a control-share acquisition, if the acquiring person has not requested the special or annual meeting to consider voting rights within 30 days after consummation of the transaction; and (2) any time within two years after the shareholders have considered according voting rights to control shares, if voting rights were not accorded or if voting rights were accorded but lapsed. *Id.* § 2567(1), (2).

The control-share acquisition act also contains an "acquiring person safe-harbor" provision.[136] This provision exempts certain persons from being labeled as acquiring persons for merely voting or giving proxies, absent other circumstances which indicate that the person in question is, in fact, an acquiror.[137] First, a person who acquires voting shares without the intention of either influencing the stockholders' vote or acquiring control of the corporation will not be considered an acquiring person.[138] Second, a person will not be deemed an acquiring person if that person would not be in control of the corporation and would not receive disproportionate consideration from a person in control should a control-share acquisition be successfully completed.[139] Third, if a revocable proxy is executed without consideration, the person tendering the proxy will not be classified as an acquiring person.[140]

The safe-harbor provision also states that the following holders of voting power within the ranges specified as a control-share acquisition will not be deemed acquiring persons: (1) holders in good faith as agents, banks, brokers, nominees, or trustees for beneficial owners who do not individually or as a group acting in concert have the requisite voting power to constitute a control-share acquisition;[141] (2) the corporation which obtained the specified voting power as a result of solicitation of proxies;[142] and (3) holders as the result of a solicitation of revocable proxies which grant no discretionary power.[143] It is only through these safe-harbor provisions that a person may escape the provisions of the control-share act once a control-share acquisition has been commenced.

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136. *Id.* § 2563.

137. *Id.* § 2563(a).

138. *Id.* § 2563(a)(1).

139. *Id.* § 2563(a)(2). This provision is designed to prohibit acquirors from offering disproportionate prices to those who own large blocks of stock. If a large shareholder was to tender large blocks of stock, however, this transaction would probably justify the classification of the stockholder as an acquiring person. *See id.* § 2562 (defining an "acquiring person" as two or more acting in concert, whether or not pursuant to an express agreement, for the purpose of disposing, holding, voting, or acquiring stock).

140. *Id.* § 2563(a)(3).

141. *Id.* § 2563(b)(1). This provision appears to provide a safe harbor for large institutional investors. However, there is no provision or test for who determines good faith or what exactly constitutes good faith in this context.

142. *Id.* § 2563(b)(2). It is not clear to what extent the managers or directors may act independently and still be acting on behalf of the corporation.

143. *Id.* § 2563(b)(3)(ii). Nondiscretionary proxies only grant the right to vote on matters specifically described in the proxy.

Finally, the last subsection states that any board determination made in reference to this subchapter will be presumed appropriate unless rebutted by clear and convincing evidence.[144]

B. *Disgorgement of Profits Subchapter*

The provision of Act 36 which disgorges the profits of certain controlling shareholders following attempts to acquire control[145] is a new animal in the forest of antitakeover statutes. The Pennsylvania legislature has apparently borrowed a provision from section 16 of the Securities and Exchange Act, which punishes those who engage in insider trading by allowing the issuing company to recover any profits that the insider has realized as a result of his unlawful conduct.[146]

Subchapter H begins with a general policy statement: "The purpose of this subchapter is to protect certain registered corporations and legitimate interests of various groups related to such corporations from certain manipulative and coercive transactions."[147] More specifically, Subchapter H is designed to (1) prevent payment of greenmail,[148] (2) ensure that persons who put corporations "in play" do not take actions which benefit themselves at the expense of the corporation or its community,[149] and (3) discourage speculators from putting Pennsylvania corporations "in play."[150] The legislature justifies its enactment of Subchapter H by stating that it recognizes its right to protect the corporations its laws create.[151] This is a direct reference to *CTS*'s endorsement of the internal affairs doctrine.[152] Apparently, the legislature is reading *CTS* to broadly endorse the state's right to regulate its corporations, and reasonably so. Its express purpose is not, however, to curtail either proxy solicitations by the

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144. *Id.* § 2568.

145. 15 PA. CONS. STAT. ANN. §§ 2571-2574 (Purdon 1990) [hereinafter Subchapter H].

146. *See* 15 U.S.C. § 78p(b) (1988) (providing that persons with certain knowledge, or insiders, who benefit from insider trading, must disgorge the profits which result from the use of this information).

147. 15 PA. CONS. STAT. ANN. § 2572(a) (Purdon 1990).

148. *Id.* § 2572(a)(1).

149. *Id.* § 2572(a)(3). Also, Subchapter H is designed to promote stable relationships among all parties associated with the corporation, presumably including suppliers and communities. *Id.* § 2572(a)(2).

150. *Id.* § 2572(a)(4).

151. *Id.* § 2572(a).

152. *See supra* note 81 and accompanying text.

corporation[153] or proxy contests concerning matters other than those related to putting corporations in play.[154] These policy statements are instead intended to express the legislature's desire to suppress only the hostile takeover, not to completely eliminate the proxy as a tool for shareholder participation in corporate affairs. This creates a problem, however, in that the statute not only deters the "corporate raider," but it also deters "every-day" stockholders who may have legitimate concerns about the effectiveness of a corporation's management.

The general rule of the disgorgement provision states that any profit[155] realized by a person who is or was a "controlling person"[156] from the sale of any equity security[157] of the target corporation within eighteen months after the person becomes a controlling person will belong to the corporation.[158] A controlling person is defined very broadly to include a person or group who has acquired, offered to acquire, or publicly disclosed the intent to acquire over twenty percent of the total voting rights entitled to be cast in an election of directors.[159] Equity securities acquired within two years prior to or eighteen months after the acquiror becomes a controlling person are subject to this disgorgement provision.[160] Again, it must be pointed out that a controlling person need not buy or acquire shares of stock to trigger the disgorgement provision. All that is required is an

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153. 15 PA. CONS. STAT. ANN. § 2572(b)(2) (Purdon 1990). Once again, the corporation is exempted by the statute, and, once again, we must ask the question whether a director who is in fact acting independently is deemed to be acting as the corporation. In all of these corporation-exempting provisions, this question becomes relevant when evaluating whether the statute favors management in violation of the Williams Act's mandate of neutrality. *See infra* notes 192-93 and accompanying text.

