Comment

STATE TAKEOVER LEGISLATION AFTER *CTS*: DOES IT GIVE STATES A FREE HAND TO REGULATE TENDER OFFERS?

I. INTRODUCTION

During the 1960s, the cash tender offer[1] replaced the proxy contest as the more popular mode of gaining corporate control because it is quicker, more efficient, less expensive, and less regulated.[2] In response to the increasing number of takeover bids, Congress passed the Williams Act in 1968 to regulate certain aspects of the tender offer.[3] The purpose of the Williams Act is to provide shareholders with information regarding offerors and to afford them certain procedural safeguards concerning the offer itself.[4] Moreover, the Williams Act attempts to remain neutral in relation to offerors and management in takeover contests.[5] Following the enactment of the Williams Act, many states passed similar legislation which regulated tender offers but these "first generation" takeover statutes[6] created

---

1. A cash tender offer is a tender offer made in cash rather than an offer made in securities or other types of consideration. It allows the shareholders of a "target" corporation to sell their shares for more than the market price. *See* Easterbrook & Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161 (1981).

2. *See* Note, *Commerce Clause Limitations Upon State Regulation of Tender Offers*, 47 SO. CAL. L. REV. 1133, 1134 (1974) [hereinafter *State Regulation of Tender Offers*]. *See also* Note, *The Continuing Validity of State Takeover Statutes—A Limited Third Generation*, 62 NOTRE DAME L. REV. 412, 413 (1987) [hereinafter *Limited Third Generation*].

3. *See* Piper v. Chris-Craft Indus., Inc., 430 U.S. 1, 22, *reh'g denied*, 430 U.S. 976 (1977). A tender offer is not explicitly defined by the Williams Act but is generally defined as a public invitation to a corporation's shareholders to purchase their stock for specified consideration. E.H.I. of Fla., Inc. v. Insurance Co. of N. Am., 652 F.2d 310, 315 (1981); Wellman v. Dickinson, 475 F. Supp. 783 (S.D.N.Y. 1979), *aff'd*, 682 F.2d 355 (2d Cir. 1982), *cert. denied*, 460 U.S. 1069 (1983). *See generally* Note, *The Developing Meaning of "Tender Offer" Under the Securities Act of 1934*, 86 HARV. L. REV. 1250, 1251-60 (1973).

4. *Piper*, 430 U.S. at 23.

5. *Id.* at 29 ("Neutrality is, rather, but one characteristic of legislation directed toward a different purpose—the protection of investors.").

6. *See* Sargent, *On the Validity of State Takeover Regulation: Responses to* MITE *and* Kidwell, 42 OHIO ST. L.J. 639, 690 n.7 (1981) (listing 37 states that enacted this initial state takeover legislation).

difficulties for offerors[7] and tended to favor target management by allowing them additional time to oppose a takeover bid.[8] The United States Supreme Court initially ruled on the constitutionality of a state takeover statute in *Edgar v. MITE Corp.*[9] where an Illinois statute was held unconstitutional on commerce clause grounds.[10] Subsequently, several states passed "second generation" statutes[11] to reconcile their regulatory schemes with *MITE* and thus preserve their ability to regulate certain aspects of corporate takeovers.[12] The constitutionality of these statutes, however, was uncertain as several circuit courts struck them down under both the supremacy and commerce clauses.[13]

In *CTS Corp. v. Dynamics Corp. of America*,[14] the Supreme Court resolved much of the uncertainty surrounding this second generation of state takeover legislation by upholding an Indiana law which restricts corporate control transitions through tender offers for certain publicly held Indiana corporations.[15] The Indiana "control share acquisition" statute validated by the Court withholds voting rights from an acquirer until a majority of the preexisting, disinterested shareholders approve the acquisition.[16] The Court ruled that the Indiana law was constitutionally permissible, viewing it as a legitimate

---

7. *See* Warren, *Developments in State Takeover Regulation:* MITE *and Its Aftermath*, 40 BUS. LAW. 671, 677 (1985).

8. *See generally* Easterbrook & Fischel, *supra* note 1 (discussing management's resistance to takeover bids and the resulting decrease in shareholder welfare).

9. 457 U.S. 624 (1982).

10. *Id.* at 646.

11. *See* Bainbridge, *State Takeover and Tender Offer Regulations Post-*MITE: *The Maryland, Ohio and Pennsylvania Attempts*, 90 DICK. L. REV. 731, 743-44 (1986) (listing states that enacted second generation takeover legislation).

12. *See generally* Block, Barton, & Roth, *State Takeover Statutes: "The Second Generation,"* 13 SEC. REG. L.J. 332 (1986) (discussing recent developments in the area of state takeover regulation).

13. *See, e.g.*, Mesa Petroleum Co. v. Cities Serv. Co., 715 F.2d 1425 (10th Cir. 1983) (Oklahoma takeover statute found to violate the commerce clause); Telvest, Inc. v. Bradshaw, 697 F.2d 576 (4th Cir. 1983) (Virginia takeover statute found to violate the commerce clause); Martin-Marietta Corp. v. Bendix Corp., 690 F.2d 558 (6th Cir. 1982) (Michigan takeover statute found to violate the commerce clause); National City Lines, Inc. v. LLC Corp., 687 F.2d 1122 (8th Cir. 1982) (Missouri takeover statute found to violate the commerce and supremacy clauses). *But see* Agency Rent-a-Car, Inc. v. Connolly, 686 F.2d 1029 (1st Cir. 1982) (Massachusetts takeover statute found not to violate the supremacy clause).

14. 107 S. Ct. 1637 (1987).

15. *Id.* at 1652.

16. IND. CODE §§ 23-1-42-1 to -42-11 (Supp. 1986).

attempt to protect shareholders as well as to define the attributes of shares within that state's corporations.[17] In its decision, the Court found the takeover statute to be consistent with the Williams Act because it did not conflict with its text or purpose.[18] In addition, the Indiana statute was not found to violate the commerce clause though it might arguably reduce the number of tender offers and thus have some adverse impact on interstate commerce.[19] Most significantly, the Court couched its commerce clause analysis in the "internal affairs" doctrine which permits a state to govern companies it incorporates.[20] Though the decision may validate other types of takeover statutes that are similarly couched in terms of a state's corporate law, the holding of *CTS* is necessarily limited to control share acquisition statutes which allow shareholders to collectively decide whether a shift of corporate control through a takeover bid is desirable.[21]

The purpose of this note is to analyze the Court's holding and reasoning in *CTS* and its effect in spawning a "third generation" of takeover statutes.[22] In particular, Delaware's recently enacted takeover statute will be examined in light of the constitutional parameters delineated by both *MITE* and *CTS*. Congress's reaction to the *CTS* decision and the possibility of federal preemption of state takeover statutes will also be analyzed. Finally, the implications of the adoption in *CTS* of the internal affairs doctrine in view of the interstate and international nature of the securities trade will be investigated from both public policy and economic perspectives.

---

17. *CTS*, 107 S. Ct. at 1652.

18. *Id.* at 1648.

19. *Id.* at 1652.

20. *See id.* at 1649. According to the Supreme Court, "[t]he internal affairs doctrine is a conflict of laws principle which recognizes that only one State should have the authority to regulate a corporation's internal affairs—matters peculiar to the relationships among or between the corporation and its current officers, directors, and shareholders." *MITE*, 457 U.S. at 645.

21. *CTS*, 107 S. Ct. at 1652.

22. The 14 states that have enacted third generation statutes after the *CTS* decision include Arizona, Delaware, Florida, Louisiana, Massachusetts, Minnesota, Missouri, Nevada, North Carolina, Oklahoma, Oregon, Utah, Washington, and Wisconsin. The 15 other states that have existing antitakeover statutes include Connecticut, Georgia, Hawaii, Illinois, Indiana, Kentucky, Maine, Maryland, Michigan, Mississippi, New Jersey, New York, Ohio, Pennsylvania, and Virginia. *See* Mendelsohn & Berg, *Anti-Takeover Bill Would Shift Balance of Power*, Nat'l L.J., Feb. 8, 1988, at 41, col. 4 n.5.

II. BACKGROUND

A. *The Williams Act*

Federal securities regulation governing tender offers was promulgated in 1968 when Congress passed the Williams Act[23] in response to the increasing number of takeover bids. Prior to its enactment, cash tender offers were not regulated by the disclosure requirements found in federal securities law.[24] The Williams Act seeks to protect a target company's shareholders by imposing disclosure requirements on the offeror and establishing procedural rules to govern the offer.[25] In addition, the Williams Act closed the legislative gap between the cash tender offer and other functionally similar SEC-regulated transactions such as proxy contests, consolidations, and the like.[26] Furthermore, the Williams Act "provides a mechanism to get information [concerning] potential shifts of corporate control to the relevant [securities] market."[27] In drafting the legislation, Congress attempted to ensure that the Williams Act was neutral with respect to the tender offeror and target management so that the law would neither promote nor inhibit a successful takeover bid.[28] Thus, in interpreting the legislative intent of the Williams Act, courts have emphasized this policy of neutrality which is both implied and central to its operation.[29]

---

23. 15 U.S.C. §§ 78m(d)-(e), 78n(d)-(f) (1982). The Williams Act, Pub. L. No. 90-439, 82 Stat. 454, was enacted as an amendment to the Securities Exchange Act of 1934.

24. *CTS*, 107 S. Ct. at 1644. *See Piper*, 430 U.S. at 22. *See also* Comment, *Beyond* CTS: *A Limited Defense of State Tender Offer Disclosure Requirements*, 54 U. CHI. L. REV. 657, 658-59 (1987). *See generally* S. REP. No. 550, 90th Cong., 1st Sess. 2-4 (1967); H.R. REP. No. 1711, 90th Cong., 2d Sess. 2-4 (1968).

25. *See CTS*, 107 S. Ct. at 1644. *See also MITE*, 457 U.S. at 633. "There is no question that in imposing [the Williams Act] Congress intended to protect investors." *Id.* (citations omitted).

26. Profusek & Gompf, *State Takeover Legislation After* MITE: *Standing Pat, Blue Sky, or Corporation Law Concepts?*, 7 CORP. L. REV. 3, 4 (1983).

27. *Symposium: Current Issues in Tender Offers, the Elusive Definition of a Tender Offer*, 7 J. CORP. L. 503, 504 (1982).

28. *See* 113 CONG. REC. 854 (daily ed. Jan. 18, 1967) (statement of Senator Williams).

> I have taken extreme care with this legislation to balance the scales equally to protect the legitimate interests of the corporation, management, and shareholders without unduly impeding cash takeover bids. Every effort has been made to avoid tipping the balance of regulatory burden in favor of management or in favor of the offeror.

Id.

29. *See MITE*, 457 U.S. at 633; *Piper*, 430 U.S. at 35; Rondeau v. Mosinee Paper Corp., 422 U.S. 49, 58 (1975).

The disclosure provisions of the Williams Act attempt to ensure that management, the investing public, and especially shareholders have adequate information concerning the offeror so that these constituencies may make informed investment decisions.[30] Under the Williams Act, disclosure of information is triggered in two situations: (1) when a person acquires 5% or more of the equity securities registered under section 12[31] of the Securities Exchange Act of 1934 (1934 Act);[32] or (2) when a person attempts through a tender offer to acquire more than 5% of the equity securities registered under section 12.[33] The information required to be filed includes the offeror's identity, background, source of funds, planned changes regarding the target, present stock ownership in the target, and any contracts or undertakings entered into by the purchaser regarding the target's shares.[34] The SEC reviews the adequacy of these disclosures, and if any disclosure is insufficient, the SEC has the authority to order further disclosures in order to clarify or supplement the information filed.[35] However, the SEC only reviews the adequacy of the offeror's disclosures and does not examine the merits of the proposed tender offer.[36]

The Williams Act also imposes three substantive requirements on the terms of the offer: (1) offerees who have tendered their shares must be allowed to withdraw them within fifteen days of, and after sixty days from, the commencement of the offer;[37] (2) if within ten

---

30. *MITE*, 457 U.S. at 634; *Piper*, 430 U.S. at 35; *Rondeau*, 422 U.S. at 58.

31. *See* 15 U.S.C. § 78n(d)(1) (1982). Section 12(a) of the 1934 Act states that any securities traded on a national exchange must be registered. *See id.* § 78*l*. In addition, § 12(g)(1) of the 1934 Act requires registration of the securities of any company with over $5 million in assets and over 500 shareholders in a class of equity securities. *See id.* § 78*l*(b)(1).

32. 15 U.S.C. § 78m(d)(1) (1982). *See* 17 C.F.R. § 240.13d-1(a) (1986). The informational schedule required under these circumstances must be filed with the SEC, the relevant exchange, and the issuer of the stock within 10 days of attaining the 5% ownership level. *Id.*

33. 15 U.S.C. § 78n(d)(1) (1982). *See* 17 C.F.R. § 240.14d-3(a) (1986). The schedule required in this instance must be filed with the SEC prior to making the tender offer; in addition to the requested information, the offeror must provide any solicitation materials prepared in connection with the offer. *Id.*

34. 15 U.S.C. § 78n(d)(1) (1982).

35. Note, *The Tender Offer Regulation Battle Continues: Should States Regulate Only Local Companies?*, 60 IND. L.J. 721, 723 (1985).

36. *Id.*

37. 17 C.F.R. § 240.14d-7 (1986), enacted by the SEC pursuant to § 14(d)(5) which extended the withdrawal period to seven days. *Compare* 15 U.S.C. § 78n(d)(5) (1982) *with* 17 C.F.R. § 240.14d-7 (1986).

days of when the offer was made, the offeror has been tendered more shares than he is willing to accept, then the offeror must purchase all the shares on a pro rata basis;[38] and (3) if the offeror increases the price for tendered shares during the offer, the offeror must pay the additional amount to those who have already tendered their shares.[39] To a degree, these requirements somewhat insulate shareholders from the coerciveness associated with tender offers and prevent shareholders from stampeding to tender their shares on a "first come, first served" basis.[40] Finally, the Williams Act contains a broad antifraud provision which prohibits all "fraudulent, deceptive or manipulative acts or practices" and thus provides additional protection for shareholders.[41] Indeed, courts have construed this provision as compelling the offeror to disclose material information not otherwise required under the Williams Act.[42]

B. *First Generation Takeover Statutes*

Following the enactment of the Williams Act, states made similar attempts to regulate tender offers in order to curtail the growth of hostile takeovers which had adversely affected local interests. Target companies are viewed as "local" in states where they are headquartered or where their financial facilities are located; consequently, an attempted takeover of these local companies with the accompanying possibility of relocation, plant closings, layoffs, and the like, poses a very real threat to local interests.[43] As a result, the state may benefit by inhibiting takeovers which would adversely affect these local interests even though it would be at the cost of the target's shareholders or the overall economy.[44] Nonetheless, the first gen-

---

38. 15 U.S.C. § 78n(d)(6) (1982). In an oversubscribed offer, this provision ensures that shareholders receive a proportionate share of the tender premium and thereby alleviates some of the panic and haste to tender shares as quickly as possible. *See id.* This benefit was extended by the SEC to include all shares that were tendered at any time during the tender offer. *See* 17 C.F.R. § 240.14d-8 (1985).

39. *See* 15 U.S.C. § 78n(d)(7) (1982).

40. *See Limited Third Generation, supra* note 2, at 414.

41. *See* 15 U.S.C. § 78n(e) (1982). *See also Piper*, 430 U.S. at 24.

42. *See* Sonesta Int'l Hotels Corp. v. Wellington Assocs., 483 F.2d 247, 250 (9th Cir. 1973).

43. *See* R. GILSON, THE LAW AND FINANCE OF CORPORATE ACQUISITIONS 1059-60 (1986); Lipton, *Corporate Governance in the Age of Finance Corporatism*, 136 U. PA. L. REV. 1, 25 (1987) (discussing impact of takeovers on local communities).