154. 15 PA. CONS. STAT. ANN. § 2572(b)(1) (Purdon 1990). Specifically, the legislature is not attempting to curtail proxy contests regarding cumulative voting provisions, environmental issues, or business transactions in foreign countries. *Id.*

155. "Profit" is defined by the statute as the positive value of the difference between consideration received by the sale of the security and the consideration paid for acquiring the security. *Id.* § 2573 (defining "profit").

156. *Id.* § 2573 (defining "controlling person or group").

157. "Equity security," as used in the statute, refers to all shares, stock, or similar security. *Id.* (defining "equity security").

158. *Id.* § 2575(1).

159. *Id.* § 2573(1)(i). A controlling person may also be a person or group who has publicly disclosed that it seeks to acquire control of the corporation through any means. *Id.* § 2573(1)(ii). Finally, a controlling person may be two or more persons acting in concert, not necessarily pursuant to an agreement, for the purpose of selling, buying, or voting equity securities of the corporation. *Id.* § 2573(2).

160. *Id.* § 2574(2).

acquisition of voting rights. Thus, the solicitation of proxies may trigger Subchapter H.

Reading the statute literally, any shareholder who merely mentions a desire, whether seriously or not, to acquire twenty percent of the voting rights would be subject to disgorgement.[161] Taking into consideration the broad definition of who may be a controlling person, what activities will trigger the statute, and the type of "punishment" it mandates, it is not difficult to see why Act 36 has drawn so much negative reaction.

Subchapter H applies to the same registered corporations to which Subchapter G applies,[162] and affected corporations may opt out of the statute's protection through a procedure identical to Subchapter G's opt-out provision.[163] Also, certain transactions and transfers are exempt from disgorgement. Some of the provisions exempting transfers have been analogized to grandfather clauses[164] in that the transfer would be subject to disgorgement if it had not been commenced before a specified date.[165] The most notable of these grandfather provisions states that disgorgement will not result from a transfer by a person who became a controlling person before October 17, 1989, if that person does not thereafter commence a

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161. *See id.* § 2573 (defining controlling person in extremely broad, ambiguous terms). This broad interpretation is, in part, due to the definition of "publicly disclosed or caused to be disclosed." This term includes, but is not limited to:

> [A]ny disclosure . . . that becomes public made by a person:
>
> (1) with the intent or expectation that such disclosure become public; or
>
> (2) to another where the disclosing person knows, or reasonable should have known, that the receiving person was not under an obligation to refrain from making such disclosure, directly or indirectly, to the public and such receiving person does make such disclosure, directly or indirectly, to the public.

Id. § 2562.

162. *See* 15 PA. CONS. STAT. ANN. § 2571(a)-(b)(1) (Purdon 1990) (providing the application and effect of Subchapter H).

163. *See id.* § 2571(b)(2) (providing the procedure for opting out of coverage by the statute).

164. *See* W. HACKNEY, DISGORGEMENT OF PROFITS IN CERTAIN SECURITIES TRANSACTIONS, PENNSYLVANIA TAKEOVER ACT OF 1990, 1990 PENNSYLVANIA BAR INSTITUTE 154 (referring to certain transaction-exempting provisions as "grandfather provisions").

165. *See* 15 PA. CONS. STAT. ANN. § 2571(b)(3)-(5)(i) (Purdon 1990). Generally, the date before which a transaction, acquisition, or disposition may be consummated and be exempted from the statute is October 17, 1989. However, there are other conditions to exemption. For example, subsection 5(i) requires that the voting rights be beneficially owned. *Id.* § 2572(b)(5)(i).

tender offer or proxy solicitation.[166] Of the rest of the exempt transfers, two other situations are worth noting. First, a transfer of equity securities by the corporation or "[a]ny savings, stock ownership, stock option, or other benefit plan of the corporation" is not subject to disgorgement.[167] As with the other sections of Act 36 exempting the "corporation," it is not stated whether a director or manager acting in his own interest would be acting as the "corporation." Second, prior approved acquisitions or dispositions of equity securities by a controlling person may be exempted from the subchapter.[168] In order to be exempted, a resolution must be approved by the directors and ratified by the shareholders.[169]

The disgorgement provision, like the control-share provision, contains a safe-harbor rule which exempts certain transferors of equity securities from disgorgement, provided that three criteria are satisfied: (1) the person or group acquiring the voting shares must not intend to change or influence control of the corporation;[170] (2) the person or group must not be in control after control of the corporation has been acquired and must not receive any disproportionate consideration;[171] and (3) if a proxy or consent is given, the person or group must execute a revocable proxy or consent for no consideration in response to a proxy or consent solicitation made by the person or group who gave the proxy or consent.[172]

Additionally, there are three categories of holders of twenty percent or more of the corporation's voting power that will not be deemed controlling persons. The first includes agents, banks, brokers, nominees, and trustees who hold in good faith for beneficial owners who either individually or as a group acting in concert are not a controlling person or group.[173] This appears to be directed to large institutional holders that are highly influential in today's market.[174] Second, the disgorgement provision will not apply if a person or group holds at least twenty percent of the voting power as a result

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166. *Id.* § 2571(4)(i).
167. *Id.* § 2571(6).
168. *Id.* § 2572(7)(ii).
169. *Id.* § 2572(7). The shareholder ratification requires an affirmative vote in which a majority of the shareholders are represented. *Id.*
170. *Id.* § 2574(a)(1).
171. *Id.* § 2574(a)(2).
172. *Id.* § 2574(a)(3).
173. *Id.* § 2574(b)(1).
174. *See* Wayne, *supra* note 1, § D, at 7, col. 3-4.

of proxies solicited by the corporation.[175] This is yet another corporation exemption, and, yet again, the extent to which directors and managers acting independently are implicated is unknown. Finally, if a person holds the requisite amount of voting power as a result of a proxy, which is given without consideration and which prohibits the holder from voting on any matter not specified in the proxy, the holder is not a controlling person.[176] Because of the limited circumstances in which a person or transfer may be exempted from the disgorgement of all profits resulting from the disposition of equity securities, it is possible that, in addition to deterring or preventing the hostile takeover of Pennsylvania corporations, Subchapter H may have a serious effect on other conventional attempts to change control, such as shareholder proxies or friendly mergers. Now, instead of exercising their traditional, inherent right to change management through a proxy fight, shareholders may have to reconsider exercising that right for fear of losing future profits.