44. *See* Levmore, *Interstate Exploitation and Judicial Intervention*, 69 VA. L. REV. 563, 622-24 (1983).

eration of state takeover statutes focused on protecting management through hindering the tender offeror with numerous regulations and requirements.[45]

First generation statutes contained certain core provisions which were based upon the disclosure and substantive provisions of the Williams Act.[46] However, these state statutes differed from the federal law in several important respects. First, the state and federal regulations differed markedly with respect to the timing of disclosure: unless a precommencement notification was filed with an appropriate official prior to a tender offer, a large number of states would not allow a tender offer to commence.[47] In contrast, the Williams Act requires disclosure at the commencement of a tender offer when the offeror files a schedule with the SEC.[48] Second, under the Williams Act, both bidder and the target company are required to disclose information,[49] whereas first generation statutes required only the tender offeror to reveal information.[50] Third, the state statutes generally required more extensive and detailed disclosure than the Williams Act.[51] Finally, "friendly" offer exemptions[52] and administrative determinations on the fairness of the tender offer[53] were clearly unique to state takeover statutes.[54] Nevertheless, challenges to these stringent statutes led many lower courts to strike down these first generation statutes as unconstitutional under the supremacy and commerce

---

45. *See, e.g.*, *MITE*, 457 U.S. at 635 (finding Illinois statute favored incumbent management). *See also Limited Third Generation*, *supra* note 2, at 415.

46. *See* Note, *Second Generation State Takeover Legislation: Maryland Takes a New Tack*, 83 MICH. L. REV. 433, 438 (1984).

47. *See* Comment, *supra* note 24, at 665. The states required notification and disclosure anywhere from 10 to 60 days before the offer was to commence. *Id.* at 666.

48. *See* Note, *supra* note 35, at 725.

49. *Id.* at 723. *See also supra* note 34 and accompanying text. The disclosure duties of the target corporation are set forth in the Code of Federal Regulations. *See* 17 C.F.R. § 240.14d-5 (1985).

50. *See* Note, *supra* note 35, at 725.

51. *Id.*

52. *See, e.g.*, GA. CODE ANN. § 22-1902(b) (Supp. 1984) (statutory exception to the application of the statute).

53. *See, e.g.*, ME. REV. STAT. ANN., tit. 13, § 804 (Supp. 1981) (providing that a public hearing on the fairness of the takeover bid must be held within 20 days after filing of the disclosure statement). These "fairness hearings" can often be instituted upon the request of the target company or by the state's securities commissioner, secretary of state, or other official. These hearings may focus upon the equality of the offering to all shareholders as well as the content and extent of disclosure. *See* Note, *supra* note 35, at 725.

54. Note, *supra* note 46, at 438-39.

clauses.[55] Subsequently, the issue of the constitutionality of state takeover legislation was addressed by the United States Supreme Court.[56]

C. *Edgar v. MITE Corp.*

In *Edgar v. MITE Corp.*,[57] the Supreme Court ruled that the Illinois Business Takeover Act[58] was unconstitutional under the commerce clause.[59] Though the Court was extremely fragmented,[60] it did agree that the Illinois takeover statute was invalid because it

---

55. *See, e.g.*, Kennecott Corp. v. Smith, 637 F.2d 181 (3d Cir. 1980) (New Jersey takeover law found to violate the supremacy clause); Crane Co. v. Lam, 509 F. Supp. 782 (E.D. Pa. 1981) (Pennsylvania takeover statute found to violate the supremacy and commerce clauses); Dart Indus., Inc. v. Conrad, 462 F. Supp. 1 (S.D. Ind. 1978) (Delaware takeover statute found to violate the supremacy and commerce clauses).

56. The first case on point to reach the Court was decided on procedural grounds. Great W. United Corp. v. Kidwell, 577 F.2d 1256 (5th Cir. 1978) (Idaho takeover statute found to violate the supremacy and commerce clauses), *rev'd on other grounds sub nom.* Leroy v. Great W. United Corp., 443 U.S. 173 (1979).

57. 457 U.S. 624 (1982). In this case, MITE Corporation, a Delaware corporation based in Connecticut, announced a cash tender offer for the stock of Chicago Rivet and Machine Company, a publicly held Illinois corporation. *Id.* at 626-28. Despite the fact that the Illinois takeover statute clearly applied in this situation, MITE refused to comply and filed suit in federal district court against the target company and the Illinois Secretary of State. *Id.* The district court issued a preliminary injunction which enjoined the application of the Illinois statute because of its unconstitutionality. *Id.* at 629. The Court of Appeals for the Seventh Circuit affirmed the district court's decision. *Id.* at 630. Subsequently, the U.S. Supreme Court also affirmed. *Id.*

58. ILL. REV. STAT. ch. 121-1/2, ¶¶ 137.51-.70 (1979) (repealed 1983). The Illinois takeover statute applied to any takeover bid where 10% of the target's shareholders were Illinois residents notwithstanding the fact that the company was not incorporated or headquartered in Illinois. The legislation was typical of many first generation statutes in that it contained: (1) a precommencement notification requirement whereby the offeror had to notify the secretary of state 20 days before the offer; (2) a hearing provision during the 20-day waiting period allowing the secretary of state to adjudicate the fairness of the offer; and (3) a substantive fairness provision allowing the secretary of state to deny tender offer registration when the offer is deemed unfair or where full disclosure has not been made.

59. *See MITE*, 457 U.S. at 625, 646.

60. The Court's opinion consisted only of a discussion of the facts and a brief commerce clause analysis written by Justice White, which was joined by Justices Blackmun, Powell, and O'Connor and Chief Justice Burger. *Id.* at 626-31, 643-46. Justice White also wrote an extensive plurality opinion joined by Justice Blackmun and Chief Justice Burger viewing the Illinois takeover law as preempted by the Williams Act. *Id.* at 631-40. Justices Brennan, Marshall, Powell and Rehnquist thought the case was moot but Justice Powell still reached the merits of the case. *Id.* at 646.

"impos[ed] a substantial burden on interstate commerce which outweigh[ed] its putative local benefits."[61] In reaching this holding, the Court applied the test of *Pike v. Bruce Church, Inc.*[62] which provides that a state statute regulating interstate commerce, even indirectly, will be invalidated if the burden imposed on commerce is excessive in relation to the local interests served by the statute.[63] The Illinois takeover statute failed the *Pike* test because the law imposed a nationwide jurisdictional reach which gave Illinois the purported power to determine whether a tender offer might proceed anywhere.[64] This interstate burden, according to the Court, outweighed the state interest of protecting resident shareholders as well as its interest in regulating the internal affairs of its corporations.[65] Specifically, the *MITE* Court found that Illinois had "no legitimate interest in protecting nonresident shareholders";[66] moreover, the Court was not convinced that the takeover statute significantly enhanced shareholder protection beyond the Williams Act's substantive provisions.[67] The Court also rejected applying the internal affairs doctrine for two reasons: (1) since tender offers intend that stock be transferred to third parties, the internal affairs of the target company are not involved;[68] (2) the takeover statute applies to companies not incorporated in the state or having their principal place of business there.[69] In sum, the Court found that the Illinois statute was overreaching under the commerce clause because it affected foreign corporations and nonresident shareholders.[70]

---

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

62. 397 U.S. 137 (1970). In *Pike*, the Court held unconstitutional an order by an Arizona agriculture official which prohibited Bruce Church from shipping its Arizona cantaloupes to California unless they were packed in an approved manner. The *Pike* Court enunciated a balancing test for state statutes that affect interstate commerce: "Where the statute regulates even-handedly 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 [interstate] commerce is clearly excessive in relation to the putative local benefits." *Id.* at 142. The *Pike* test looks to "the nature of the local interest involved, and on whether it could be promoted as well with a lesser impact on interstate activities." *Id.* at 142.

63. *Id.* at 142.

64. *MITE*, 457 U.S. at 643.

65. *Id.* at 644.

66. *Id.*

67. *Id.*

68. *Id.* at 645. *See also Great W. United Corp.*, 577 F.2d at 1280 n.53; RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 302 Comment b (1971).

69. *MITE*, 457 U.S. at 645.

70. *Id.* at 646.

Justice White also wrote a plurality opinion on the preemption issue, viewing the Illinois statute as conflicting with the Williams Act by creating unreasonable delays which favored target management over offerors.[71] Although the opinion notes that "Congress did not explicitly prohibit States from regulating takeovers,"[72] a state takeover statute is void to the extent that it substantially frustrates the objectives of the Williams Act.[73] The *MITE* plurality found that the Illinois statute upset the balance established by the Williams Act through its precommencement notification provisions.[74] In addition, the plurality criticized the substantive fairness provision because it might cause an unreasonable delay in commencing a tender offer.[75] Furthermore, the fairness hearings which allowed the Illinois Secretary of State to deny registration was inconsistent with the legislative intent of the Williams Act since "Congress intended for investors to be free to make their own decisions."[76] In sum, the plurality viewed the Illinois statute as preempted by the Williams Act and therefore unconstitutional under the supremacy clause.[77]

D. Second Generation Takeover Statutes

As a practical matter, *MITE* invalidated many of the first generation statutes.[78] Consequently, state legislatures fashioned new laws that would attempt to impede local takeovers but which would also withstand constitutional challenges to their validity.[79] After *MITE*, Ohio, New York, Maryland, and Pennsylvania adopted four different approaches, each attempting to couch their takeover statute in terms of each respective state's corporate law.[80] The Ohio type statute, a control share acquisition statute, requires approval by a majority of

---

71. *Id.* at 639.
72. *Id.* at 631.
73. *Id.*
74. *Id.* at 635 (finding the precommencement period provided target company with time to distribute information to its shareholders about impending offer but offeror was not permitted to disclose any information, thus giving incumbent management a distinct advantage).
75. *Id.* at 637.
76. *Id.* at 639.
77. *See id.* at 630-34.
78. *See* Kozyris, *Corporate Wars and Choice of Law*, 1985 DUKE L.J. 1, 76 (1985).
79. *Id.*
80. BNS Inc. v. Koppers Co., 683 F. Supp. 458, 463 (D. Del. 1988) (characterizing the four different types of second generation statutes as traditional corporate law).

the target's disinterested shareholders before an acquirer can consummate purchases above 20%, 33-1/3%, or 50% of the corporation's stock.[81] Typically, most control share acquisition statutes withhold the voting rights of the acquirer rather than blocking the transactions outright.[82]

The New York type statute, often referred to as a "freeze-out" statute, prevents mergers or other business combinations between a 20% shareholder and the target for a five-year period.[83] If the target company's board gives advance approval to the business combination before the acquirer reaches the 20% threshold, the five-year moratorium is waived.[84] The New York freeze-out statute has no other significant exceptions beyond board approval. Nevertheless, the New York statute requires other nexus besides incorporation of the target, such as headquarters located in the state and 10% of the voting stock to be owned by New York residents.[85]

The Maryland type statute, a "fair price" statute, imposes a statutory fair price formula upon business acquisitions such as a merger, sale of assets, or liquidation, but not tender offers. It also contains a supermajority provision for shareholder approval.[86] These fair price statutes generally require a successful tender offeror planning a second-step merger to either pay a fair price or obtain supermajority approval from the shareholders.[87]

Finally, the Pennsylvania type statute, sometimes called "dissenter rights" statutes, creates a statutory right of redemption which requires a person acquiring more than 30% of the stock to pay the remaining shareholders the "fair value" of their stock.[88] The statute also provides that certain transactions between a corporation and one or more of its shareholders must be approved by a majority of disinterested shareholders.[89] Both fair price and dissenter rights sta-

---

81. OHIO REV. CODE ANN. § 1701.831 (Anderson 1985).

82. *See, e.g.*, IND. CODE §§ 23-1-17-1 to -5 (Supp. 1986) (the Indiana statute which was upheld in *CTS* prevents an acquirer from obtaining voting rights after crossing "control" levels of 20%, 33-1/3%, or 50% unless a majority of the disinterested shareholders approve). *Id.* § 23-1-42-1.

83. N.Y. BUS. CORP. LAW § 912 (McKinney 1986).

84. *Id.* § 912(b).

85. *Id.* § 912(a)(13).

86. MD. CORP. & ASS'NS CODE ANN. §§ 3-601 to -603 (Supp. 1986).

87. *See* Hanks, *State Takeover Laws: The Second Generation*, Nat'l L.J., Nov. 3, 1986, at 34, col. 2.

88. PA. STAT. ANN. tit. 15, § 1409.1 (Purdon Supp. 1988).

89. *Id.*

tutes are primarily geared to protecting shareholders against the coercive effects of two-tiered tender offers.[90] Yet, these second generation statutes still faced the same constitutional challenges as the first generation statutes; the *MITE* decision gave lower courts considerable flexibility but no real guidance for evaluating the constitutional status of state takeover laws.[91] Nonetheless, the various federal circuits struck down several of these second generation statutes as unconstitutional under the commerce and supremacy clauses.[92]

III. *CTS CORP. v. DYNAMICS CORP. OF AMERICA*

The uncertainty over state regulatory schemes restricting hostile takeovers was resolved to a large degree by the Supreme Court in *CTS Corp. v. Dynamics Corp. of America.*[93] In its decision, the Court reversed the Court of Appeals for the Seventh Circuit which had struck down an Indiana takeover law as inconsistent with the Williams Act and as a violation of the commerce clause.[94] The Court reaffirmed the states' power over internal corporate affairs and cleared the way for further development of state regulation of acquisitions involving its corporations.[95] The Indiana statute at issue was a control share acquisition statute which was found not to conflict with the Williams

---

90. *See generally* Note, *Second Step Transactions in Two-Tiered Takeovers: The Case for Regulation*, 19 GA. L. REV. 343 (1985). Two-tiered tender offers are accomplished in two stages: (1) the front-end bid which has the bidder making a tender offer sufficient to obtain majority control so the target can merge into the bidder; (2) subsequently, the back-end freeze-out merger eliminates the other shareholders who failed to tender their shares in the front-end bid. These minority shareholders usually receive a lower price for their stock and may not even get cash but instead receive some other form of debt or equity security. *Id.* Many courts and commentators argue that the coerciveness inherent in the tender offer process is maximized in a two-tiered offer. *See, e.g.*, Horwitz v. Southwest Forest Indus., 604 F. Supp. 1130, 1133 (D. Nev. 1985) (discussing the unfairness of front-end loaded, two-tiered tender offers); Brudney & Chirelstein, *Fair Shares in Corporate Mergers and Takeovers*, 88 HARV. L. REV. 297, 336-40 (1974); Greene & Junewicz, *A Reappraisal of Current Regulation of Mergers and Acquisitions*, 132 U. PA. L. REV. 647, 679-81 (1984).

91. Note, *The Unsung Death of State Takeover Statutes:* Edgar v. MITE Corp., 24 B.C.L. REV. 1017, 1047 (1983).

92. *See supra* note 13.

93. 107 S. Ct. 1637 (1987).

94. Dynamics Corp. of Am. v. CTS Corp., 794 F.2d 250, 262-64 (7th Cir. 1986), *rev'd*, 107 S. Ct. 1637 (1987).

95. *See* Trevor & Edwards, CTS *Reaffirms State Role in Corporate Affairs*, Nat'l L.J., Feb. 8, 1988, at 22, col. 3. The Court has held previously that states are not precluded under the commerce clause from regulating consolidations and mergers under the states' police power. *See* Louisville & Nashville R.R. v. Kentucky, 161 U.S. 677, 702 (1896); Ashley v. Ryan, 153 U.S. 436, 443-46 (1894).

Act, nor was it violative of the commerce clause because it was sufficiently related to the state's corporate law so as to come under the "internal affairs" doctrine.[96]

A. The Facts

The Indiana Business Corporation Law was revised in early March of 1986 and included the addition of a Control Share Acquisitions Chapter.[97] The Indiana statute applied to any corporation incorporated in Indiana beginning on August 1, 1987, unless the corporation amended its articles of incorporation or bylaws to opt out of the statute.[98] Prior to the Indiana statute's operational date, any Indiana corporation could have opted into the statute by a resolution of its board of directors. This statute applies only to "issuing public corporations"[99] which include businesses that are incorporated in Indiana and have a substantial number of Indiana shareholders.[100] However, it becomes operative only when an acquirer obtains "control shares" that would bring its voting power up to or above any one of three thresholds: 20%, 33-1/3%, or 50%.[101]

---

96. *See CTS*, 107 S. Ct. at 1652.