IV. EVALUATION OF THE STATUTE

Act 36 raises two questions which, in the eyes of Justice Scalia, are completely unrelated.[177] The first is whether the statute is constitutional.[178] The second, which is of more practical significance, is whether the statute is the best way, or even a good way, to regulate hostile takeovers. If one accepts the proposition that some hostile takeovers are detrimental while others are beneficial, the question arises: Does Act 36 promote or impede economic efficiency?[179]

A. Is Act 36 Constitutional?

Because the Supreme Court is the ultimate arbiter of a state statute's constitutionality, it is appropriate to evaluate Act 36 in light

175. 15 PA. CONS. STAT. ANN. § 2574(b)(2) (Purdon 1990).

176. *Id.* § 2574(b)(3).

177. As previously noted, Justice Scalia found that antitakeover statutes could be folly yet still be constitutional. *CTS*, 481 U.S. at 96-97 (Scalia, J., concurring).

178. On the date the statute became effective, April 27, 1990, two lawsuits were filed challenging its constitutionality. Armstrong World Indus., Inc. v. Adams, No. 90-2920 (E.D. Pa. filed Apr. 27, 1990); First City Capital Fin. Corp., Ltd. v. Armstrong World Indus., Inc., No. 90-2922 (E.D. Pa. filed Apr. 27, 1990) (dismissed with prejudice June 15, 1990).

179. *See supra* notes 85-96 and accompanying text (discussing the positions of both supporters and critics of hostile takeovers and takeover laws).

of the Court's previous analyses of state antitakeover laws in *CTS*[180] and *MITE*.[181]

1. Supremacy Clause

The control-share acquisition and disgorgement provisions of Act 36 regulate the rights of persons after they have acquired either stock or voting rights in a corporation. Because the acquisition of these securities is partially regulated by federal law, it is possible that Act 36 will be preempted by the supremacy clause of the United States Constitution.[182] A state statute is preempted by federal law if the statute makes compliance with the federal law impossible[183] or frustrates the objectives of the federal law.[184] Because it is possible to comply with both Act 36 and the existing federal regulations, Act 36 will be preempted only if it frustrates Congress' objectives. The federal laws that may preempt either Subchapter G or H are the Williams Act[185] and section 14(a) of the Securities and Exchange Act.[186]

It is important to note that in *CTS* the Court held that the Williams Act did not preempt the Indiana Control Share Act, an act with several similarities to Subchapter G.[187] Therefore, it is unlikely that the Court would invalidate Pennsylvania's Control-Share Act, unless the provisions that differentiate Subchapter G were found to directly conflict with the Williams Act. The consideration of Subchapter G's constitutionality will, thus, focus on the effect of those provisions that differentiate Subchapter G from the Indiana Act. Because the *CTS* Court did not address the effect of section 14(a) on the validity of Indiana's Act, the discussion of section 14(a) will focus on the disgorgement provision.

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180. *See supra* notes 65-81 and accompanying text.

181. *See supra* notes 47-60 and accompanying text.

182. The supremacy clause provides that "[t]his Constitution, and the Laws of the United States which shall be made in Pursuance thereof . . . shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution of Laws of any State to the Contrary notwithstanding." U.S. CONST. art. VI, cl. 2.

183. *See* Florida Lime & Avocado Growers, Inc. v. Paul, 373 U.S. 132, 142-43 (1963).

184. Hines v. Davidowitz, 312 U.S. 52, 67 (1941).

185. 15 U.S.C. §§ 78m(d)-(e), 78n(d)-(f) (1988).

186. 15 U.S.C. § 78n(a) (1988).

187. *See supra* notes 65-81 and accompanying text.

a. *Williams Act.*

Taking Subchapter G first, the *CTS* Court found that the Indiana Control-Share Act did not frustrate, but *furthered*, Congress' objectives in enacting the Williams Act.[188] More specifically, it held that the statute did not violate the Williams Act's policy of neutrality between investor and management, but instead put the two parties on equal footing.[189] This conclusion would seem to end the discussion concerning the similar Pennsylvania Act. There is, however, another question: Does the Pennsylvania Control-Share Act have any provisions that are not contained in the Indiana statute that could possibly conflict with the Williams Act?

The Supreme Court has found the objectives of the Williams Act to include the protection of shareholders and the placement of management and offerors on level ground.[190] Subchapter G's provision that exempts transactions consummated by the corporation or its subsidiaries appears to favor management in violation of the Williams Act.[191] If this provision implies that directors may freely engage in transactions that would be considered control-share transactions if consummated by someone other than a director, then it would seem that management is being impermissibly favored. More specifically, an obvious advantage would exist if management, while acting as the corporation, did not need to get shareholder approval before voting its shares in an election when outsiders *would* need such approval. The plain language of the provision states that "the corporation" is exempt.[192] It does not say that managers or directors are exempt or that they are "the corporation." It would be difficult to imagine, however, a situation in which "the corporation" would solicit or purchase voting power and then use those votes in an election of directors.[193] Unless one concludes that this provision was included without any specific applicable situation in mind, it would seem that directors and managers are intended to be "the corpo-

188. *CTS*, 481 U.S. at 83.

189. *Id.* at 82.

190. *See supra* notes 34-37 and accompanying text.

191. 15 PA. CONS. STAT. ANN. § 2561(b)(5)(ix) (Purdon 1990).

192. *Id.*

193. The statute constantly speaks in terms of potential voting power in an election of directors. *See id.* § 2562 (defining "controlling person"). Furthermore, the entire focus of the statute is on the election of directors. The reason the corporate exemption seems so odd is that it is hard to imagine the corporation participating in an election of directors.

ration." This discussion, however, like any conclusion drawn before a court's final decision, is purely conjecture. A court could find that, consistent with the plain language, the provision does not grant management such power and that it does not frustrate federal law.