97. IND. CODE §§ 23-1-17-1 to -27-11 (Supp. 1986).

98. IND. CODE §§ 23-1-17-3(a), (b) (Supp. 1986).

99. IND. CODE § 23-1-42-4(a) (Supp. 1986). This section defines an "issuing public corporation" as a corporation that has:

(1) One hundred (100) or more shareholders;

(2) Its principal place of business, its principal office, or substantial assets within Indiana; and

(3) Either:

(A) More than ten percent (10%) of its shareholders resident in Indiana;

(B) More than ten percent (10%) of its shares owned by Indiana residents; or

(C) Ten thousand (10,000) shareholders resident in Indiana.

Id.

100. *Id.*

101. *Id.* § 23-1-42-1. This provision defines the meaning of control shares as follows:

As used in this chapter, "control shares" means shares that, except for this chapter, would have voting power with respect to shares of an issuing public corporation that, when added to all other shares of an issuing public corporation owned by a person or in respect to which that person may exercise or direct the exercise of voting power, would entitle that person, immediately after acquisition of the shares (directly or indirectly, alone or as part of a group), to exercise or direct the exercise of the voting power of the issuing public corporation in the election of directors within any of the following ranges of voting power:

(1) One-fifth (1/5) or more but less than one-third (1/3) of all voting

The Indiana statute prevents the acquirer from gaining voting rights once these levels have been reached until a majority of all the disinterested shareholders holding each class of stock grants these rights.[102] The practical effect of this requirement is to condition the acquisition of control of a corporation on the approval of a majority of the preexisting, disinterested shareholders.[103]

In early 1986, Dynamics Corporation of America, a New York corporation, announced a tender offer for a million shares of stock in CTS Corporation which would increase Dynamics's ownership interest from 9.6% to 27.5%.[104] In addition, on that same day, Dynamics filed suit in the United States District Court for the Northern District of Illinois, alleging that CTS had violated certain federal securities laws.[105] In late March, CTS's board of directors elected to be governed by the provisions of the Indiana statute.[106] Four days later, Dynamics moved for leave to amend its complaint to allege that the Indiana statute was preempted by the Williams Act and violated the commerce clause.[107] Dynamics sought from the district court a temporary restraining order, a preliminary injunction, and declaratory relief against CTS's use of the Illinois takeover statute.[108]

B. The District Court

The district court issued a series of orders which granted Dynamics a preliminary injunction and declaratory relief.[109] Initially,

---

power.

(2) One-third (1/3) or more but less than a majority of all voting power.

(3) A majority or more of all voting power.

Id.

102. *Id.* § 23-1-42-9. A resolution granting the acquirer control shares voting rights shall be made at a special shareholders meeting. *Id.* § 23-1-42-7(a). Unless the acquirer agrees to another date, the special shareholders meeting must be held within 50 days after making a tender offer. *Id.* § 23-1-42-7(b).

103. *See CTS*, 107 S. Ct. at 1641.

104. *Id.* at 1642.

105. *Id.* (violations were not enunciated in the opinion because the court deemed them as being irrelevant to the proceedings).

106. *Id.*

107. *Id.*

108. *Id.*

109. Dynamics Corp. of Am. v. CTS Corp., 635 F. Supp. 1174 (May 3, 1986) (preliminary injunction denied); 637 F. Supp. 389 (Apr. 9, 1986) (declaratory judgment, statute unconstitutional as applied); 637 F. Supp. 406 (Apr. 17, 1986) (preliminary injunction of implementation of shareholder rights plan granted); 638 F. Supp. 802 (N.D. Ill. June 20, 1986) (decisions of Apr. 17 and May 3 adhered to), *aff'd*, 794 F.2d 250 (7th Cir. June 9, 1986), *rev'd* 107 S. Ct. 1637 (1987).

the district court held that the Indiana statute violated the supremacy clause because it violated the policy of neutrality between management and offerors implied in the Williams Act.[110] Judge Getzendanner based her preemption analysis on the *MITE* plurality opinion reasoning that "state laws which build extended delays into the tender offer process are themselves in conflict with the federal law."[111] Since a shareholder meeting to confer voting rights may take up to fifty days, this delay favors the incumbent management over the tender offeror and conflicts with the twenty-day timetable of the Williams Act.[112] Consequently, the court found that this "situation wholly frustrates the purpose and objective of Congress in striking a balance between the investor, management, and the takeover bidder in takeover contests."[113] One week later, the district court issued another opinion which relied on the *MITE* majority opinion and concluded that the Indiana statute violated the commerce clause.[114] The court found that because the Indiana statute denied an integral aspect of stock ownership, i.e., voting rights, it deprived the transaction of value and thus "the statute undeniably 'regulates' interstate commerce by restricting the sale and purchase of stock in interstate transactions."[115] Subsequently, CTS appealed the court's ruling to the Court of Appeals for the Seventh Circuit.[116]

C. The Seventh Circuit

The court of appeals affirmed the district court holding that the Indiana statute was preempted by the Williams Act and violated the commerce clause.[117] After disposing of other matters,[118] Judge Posner, writing for the court, relied on the *MITE* plurality's preemption analysis in finding that the state statute upsets the balance established by the Williams Act between offeror and management.[119] The fifty-day delay under the Indiana law conflicted with the twenty-business-

110. *CTS*, 637 F. Supp. at 396-97.
111. *Id.* at 398.
112. *Id.* at 397.
113. *Id.* at 399 (citing *MITE*, 457 U.S. at 637-38).
114. *Id.* at 406.
115. *Id.* at 402.
116. Dynamics Corp. of Am. v. CTS Corp., 794 F.2d 250 (7th Cir. 1986), *rev'd*, 107 S. Ct. 1637 (1987).
117. *Id.*
118. Much of Judge Posner's opinion was devoted to the district court's order enjoining CTS from adopting a "poison pill" takeover defense. *See id.*
119. *Id.* at 261.

day minimum established by the SEC[120] in which a tender offer must remain open.[121] Consequently, the state takeover law favored management over offerors because management would benefit significantly by the longer delay.[122] As a result, the court found the Indiana statute preempted by the Williams Act and therefore invalid under the supremacy clause.[123] With respect to the commerce clause, the court applied the *Pike* balancing test to find that the Indiana statute imposed burdens on interstate commerce that were "excessive in relation to its putative local benefits."[124] The court explained that Indiana had no interest in protecting nonresident shareholders, and the takeover statute gravely impaired Dynamics, a nonresident corporation, from conducting business with nonresident shareholders of CTS.[125] The court concluded that the statute excessively impeded interstate commerce since "Indiana has erected a barrier at once formidable and arbitrary to tender offers whose principal effects will be felt outside Indiana" and thereby violated the commerce clause.[126]

D. *The Supreme Court*

The Supreme Court decided by a six to three vote that the Indiana takeover statute was constitutional, thus reversing the judgment of the court of appeals.[127] Justice Powell authored the majority opinion[128] which held that the takeover statute was neither preempted

---

120. *See* 17 C.F.R. § 240.14e-1(a) (1987).
121. *CTS*, 794 F.2d at 261.
122. *Id.* at 262.
123. *Id.* at 262-63.
124. *Id.* at 263.
125. *Id.*
126. *Id.* at 264.
127. CTS Corp. v. Dynamics Corp. of Am., 107 S. Ct. 1637 (1987).
128. The Court's opinion written by Justice Powell was joined by Justices Brennan, Marshall, and O'Connor and Chief Justice Rehnquist. Justice Scalia concurred in part with the Court's opinion. *Id.* at 1640. The *CTS* Court represents a much more cohesive majority than the *MITE* Court which was extremely fragmented and could only agree on utilizing the *Pike* test to strike down the Illinois takeover law on commerce clause grounds. Nevertheless, the Justices appeared to line up behind the Court's opinion for different reasons: Justices O'Connor and Scalia and Chief Justice Rehnquist probably opted for the internal affairs approach because of their philosophy advocating states' rights; Justices Brennan, Marshall, and Powell probably were more concerned with the practical effects of hostile takeovers on employees and communities. *See generally* H. BLOOMENTHAL, SECURITIES LAW HANDBOOK § 20.07, at 583 (1987-88 ed.) (discussing what the breakdown in voting was in *MITE*).

by the Williams Act nor in violation of the commerce clause.[129] Justice Scalia wrote a concurring opinion which agreed with the majority that the statute did not violate the commerce clause, but he refused to go into the balancing aspects of the Court's commerce clause analysis.[130] Moreover, Justice Scalia found it unnecessary to go beyond a conflicting provision test in determining whether the statute was preempted.[131] Justice White dissented stating that the Indiana takeover statute was unconstitutional since it was preempted by the Williams Act and in conflict with the commerce clause.[132]

1. The Preemption Analysis

After reviewing the facts and the procedural posture,[133] the Court examined whether the Indiana statute was preempted by the Williams Act.[134] The Court noted that a state law is preempted only "where compliance with both federal and state regulations is a physical impossibility"[135] or if the "law stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress."[136] Since it was physically possible for entities to comply with both the Williams Act and the Indiana statute, the Court said that the state statute could be preempted only if it frustrated a purpose of the federal law.[137] Thus, the Court focused on whether the Indiana statute frustrated the congressional purposes behind the enactment of the Williams Act.[138]

After reviewing the legislative intent of the Williams Act,[139] the Court emphasized that it was not bound by the *MITE* plurality regarding the preemption issue. Nevertheless, the Court proceeded

---

129. *CTS*, 107 S. Ct. at 1652.

130. *Id.* at 1652-53.

131. *Id.* at 1653.

132. *Id.* at 1653-56. Justice White was joined by Justices Blackmun and Stevens in Part II of the dissent which viewed the Indiana control share acquisition statute as invalid under the commerce clause. *Id.* at 1655-56.

133. *Id.* at 1641.

134. *Id.* at 1644.

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

136. *Id.* (quoting Hines v. Davidowitz, 312 U.S. 52, 67 (1941); Ray v. Atlantic Richfield Co., 435 U.S. 151, 158 (1978)).

137. *Id.*

138. *Id.*

139. *Id.* at 1644-45. The Court reiterated its position that the Williams Act is intended to protect investors through disclosure requirements and to regulate tender offers through procedural rules.

to approach Indiana's control share acquisition statute from within the *MITE* plurality's framework.[140] The primary concern of the *MITE* plurality was that the state takeover law strongly favored the target's management over the tender offeror, and this tip in the scales upset the careful balance that the Williams Act set between offerors and management.[141] The *CTS* Court distinguished the Williams Act from the law struck down in *MITE* stating that:

> [u]nlike the *MITE* statute, the Indiana Act does not give either management or the offeror an advantage in communicating with the shareholders about the impending offer. The Act also does not impose an infinite delay on tender offers. . . . Nor does the Act allow the state government to interpose its views of fairness between willing buyers and sellers of the target company. Rather, the Act allows *shareholders* to evaluate the fairness of the offer collectively.[142]

Consequently, the Court viewed the Indiana statute as furthering the federal policy of investor protection by allowing shareholders to insulate themselves from the coercive aspects of tender offers by voting as a group.[143]

The Court specifically addressed the Seventh Circuit's finding that the fifty-day delay under the Indiana statute precluded an offeror from purchasing shares as soon as the federal law permitted.[144] Since voting rights may not be conferred until a special stockholder meeting, which must be convened within fifty days after the commencement of the offer, the court of appeals found that the statute conflicted with the twenty-business-day period established by federal law.[145] However, the Court viewed the "alleged conflict illusory"[146] stating that "[i]f an offeror fears an adverse shareholder vote under the Act,

---

140. *Id.* at 1645.

141. *MITE*, 457 U.S. at 632-34.

142. *CTS*, 107 S. Ct. at 1646.

143. *Id.* It is interesting to note that the Supreme Court implied endorsement of the conventional wisdom that tender offers are inherently coercive and that as a result target shareholders "are at a disadvantage." *Id.*

144. *Id.* at 1647.

145. *Id.* Delay is a powerful weapon for incumbent management because it allows them time to set up defensive tactics to fight off the takeover bid. *See* Langevoort, *State Tender-Offer Legislation: Interests, Effects, and Political Competency*, 62 CORNELL L. REV. 213, 238 (1977); Wachtell, *Special Tender Offer Litigation Tactics*, 32 BUS. LAW. 1433, 1437-42 (1977).

146. *CTS*, 107 S. Ct. at 1647.

it can make a conditional tender offer, offering to accept shares on the condition that the shares receive voting rights within a certain period of time."[147] Moreover, the Court stated that even if there was a delay imposed by the statute, the delay was still within the congressionally determined period of time[148] and therefore not unreasonable.[149]

Finally, the Court found that other devices, such as staggering the terms of directors[150] or cumulative voting,[151] might delay takeovers but rejected the notion that these traditional state controls should be preempted by the Williams Act.[152] The Court viewed the delay of voting control as having longstanding prevalence within the dominion of state regulation.[153] In sum, the Court stated that "if Congress had intended to preempt all state laws that delay the acquisition of voting control, it would have said so explicitly. The regulatory conditions that the Act places on tender offers are consistent with the text and purposes of the Williams Act."[154]

2. The Commerce Clause Analysis

The next issue the Court addressed was whether the Indiana statute violated the commerce clause by imposing an unfair burden on interstate commerce. The Court stated that the dormant commerce clause[155] has historically prohibited states from taking certain actions with respect to interstate commerce; however, the mere burden imposed by a state regulation on some interstate companies is not

---

147. *Id.*

148. Congress has established a 60-day maximum period for how long a tender offer may be held open. 15 U.S.C. § 78n(d)(5).

149. *CTS*, 107 S. Ct. at 1647.

150. Staggered terms provide for different classes of directors to be elected at different times by the shareholders; typically, most staggered boards have three classes of directors where one-third are elected annually to serve three-year terms. H. HENN & J. ALEXANDER, LAWS OF CORPORATIONS 556-57 (3d ed. 1983).

151. Cumulative voting is a form of proportional representation to assure that minority shareholders have a voice on the board of directors. Every share carries with it as many votes as there are vacancies to be filled, and the shareholders may distribute votes among the candidates. *Id.* at 495.

152. *CTS*, 107 S. Ct. at 1647-48.

153. *Id.* at 1648.

154. *Id.*

155. The commerce clause grants to Congress the power "[t]o regulate Commerce . . . among the several States . . . ." U.S. CONST. art. I, § 8, cl. 3. Still, the "dormant commerce clause" has been held to prohibit certain state actions with respect to interstate commerce even absent congressional action. *See* Cooley v. Board of Wardens, 53 U.S. (12 How.) 298 (1852).

sufficient to sustain a discrimination claim under the clause.[156] Since nothing in the Indiana statute imposes a greater burden on out-of-state offerors than in-state offerors, the Court rejected the argument that the takeover statute discriminated against interstate commerce.[157]

Additionally, the Court found that the Indiana statute could not be invalidated because of its risk in generating inconsistent regulation among the states which might interfere with interstate commerce.[158] Though the commerce clause prohibits states from regulating subjects that are national in nature, if each state regulates the voting rights for the corporations it has created, each corporation will be subject to the law of only one state.[159] Thus, the Court applied the internal affairs doctrine which allows each state to regulate its domestic corporations,[160] including the power to define the voting rights of shareholders.[161] Under this internal affairs approach, the Court found that the Indiana statute was consistent with the commerce clause because it did not create an impermissible risk of inconsistent regulation by different states.[162]

The Court rejected the Seventh Circuit's view that the Indiana control share acquisition statute violated the commerce clause because of its potential for hindering tender offers.[163] Once again, the internal affairs doctrine, which views a corporation as a creature of the state of incorporation and therefore subject to its regulation, was the premise of the Court's reasoning.[164] The statute's primary purpose

---

156. *CTS*, 107 S. Ct. at 1649. Dynamics asserted that the Indiana statute would "apply most often to out-of-state entities." *Id.* The Court believed this was based on the contention that the majority of hostile takeovers would come from out-of-state offerors. *Id.*

157. *Id.*

158. *Id.*

159. *Id.*

160. Although the Court did not use the phrase "internal affairs doctrine," it was noted that "no principle of corporation law and practice is more firmly established than a state's authority to regulate domestic corporations. . . ." *Id.*

161. *Id. See* RESTATEMENT (SECOND), *supra* note 68, § 302 (which concludes that the law of the incorporating state should generally determine the right of a shareholder to participate in the administration of the corporation's affairs). *See also* Harr v. Pioneer Mechanical Corp., 65 F.2d 332 (2d Cir.), *cert. denied*, 290 U.S. 673 (1933).