The provision in Subchapter G that deems all board determinations made pursuant to the subchapter to be correct unless rebutted by clear and convincing evidence also appears to favor management.[194] An example of a situation in which the board is granted this discretion is when the board can refuse to submit the issue of restoring voting rights to control shares unless the acquiror provides statements indicating that it has secured financing adequate to complete the control-share acquisition.[195] If the board determines that the financing is not adequate, then the voting rights may not be granted.[196]

At first glance, this provision seems to clearly favor management because it makes management, who in most cases will go to great lengths to defeat a hostile offer,[197] the judge and jury for determining if the offeror complies with the sections of the Act that are essential to proceeding with the acquisition of voting rights. In addition, the possibility that the issue of voting rights will be delayed indefinitely, or not be submitted at all, looks like the type of result that Justice White found to violate the Williams Act in *MITE*.[198] Justice White's preemption argument, however, was not adopted by a majority of the Court.[199] Furthermore, the majority in *CTS* cut back significantly on the consequences that delay could have in a tender offer situation. Although the Court recognized that indefinite delay may be unreasonable,[200] it is also noted that many

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194. *Id.* § 2568.

195. *Id.* § 2565(d)(2).

196. *See id.* (implying that if the board determines the financing to be inadequate, the restoration issue need not be submitted to the shareholders, which would result in the control shares never attaining the power to be voted).

197. *See* Proxmire, *supra* note 8, at 356 (explaining that management will try to defeat a hostile offer by borrowing heavily in order to finance large amounts of stock to outmatch the offeror).

198. *See MITE*, 457 U.S. at 637 (White, J., opinion) (stating that the possibility that a tender offer may be delayed indefinitely by a hearing provision provided management a weapon with which to defeat the offer).

199. In fact, only two other members of the Court, Chief Justice Berger and Justice Blackmun, endorsed Justice White's view. Edgar v. MITE Corp., 457 U.S. 624 (1982).

200. *CTS*, 481 U.S. at 85. The Court was comparing the provision in the Indiana statute, which only caused a 50-day delay, with the Illinois provision which

state corporate laws[201] of "unquestioned validity" delay the tender offer process, and, if Congress intended to preempt all of these laws, it would have done so expressly.[202] From *CTS*, it appears that the Court's present direction is moving away from interference with the state unless the state statute directly conflicts with federal law or policy. Therefore, even though Subchapter G may cause indefinite delay, it is entirely possible that a court could reject Justice White's findings and conclude that such a provision is not preempted by the Williams Act.

Considering these arguments, it is possible, but not likely, that a challenge to the constitutionality of Subchapter G on supremacy clause grounds would be successful. An activist judge might find that the statute goes too far and, therefore, violates the Williams Act. Considering the non-activist nature of the Supreme Court today, however, it is not likely that such a decision would be upheld.

As for the disgorgement provision, because a tender offer may result in the offeror acquiring over twenty percent of the corporation's voting rights, Subchapter H could interfere with the Williams Act. After resolving this preliminary hurdle, the same inquiry must be made: Do the provisions of this section frustrate the accomplishment of the objectives of the Williams Act?

Although the disgorgement provision may offend some sense of justice because it takes shareholders' profits, it does not interfere with the objectives of the Williams Act. The use of the *MITE* conclusions as a measuring stick supports this conclusion. None of the elements that the *MITE* Court found to violate the Williams Act exist in Subchapter H. First, no provisions directly conflict with the Williams Act, as did the precommencement provision in *MITE*. Second, and most importantly, the statute causes no delay that could

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could potentially result in an indefinite delay. In *MITE*, Justice White had referred to unreasonable delay. *MITE*, 457 U.S. at 639. The *CTS* Court, however, found that the 50-day delay was not unreasonable. One must keep in mind that the *CTS* Court never specifically rejected or accepted *MITE* as controlling; it was merely comparing the Indiana statute to the findings in *MITE*. Nevertheless, *CTS* was a majority opinion, whereas *MITE* was not; therefore, it is *CTS* to which we must look for binding law.

201. Specifically, paying deference to state *corporate* laws is a subtle indication of the Court's sentiment that this takeover statute, as well as others of its kind, was enacted under the state's traditional authority to regulate its corporations. Therefore, unless it directly conflicts with federal law, it seems unlikely that the Court will intrude on the state's domain.

202. *CTS*, 481 U.S. at 86.

compromise the policy of neutrality.[203] Subchapter H does, however, contain a provision that exempts transfers by the corporation from the Act.[204] As with Subchapter G, if the provision is attacked, the analysis undertaken previously would apply.[205]

Looking outside of *MITE*'s specific findings, one could argue that the subchapter as a whole works to impermissibly protect management by deterring proxies or tender offers that could lead to their dethroning. The provisions of the statute, however, do not directly cause this result. Deterrence of tender offers will be an incidental and indirect effect of the statute, but the protection of management through delay that the *MITE* Court found objectionable was a certain and direct result of the Illinois statute's provisions. Another way to explain the difference is this: Pursuant to the Illinois statute in *MITE*, if the Secretary of State were to call a hearing, one of the direct results would be a delay in the tender offer process, allowing management extra time to thwart the offer. With the disgorgement statute, however, nothing called for by the statute will directly result in management having the upper hand. A tender offeror could still proceed with the offer unfettered. Management gains an advantage only when the offeror itself decides that the possibility of disgorgement exists and, therefore, does not commence the offer. Nothing in the statute mandates or directly causes this decision; it is an incidental effect of the statute. Should a court find that this incidental effect frustrates Congress' objectives, the act would be preempted. In the end, however, every takeover statute will deter hostile takeovers to some degree. Subchapter H may be a severe deterrent, but if it does not interfere with the objectives of an act of Congress, then it is a valid exercise of the state's power to regulate its corporations.[206]

Other than this, the disgorgement provision does not directly favor management over the corporation. Furthermore, the Williams Act's policy of protecting investors was aimed at shielding them from

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203. It was this element that the *MITE* Court found so offensive to the Williams Act. *See CTS*, 481 U.S. at 81-82 ("As is apparent from our summary of its reasoning, the overriding concern of the *MITE* plurality was that the Illinois statute considered in that case operated to favor management against offerors, to the detriment of shareholders.").