162. *CTS*, 107 S. Ct. at 1649.

163. *Id.*

164. *Id.* at 1649-50. The Court stated that it "is an accepted part of the business landscape in this country for states to create corporations, to prescribe their powers and to define the rights that are acquired by purchasing their shares." *Id.* at 1650.

is to protect shareholders of Indiana corporations, and "it is well within the State's role as overseer of corporate governance"[165] to afford "shareholders, when a takeover offer is made, an opportunity to decide collectively whether the resulting change in voting control of the corporation, as they perceive it, would be desirable."[166] The Court viewed the autonomy granted under the Indiana statute as entirely consistent with the state's interest in preventing unfair business dealings, especially since the statute only operates when a significant number of shareholders are Indiana residents.[167] Furthermore, the state has an interest in defining the characteristics of its corporations' stock.[168] The Court concluded that:

> [t]he very commodity that is traded in the securities market is one whose characteristics are defined by state law. Similarly, the very commodity that is traded in the "market for corporate control"—the corporation—is one that owes its existence and attributes to state law. Indiana need not define these commodities as other States do; it need only provide that residents and nonresidents have equal access to them. This Indiana has done. Accordingly, even if the Act should decrease the number of successful tender offers for Indiana corporations, this would not offend the Commerce Clause.[169]

Consequently, the *CTS* Court did not directly apply the *Pike* test in balancing the statute's local benefits against its burden to interstate commerce. Rather, the Court emphasized the internal affairs doctrine which gives the state a role in defining and regulating the corporations it charters.[170]

3. The Concurrence

Justice Scalia concurred in the Court's opinion insofar as finding that the Indiana statute neither discriminated against interstate com-

---

165. *Id.* at 1651.

166. *Id.*

167. *Id.* at 1651-52. The Indiana statute applies only to "issuing public corporations" and, among other things, requires that the corporation have either (a) more than 10% of its shareholders resident in Indiana; (b) more than 10% of its shares owned by Indiana residents; or (c) 10,000 shareholders resident in Indiana. *See* IND. CODE § 23-1-42-4(a) (Supp. 1986).

168. *See CTS*, 107 S. Ct. at 1652.

169. *Id.*

170. *Id.* at 1651-52.

merce nor created an impermissible risk of inconsistent regulation by different states.[171] Yet, he believed that the Court should rarely, if ever, attempt to balance a statute's burden on interstate commerce against the putative local benefits as has been the Court's practice since *Pike v. Bruce Church, Inc.*[172] Justice Scalia cited one commentator[173] who argued that statutes that do not discriminate against commerce or present a threat of multiple and inconsistent burdens might still be struck down under such a balancing test.[174] Agreeing, Justice Scalia stated that "[a]s long as a State's corporation law governs only its corporations and does not discriminate against out-of-state interests, it should survive this Court's scrutiny under the Commerce Clause, whether it promotes shareholder welfare or industrial stagnation. Beyond this, it is for Congress to prescribe its invalidity."[175]

Justice Scalia also agreed with the Court that the Indiana takeover statute was not preempted by the Williams Act. He based this conclusion, however, on the antipreemption provision of the 1934 Act[176] which forecloses preemption unless the state statute has a conflicting provision rather than a conflicting purpose.[177] Applying this "conflicting provision" test, Justice Scalia found the Indiana statute consistent with the Williams Act. Furthermore, he noted that Congress has never intentionally interfered with the state's power to govern its corporations in prescribing voting rights.[178] Finally, the concurrence commented that, although it did not share the Court's apparent high estimation of such takeover legislation, "a law can be both economic folly and constitutional" and the Indiana statute was at least the latter.[179]

---

171. *Id.*

172. 397 U.S. 137 (1970). *See also CTS*, 107 S. Ct. at 1652.

173. *CTS*, 107 S. Ct. at 1653 (citing Regan, *The Supreme Court and State Protectionism: Making Sense of the Dormant Commerce Clause*, 84 MICH. L. REV. 1091 (1986)).

174. *CTS*, 107 S. Ct. at 1653.

175. *Id.*

176. 15 U.S.C. § 78bb(a) (1982). This provision provides that nothing it contains "shall affect the jurisdiction of the securities commission (or any agency or officer performing like functions) of any State over any security or any person insofar as it does not conflict with the provisions of this chapter or the rules and regulations thereunder." *Id.*

177. *CTS*, 107 S. Ct. at 1653.

178. *Id.*

179. *Id.*

4. The Dissent

Justice White authored a dissenting opinion in which he disagreed with the majority's opinion that the Indiana statute was not preempted by the Williams Act or in violation of the commerce clause.[180] In his preemption analysis, Justice White observed that the primary purpose of the Williams Act was to protect individual investors, and the Indiana statute frustrates this federal policy by often preventing individual investors from selling their stock at a premium.[181] Though the takeover statute unquestionably protects the interests of a majority of shareholders, it may, at the majority's discretion, prevent minority shareholders from tendering their shares to a willing offeror.[182] He concluded that the statute is preempted by the Williams Act because "Indiana's scheme conflicts with the Williams Act's careful balance which was intended to protect individual investors and permit them to decide whether it is in their best interest to tender their stock."[183]

In his commerce clause analysis, Justice White argued that Indiana's control share acquisition statute is a restraint on the transferability of voting rights in specified transactions;[184] since voting rights are an integral part of stock ownership, the statute is effectively a restraint on the national securities trade.[185] He stated that the Framers included the commerce clause in the Constitution because they recognized "that in order to succeed, the new Union would have to avoid the tendencies toward economic Balkanization."[186] In his view, the Indiana statute engages in the very type of economic protectionism that the Framers sought to prevent through the commerce clause.[187] Justice White reasoned that unlike state blue sky laws,[188] the Indiana takeover law regulates stock transactions in in-

---

180. *Id.*
181. *Id.* at 1653-54.
182. *Id.* at 1654.
183. *Id.*
184. *Id.* at 1655.
185. *Id.*
186. *Id.* (quoting Hughes v. Oklahoma, 441 U.S. 322, 325-26 (1979)).
187. *Id.*
188. State statutes which relate to securities fraud are usually referred to as "blue sky laws" and were enacted long before the Security Exchange Act of 1933. State legislatures felt it necessary to regulate in this area because of the intricate nature of the securities market and the availability of opportunities for dishonesty in the business of trading securities. *See* L. LOSS & E. COWETT, BLUE SKY LAW 3 (1958). *See also* 14 W. FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 6737 (1987).

terstate commerce and thereby substantially interferes with trading in the interstate securities markets.[189] Justice White, who authored the majority opinion in *MITE* which struck down that takeover law on commerce clause grounds, similarly concluded that the Indiana statute was in conflict with the commerce clause and should be found unconstitutional.[190]

IV. EVALUATION

The *CTS* decision reaffirms the states' power to regulate takeovers of corporations that they charter based upon their authority over corporate governance.[191] The power of the state to regulate the corporate structure under the internal affairs doctrine is buttressed by other factors such as the principal place of business, the number of resident shareholders, the concentration of shares within the state, and the amount of assets that the corporation holds within the state.[192] In addition, the state, under the control share acquisition statute, plays no supervisory role in determining the fairness of the tender offer.[193] Most significantly, the Indiana takeover statute is jurisdictionally limited to the state of incorporation, unlike the first generation statutes struck down by *MITE*.[194] Instead of applying the *Pike* balancing test as in *MITE*, the *CTS* Court applied the internal affairs doctrine, a conflict of laws principle, as the primary basis for its holding that such takeover statutes, limited to the state of incorporation are constitutional.[195]

The Indiana statute can also be distinguished from the Illinois statute struck down in *MITE* in the following respects: (1) the Indiana statute protects shareholders from both offerors and management rather than favoring management against offerors to the detriment of shareholders; (2) the Indiana statute does not have the potential for unreasonable delay of the takeover process as did the Illinois statute; (3) the Indiana statute applies only to corporations that have

---

189. *CTS*, 107 S. Ct. at 1656.