204. *See* 15 PA. CONS. STAT. ANN. § 2571(b)(6)(i) (Purdon 1990).

205. *See supra* notes 192-93 and accompanying text.

206. *CTS*, 481 U.S. at 78-79 (stating that a state statute is preempted, absent express indication by Congress, only when the statute frustrates the purposes of a federal law).

the coercive tactics of the offeror, not the state.[207] Any other argument, such as one made by SEC General Counsel Daniel Goelzer, that Congress intended shareholders to be able to solicit proxies in order to change the board without running the draconian risk of having to surrender profits, fails to consider what is required before a statute is preempted.[208]

Finally, an indication that this provision will pass muster is the Court's suggestion in *CTS* that it will not preempt state laws unless Congress expressly indicates an intent to do so.[209] The Williams Act contains no such indication. Therefore, although Subchapter G may turn out to be detrimental to shareholders, and although it may be folly, it is most likely constitutional for the purposes of the supremacy clause.

b. *Section 14(a)*

Although Subchapter H may not offend the Williams Act, it may offend section 14(a) of the SEC Act, which deals with proxy regulation. Most commentators who have written about the disgorgement subchapter are more concerned with the subchapter's effect on proxies than tender offers.[210] The primary concern of these commentators is that the statute is triggered when a person, who had "acquired, offered to acquire or . . . publicly disclosed or caused to be disclosed . . . the intention of acquiring" over twenty percent of the corporation's voting power, disposes of equity securities in the corporation within eighteen months of acquiring the votes.[211] Thus, a long-term shareholder who is upset with management will be subject to disgorgement if that shareholder disposes of its interest after an attempt to enter into a proxy solicitation in order to change the direction of the company.

In order to be preempted, the statute must frustrate the purposes of section 14(a). Courts that have discussed the objectives of this

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207. 17 C.F.R. § 240.14a-1 to -11 (1990). All of the provisions speak in terms of what the offeror must do. From this, the conclusion is drawn that the evil from which the shareholders are protected is an offeror who either has not made full disclosure or who will use coercive tactics.

208. Franklin, *Tough Takeover Statute; Critics Say Pennsylvania's New Law is Extreme*, N.Y.L.J., May 3, 1990, at 5 (quoting Daniel Goelzer, SEC general counsel).

209. *See supra* note 76 and accompanying text.

210. *See generally* Franklin, *supra* note 208; Klein & Greenbaum, *supra* note 14; Marr, *supra* note 7.

211. *See* 15 PA. CONS. STAT. ANN. §§ 2573, 2574 (Purdon 1990) (stipulating to whom and when the disgorgement provision will be activated).

section emphasize that "Congress's central concern was with disclosure"[212] and ensuring "fair shareholder suffrage."[213] These conclusions are reinforced by examining the regulations supporting section 14(a) because they deal almost exclusively with disclosure of information.[214] Furthermore, the Williams Act was enacted because tender offers were not subject to the same types of regulations that governed proxies.[215] Because the Williams Act is primarily a disclosure act, it would follow that section 14(a), as the role model for the Williams Act, was also aimed at disclosure.

Comparing the provisions of Subchapter H with the objectives of Congress, it does not appear that the statute frustrates any of Congress' objectives of providing adequate disclosure. In fact, nothing in Subchapter H affects the procedure of voting or the distribution of information. All that can be said, as with Subchapter G, is that a particular activity is deterred. Furthermore, by again looking at *CTS*'s suggestion that Congress would have expressly preempted state law had it intended to do so,[216] section 14(a) does not indicate that Congress intended to preempt a state law governing proxies that did not regulate disclosure.

The state's "corporatizing" of its antitakeover laws puts them out of the reach of federal intervention. Although the statutes regulate securities that are also regulated at the federal level, they affect incidents of corporations that are traditionally within the sphere of state law.[217] Therefore, as with Subchapter G, Subchapter H may be offensive and it may be folly, but this does not mean that it violates the Constitution.

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212. *Business Roundtable*, 905 F.2d at 410. *See also Santa Fe Indus.*, 430 U.S. at 477-78 (stating that full and fair disclosure is the primary concern of § 14(a)); *J.I. Case Co.*, 377 U.S. at 431 ("The purpose of [§] 14(a) is to prevent management or others from obtaining authorization for corporate action by means of deceptive or inadequate disclosure in proxy solicitation.").

213. *See Business Roundtable*, 905 F.2d at 410 (quoting Final Rule, 53 Fed. Reg. at 26,391-26,392).

214. *See* 17 C.F.R. § 240.14a-1 to -11 (1990) (setting forth the Commission's regulations governing what types of disclosure must be made in various situations in which proxies may be utilized).

215. *See supra* notes 31-33 and accompanying text.

216. *See CTS*, 481 U.S. at 86 (stating that had Congress intended to preempt all state laws that caused delay, it would have done so expressly). *See also* Garfield, *supra* note 33, at 556 ("Stressing its hesitancy to preempt state corporate law, the Court remarked . . . .").

217. *See* Comment, *supra* note 30, at 1031 (stating that antitakeover statutes since *MITE* are "couched" in state corporate law).

2. Commerce Clause

The similarities between the jurisdictional reach of Act 36 and the Indiana statute validated in 1987 call for a more detailed review of the commerce clause analysis in *CTS Corp. v. Dynamics Corp. of America*.[218] In *CTS*, the Court found that the Indiana Control-Share Act did not impermissibly burden interstate commerce.[219] It began by making the crucial determination that the act did not discriminate against interstate commerce.[220] Although Dynamics asserted that most of the acquirors affected by the statute would be out-of-state persons, the Court found this unpersuasive.[221] The Court conclusively stated that the statute was not discriminatory because it burdened out-of-state offerors in the same degree that it did in-staters.[222] It then considered Dynamics' primary claim that the Act would limit the number of successful tender offers. After apparently performing a balancing test,[223] the Court found that this harm was outweighed by the state's interest in regulating the corporations that its law created.[224] Furthermore, the reduction of the occurrence of tender offers had no bearing on the commerce clause. The Court found that the statute merely provided regulations for the protection of Indiana corporations.[225] All that was required was that the statute regulated non-discriminatorily.[226] Because the statute did not discriminate, the Court held that it did not violate the commerce clause.

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218. 481 U.S. 69 (1987).

219. *Id.* at 94.

220. This is a traditional commerce clause test that determines whether a statute is per se unconstitutional. *See CTS*, 481 U.S. at 87 (stating that the principal objects of commerce clause scrutiny are those that discriminate against interstate commerce).

221. The majority rejected Dynamics' claim by stating, "The fact that the burden of a state regulation falls on some interstate companies does not, by itself, establish a claim of discrimination against interstate commerce." *Id.* at 88 (citing Exxon Corp. v. Governor of Md., 437 U.S. 117, 126 (1978)).

222. *Id.* at 90.

223. *See supra* note 80 and accompanying text.

224. *See supra* note 81 and accompanying text.

225. *CTS*, 481 U.S. at 93-94. In downplaying the significance of a reduction in the number of tender offers, the Court implied that the fact that the statute did not expressly prohibit tender offers was important. "[T]his [Indiana Control-Share] Act does not prohibit any entity—resident or nonresident—from offering to purchase, or from purchasing, shares in Indiana corporations, or from attempting thereby to gain control. It only provides regulatory procedures designed for the better protection of the corporations' shareholders." *Id.*

226. *See id.* at 94 (stating that all the statute need do is allow both residents and nonresidents equal access to the corporations that its regulations protect).

The portions of Subchapters G and H that are relevant to determining whether they violate the commerce clause are those which describe to whom the sections apply. Subchapter G, Subchapter H, and the Indiana statute all apply only to domestic corporations.[227] The only difference between the statutes is that Subchapters G and H do not have the extra nexus requirements contained in the Indiana Act.[228] The nexus provisions, however, do not change the outcome. Subchapters G and H apply to in-state offerors and out-of-state offerors in the same way. The provisions of the subchapters are triggered whenever an offeror, in-state or out-of-state, either makes or attempts to make a control-share acquisition of a Pennsylvania corporation or transfers equity securities after being labeled a controlling person. Furthermore, none of the provisions exempting certain persons and transactions from the statute depend on the domicile or residence of the offeror or corporation. Therefore, Subchapters G and H appear to comply with the commerce clause mandate that the state statute regulate non-discriminatorily.

After making this crucial determination, the analysis in *CTS* is controlling. Subchapters G and H are state efforts to protect corporations created by its corporate laws.[229] According to *CTS*, the state has an interest in doing so, notwithstanding the fact that the statute may result in a reduced number of successful takeovers.[230] If a statute applies uniformly to resident and nonresident offerors, then the statute does not violate the commerce clause. Again, an activist judge could find that Subchapters G and H are discriminatory or that the burdens of the statute outweigh the state's interest, but given the sweeping and confident language espoused by the *CTS* majority,[231] it is unlikely that such a decision would survive appellate review.

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227. *See* 15 PA. CONS. STAT. ANN. §§ 2561(a)-(b)(1), 2571(a)-(b)(1) (Purdon 1990).

228. *See supra* note 68 (discussing these nexus requirements).

229. *See* 15 PA. CONS. STAT. ANN. §§ 2561(a)-(b)(1), 2571(a)-(b)(1) (Purdon 1990) (making the protections of the statute applicable to Pennsylvania registered corporations).

230. *See supra* note 81 and accompanying text.

231. *CTS*, 481 U.S. at 94. The language used here by the Court could reasonably be interpreted to mean that laws governing corporations only need to pass one test: Does the statute regulate indiscriminatorily? If so, then the statute does not violate the commerce clause.

B. Is Act 36 Folly?

Act 36 has not been welcomed with open arms. Legal and economic scholars, the chairman of the SEC, and some of the largest institutional investors in the country have expressed their discontent to Governor Casey and the Pennsylvania General Assembly prior to and after the statute's signing.[232] Additionally, at least sixty-seven of the estimated 200 companies affected by the statute have exercised their right to opt out of at least one of its subchapters.[233] Thus, even though it appears that state regulations can be drafted without conflicting with federal law, it remains to be seen if these regulations are economically efficient.

Most of the criticism of Act 36 has focused on the disgorgement provision.[234] This may be because control-share acts have become common since *CTS* or because the loss of profits is more offensive than the postponement of voting rights. For this reason, the following critique will focus primarily on the disgorgement provision. The first question to be answered is: Why have so many corporations, which the statute is supposed to protect, decided to opt out? The second question, which may provide an explanation for all of the negative press Subchapter H has received, is whether the disgorgement provision is beneficial and whether it is the optimal way to accomplish the legislature's objectives.

There have been two different explanations for the large number of corporations opting out of the disgorgement provision. Managers of the corporations contend that opting out prevents the price of the corporation's stock from falling, thereby protecting investors.[235] Apparently, management felt that investors would shy away from corporations in which there was a risk of possible disgorgement of profits. The decision to opt out, however, if truly motivated by this reason, may have come too late. A recent study shows that Pennsylvania stocks underperformed the Standard & Poors 500 by 6.9% from October of 1989, when Act 36 was announced, to January of

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232. Klein & Greenbaum, *supra* note 14, at 15.

233. Armstrong, *Spurn Protection of State Takeover Law*, 2 PHILA. BUS. J., June 4, 1990, at 1. This number only represents the corporations that have publicly announced their decision to opt out. Because there is no provision requiring disclosure of the decision to opt out, this number may be even greater.

234. *See, e.g.*, Marr, *supra* note 7, at 14; Klein & Greenbaum, *supra* note 14.

235. Wayne, *Many Companies in Pennsylvania Reject State's Takeover Protection*, N.Y. Times, July 20, 1990, § A, at 4, col. 1.

1990, when it passed in the Senate.[236] Another study indicates that the combined market value of Pennsylvania companies declined $4 billion between the date the Act was announced and the date it was signed. This figure is significant considering that the decline in market value of companies in twenty-five other states was $6 billion combined. This decline most likely reflects an overall reduction in demand for Pennsylvania corporations.

Commentators, however, suggest a different reason. Many feel that the decision to opt out was motivated by threats of large institutional investors to divest their interests in companies that did not opt out.[237] Two large institutional investors, Houston Fireman's Relief & Retirement Fund and a pension fund for the city of Flint, Michigan, have threatened to sell all of their interests in the Pennsylvania corporations that do not opt out.[238] Large institutional investors have become a dominant force in the market, controlling huge blocks of shares.[239] Fund managers do not like the disgorgement provision because they want a say in the management and policy formation in corporations in which they invest, without the risk of losing profits on disposition of their interests.[240] Thus, commentators suggest that management, fearing a large drop in share prices that would result from the heavy selling by these large institutional investors, opted out to avoid the corresponding price shock.

There may, however, be other reasons behind management's decision to opt out. Consider the following situation: Assume that a corporation has staggered elections, and incumbent management wishes to elect a particular candidate as director. If the incumbent managers, who are not up for election, vote or solicit proxies to vote for the candidate, they may be considered to have "act[ed] in concert . . . for the purpose of . . . voting . . . equity securities." Therefore, they would be a controlling person[241] subject to disgorgement upon

236. This study was performed by Professors Jonathon M. Karpoff and Paul H. Malatesta, from the University of Washington. Anand, *Pennsylvania Anti-Takeover Law Slams Stock Prices, Study Finds*, Investors Daily, Oct. 1, 1990, at 31.

237. This study was performed by Professors Samuel H. Szewczyk and George P. Tsetsekos, of Drexel University. *See id.* at 81.

238. Armstrong, *At Least 67 Firms Buck Act 36*, 1 PHILA. BUS. J., July 30, 1990, at 1.

239. *See* Wayne, *supra* note 1, § D, at 7, col. 3 (citing the fact that institutional investors control over 50% of the equity in American corporations).

240. *Id.*

241. *See* 15 PA. CONS. STAT. ANN. § 2573(2) (Purdon 1990) (defining "controlling person" as two or more persons acting in concert for the purpose of voting equity securities).

disposition of their equity securities. Furthermore, shareholders may be skeptical about participating in a proxy solicitation involving management for fear that their profits will be disgorged. In addition, consider the situation where a corporate raider gains control of a company's board and ousts present management. If the ousted managers owned any stock, it would be detrimental to them to try to regain control of the corporation since this would subject their interests to disgorgement. The common denominator in these situations is that the directors or managers, who must vote whether to opt out, may be adversely affected by the provision.

These are not the only scenarios in which management could be the adversely affected party. Depending on the subtle interpretations of Subchapter H,[242] in which management could be subject to disgorgement, the possible situations are limited only by one's imagination. Thus, although the arguments that fears of falling share prices or threats by institutional investors may be accurate, it is also possible that managers opted out to protect their own interests.

The second issue is whether the disgorgement provision will accomplish its objectives of deterring the payment of greenmail and promoting stability in corporations by discouraging control contests.[243] On its face, the answer is yes. A more critical analysis, however, demonstrates that this statute will do much more.

The positive aspects of Subchapter H are those commonly cited by supporters of antitakeover laws. The threat of disgorgement of profits will most definitely make potential "raiders" think twice about putting a protected corporation "in play." The raider who would acquire a corporation to realize its liquidation value will be denied the very profit which motivated its decision to consummate the takeover. The money and effort expended in completing such a transaction could be spent more profitably where profits will not be disgorged. Another related benefit is that incumbent management

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242. Possibly one of the most important interpretations would be construing the Act so that "the corporation" is exempted from the statute when it solicits proxies or transfers equity securities. 15 PA. CONS. STAT. ANN. §§ 2571(b)(6)(i), 2574(b)(2) (Purdon 1990). *See supra* notes 192-93 and accompanying text. Should a court interpret these provisions to mean that managers acting independently are acting as the corporation, then the number of situations in which management could be harmed is not as great because transactions involving management would not be subject to disgorgement. If, however, managers are *not* the corporation, then management is much more vulnerable.

243. *See* 15 PA. CONS. STAT. ANN. § 2572(1)-(4) (Purdon 1990) (describing the policies and purposes of the disgorgement provision).

need not be as concerned with being displaced by a corporate raider. As such, they can concentrate on long-term growth, rather than on trying to maximize short-term gains in an effort to make the company an unlikely takeover target. Long-term stability is also beneficial to suppliers, employees, and the community, who can feel safe that the corporation will continue to survive. In short, all of the ills that commentators cite as results of the unimpeded hostile takeover market will be cured to some extent.

On other hand, this statute may redefine the concept of a "share" of stock. Traditionally, the shareholders' right to elect directors who will represent them as owners of the corporation has been thought of as an inherent right. With the threat of disgorgement of profits, however, the right of the shareholders to elect directors who they feel can operate the corporation most effectively is basically eliminated. Consider the simplest example: A long-time shareholder of a corporation, who is genuinely interested in the effectiveness of carrying out the corporate objectives, is unhappy with current management. If that shareholder, for no other reason than for the perpetuation of the corporate goal and the long-term service of the corporation to the community, merely announces an intention to solicit proxies in order to change management, that investor is subject to having the profits that motivated the original investment disgorged. Disgorgement may even result when a shareholder tenders a proxy to another shareholder who has intentions of ousting incumbent management.

In addition to the deterrent effect on the shareholders, the statute makes it detrimental for outside acquirors to take preliminary steps toward initiating "friendly takeover[s]."[244] Consider the following example: Corporation A (*A*) makes a friendly offer to Corporation B (*B*) to merge *B* into *A*, cashing out *B*'s shareholders at $25 per share.[245] At this point, *A* has become a "controlling group"[246] because it has either offered to acquire or publicly disclosed the intention of acquiring at least twenty percent of *B*'s voting rights. If this trans-

244. Marr, *supra* note 7, at 14.

245. It is assumed that *B*'s stock would be converted into *A*'s stock, thereby allowing *A* to meet the requisite 20% voting rights requirement for a controlling shareholder. *See infra* note 246 (defining "controlling person or group").

246. *See* 15 PA. CONS. STAT. ANN. § 2573(1)(i) (Purdon 1990) (defining "controlling person or group").

action is approved by the board, *A* would not have to disgorge.[247] Assume, however, that the board rejects the offer. If *A* had purchased five percent of *B*'s shares in anticipation of the acquisition, *A* would have to disgorge its profits if it sold the shares on the market or to another acquiror. This is due to *A*'s previous controlling group status. No one will be willing to initiate a change in corporate control, friendly or unfriendly.[248] Therefore, the extremely broad category of persons or groups who will be considered to have "controlling" status not only deters the corporate raider, but also limits shareholders and friendly acquirors interested in making beneficial changes in the corporation. Deterring friendly takeovers may deny synergies that would be beneficial to all affected parties.

Proponents of the provision will argue that disgorgement only affects those persons interested in the short-term gain. This group will indeed be one of the affected classes, but it would be imprudent to think that they are the only investors who will sell their interests within eighteen months of acquisition. In light of today's economic situation, shareholders may be unwilling to hold their securities for eighteen months. The early 1990s are a time of economic uncertainty. With the Gulf crisis causing oil prices to rise, a huge budget deficit, and the savings and loan crisis looming over the banking industry, the volatility of the securities markets has become a fact of life. From this perspective, asking shareholders to hold their interests for eighteen months is a tall order because they may wind up losing more in the market than they would upon disgorgement. Thus, believing that the corporate raider is the only entity that will dispose of securities within eighteen months of acquisition is misguided.

The reduction in the rights of shareholders could have serious consequences. One result of this reduction in stock rights could be the underperformance of Pennsylvania corporations.[249] Why would an investor choose to invest in a Pennsylvania corporation when that investor could invest in a non-protected corporation and have greater rights? This lack of demand may cause protected Pennsylvania corporations to experience a steady decline in share prices.

Another result, which is a consequence of the effective elimination of the shareholders' right to change management, is the

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247. This is due to the provision exempting from disgorgement transfers of equity securities, the acquisition of which was approved by the board and ratified by the shareholders. *Id.* § 2571(b)(7).

248. Marr, *supra* note 7, at 14.

249. *See* Wayne, *supra* note 235, § D, at 4, cols. 1-2.

promotion of inefficiency.[250] With virtually no fear of being displaced, directors and mangers have no incentive to perform. Since they need not answer to the shareholders, they become almost untouchable. This is a common argument made by proponents of an uninhibited takeover market, and through the disgorgement provision, it is taken to the extreme. Because the shareholders cannot effect a change, the only way to rotate management is when the existing board either participates in or approves such a transaction.[251] If the board is already functioning inefficiently, this may only perpetuate the ineffectiveness, and the final result will be that "managers have tenure at the expense of [the] shareholders."[252]

Finally, if we assume that some takeovers are beneficial, the deterrence of these transactions may foreclose the possibility of realizing any of the benefits of "good" takeovers. The corporation will not be able to auction itself because the bidder will not be able to realize any profits. As a result, shareholders will not realize the huge takeover premium, management of truly inefficient corporations will not be rotated, and synergies will be stymied.

If we apply the ever-popular balancing test, the scale is tipped heavily against this statute. The loss of a traditional shareholder right, the bullet-proofing of inefficient management, and the foreclosure of any possibility of experiencing a healthy takeover far outweigh any benefits offered. Keep in mind that this note does not advocate either of the arguments made by commentators on the utility of takeovers or takeover statutes. On the contrary, this note assumes that there are good and bad takeovers. The issue presented is whether this statute is the most effective way to maximize the occurrence of healthy takeovers while minimizing those that are detrimental. The conclusion reached is that this statute deters the bad *and* the good, and that the negative effects of deterring takeovers highlighted by commentators are taken to their extreme. Furthermore, shareholders will lose rights that are inherent in the concept

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250. *Id.*

251. Recall that Subchapter H does not foreclose all possibilities of changing management without being subject to losing profits. An acquisition or disposal of equity securities approved by a resolution before either transaction will be exempt from disgorgement. The resolution must be approved first by the board of directors and then by a majority of the shareholders. Therefore, any change in management must first be approved by the directors who are about to be displaced. Since it is unlikely that any manager would vote for his or her own ouster, the only time that such an approval will be obtained is where existing directors voluntarily effect a change.

252. Marr, *supra* note 7, at 14.

of a "share" of stock. This may cause investors to look elsewhere, to the detriment of the entire Commonwealth of Pennsylvania.

V. CONCLUSION

In 1987, the Supreme Court handed down *CTS Corp. v. Dynamics Corp. of America*. The Court spoke in broad and ambiguous terms, appearing to reject the earlier *MITE* decision but not going so far as to expressly overrule that case. In April of 1990, the Pennsylvania legislature took *CTS* to its extreme by enacting Act 36. Act 36 pushes *CTS* to its constitutional limits by all but outlawing hostile takeovers within the borders of Pennsylvania. Its most significant and "radical" provision is the one that requires disgorgement of profits resulting from disposition of equity securities by controlling persons. The Act's definition of a controlling person is so broad that the corporate raider, as well as the everyday stockholder, could be required to disgorge after attempting to solicit or tender proxies. Although the statute may fall within constitutional requirements, shareholders may be stripped of their inherent right to select directors. Further, because the demand for a company's stock is affected by the statute, Pennsylvania companies may suffer a loss in stock value due to the decreased demand for their stock. In the final analysis, the statute is legislative overkill and may wind up backfiring. Instead of eliminating detrimental hostile takeovers and protecting Pennsylvania corporations and communities, Act 36 may cause corporations and communities to suffer by locking in ineffective management, preventing healthy management changes, and halting the allocation of resources in domestic companies.

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