190. *Id.*

191. *Id.* at 1649-50.

192. *Id.*

193. *See id.* at 1646. As was discussed earlier, this supervisory role was one factor which caused the Illinois statute to be found unconstitutional in *MITE*. *See supra* notes 57-77 and accompanying text (discussing *MITE*).

194. *See* Buxbaum, *The Threatened Constitutionalization of the Internal Affairs Doctrine in Corporation Law*, 75 CALIF. L. REV. 29, 33 (1987).

195. *CTS*, 107 S. Ct. at 1649-51.

a substantial number of resident shareholders unlike the Illinois statute; and (4) the Indiana statute does not discriminate against interstate commerce because it imposes no greater burden on out-of-state offerors than it does on in-state offerors.[196] After *CTS*, it appears clear that similar takeover statutes, which allow shareholders to collectively withhold voting rights from an acquirer, are constitutional.[197] In practice, control share acquisition statutes effectively deter tender offers by increasing the offeror's cost while reducing the chances of success.[198] Furthermore, the statutes deprive shareholders of a substantial premium for their shares as well as limit their ability to check incumbent management.[199] Most third generation statutes spurred on by *CTS* approach the problem of hostile takeovers by making substantive changes in the state's corporate law governing the internal affairs of corporations,[200] usually by fashioning an Indiana type control share acquisition statute.[201]

A. Constitutionality of Non-Control Share Takeover Statutes and the Evolving Third Generation of State Legislation

The constitutionality of state takeover statutes other than the control share acquisition type still remains somewhat questionable after *CTS*. The case stressed the limitations of the Indiana takeover statute, such as its applicability only to companies incorporated in

---

196. *See* REINHOLTZ & ZAJDEL, *supra* note 188, § 6738.

197. The states with control share acquisition statutes include: Hawaii, HAW. REV. STAT. §§ 416-171 to -172 (Supp. 1986); Indiana, IND. CODE ANN. § 23-1-42 (Burns 1986); Minnesota, MINN. STAT. ANN. § 302A.671 (West Supp. 1987); Missouri, MO. ANN. STAT. § 351.407 (Vernon Supp. 1986); Ohio, OHIO REV. CODE ANN. § 1701.831 (Anderson 1985); Wisconsin, WIS. STAT. ANN. § 180.25(9) (West Supp. 1986).

198. Note, *The Constitutionality of Second Generation Takeover Statutes*, 73 VA. L. REV. 203, 231 (1987).

199. *Id.* The consideration in a tender offer usually represents a substantial premium over the current market price of the securities. A SEC study of 148 tender offers between 1981 and 1982 revealed that the premium can range from 31.3% of the market price to 63.4%, depending on the type of tender offer. *See Proposed Rules*, 49 Fed. Reg. 26,755, 26,760, table 4 (June 29, 1984). *See also* Andre, *Tender Offers for Corporate Control: A Critical Analysis and Proposals for Reform*, 12 DEL. J. CORP. L. 865 (1987).

200. Buxbaum, *supra* note 194, at 32. Many states are overlapping various types of takeover statutes to optimize their influence in regulating corporate acquisitions. For example, Indiana has passed a freeze-out statute in addition to its control share acquisition statute. *Compare* IND. CODE ANN. § 23-1-43 (Burns 1987) *with* IND. CODE ANN. §§ 23-1-17-1 to -27-11 (Burns Cum. Supp. 1988).

201. *See supra* note 22 (states that have adopted third generation statutes).

that state,[202] and the fact that shareholders, rather than management or the state, collectively decide if a tender offeror should be granted voting rights.[203] Fair price statutes, first enacted in Maryland,[204] and then by several other states,[205] attempt to regulate takeovers through the internal affairs doctrine in a manner analogous to control share acquisition statutes.[206] Fair price statutes, however, usually permit the target's board of directors to determine the statute's applicability to the individual tender offer.[207] This allows management to negotiate transactions on behalf of shareholders without resorting to the fair price or supermajority provisions provided for in these statutes.[208] Though *CTS* does provide a narrow opening to submit fair price statutes to preemption scrutiny based upon the Williams Act,[209] it is difficult to measure what degree of bias in favor of management would be necessary for preemption.

---

202. *CTS*, 107 S. Ct. at 1649. A recent decision by the U.S. District Court for the Western District of Oklahoma ruled that an Oklahoma control share acquisition statute was unconstitutional because it attempted to regulate the internal affairs of corporations outside of Oklahoma. The court granted a preliminary injunction amid a takeover contest between two Delaware corporations which prevented management from invoking the Oklahoma statute's provisions; the court stated that the tender offeror was certain to prevail on the merits of its case because the law violated the commerce clause by creating an impermissible risk of inconsistent regulation of tender offers and voting rights among different states. TLX Acquisition Corp. v. Telex Corp., 679 F. Supp. 1022 (W.D. Okla. 1987). *See generally Oklahoma "Control-Share" Law Held Unconstitutional for Interfering in Affairs of Out-of-State Corporations*, 2 Corp. Counsel Weekly (BNA) 8 (Dec. 16, 1987) (discussing *TLX Acquisition Corp*).

203. *CTS*, 107 S. Ct. at 1646.

204. MD. CORPS. & ASS'NS CODE ANN. §§ 3-601 to -603 (Supp. 1987).

205. *See* Connecticut, CONN. GEN. STAT. ANN. §§ 33-374a to -374c (West Supp. 1986); Georgia, GA. CODE ANN. §§ 14-2-232 to -234 (Supp. 1986); Illinois, ILL. ANN. STAT. ch. 32 para. 7.85 (Smith-Hurd Supp. 1986); Kentucky, KY. REV. STAT. ANN. §§ 271A.396-.398 (Baldwin Supp. 1986); Michigan, MICH. COMP. LAWS ANN. §§ 450.1775-.1784 (West Supp. 1985); Mississippi, MISS. CODE ANN. §§ 79-25-1 to -7 (Supp. 1985); Virginia, VA. CODE ANN. §§ 13.1-725 to -728 (1985).

206. *Cf.* GILSON, *supra* note 43, at 1075 (discussing how these second generation statutes are couched in the state's corporate law). Similar to the fair price statutes which are designed to protect shareholders against the coercive effects of two-tiered tender offers, "dissenter rights" statutes adopted in Pennsylvania and at least three other states give shareholders a right to demand cash payment for their shares for a reasonable period after a tender offer. One commentator views these types of statutes as appearing constitutional under the *CTS* rubric. *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, 113-14 n.75 (1987).

207. *See* Sargent, *Do Second-Generation State Takeover Statutes Violate the Commerce Clause?*, 8 CORP. L. REV. 3, 12 (1985).

208. *See* Hanks, *supra* note 87, at 34, col. 4.

209. *See* Buxbaum, *supra* note 194, at 31.

In terms of the commerce clause, fair price statutes affect interstate commerce at least as much as the first generation statutes invalidated by *MITE*,[210] and more than the control share acquisition statutes upheld by *CTS*.[211] Fair price statutes, however, are limited in that they apply solely to the second stage of a two-tiered tender offer and can be justified as a means of protecting shareholders.[212] Analysis of fair price statutes under the commerce clause would depend on whether the Court applies the *MITE* approach where it relied on the *Pike* balancing test[213] or whether the Court uses the *CTS* approach where it applied the internal affairs doctrine. Most likely, the Court would choose the latter provided that the fair price statute applied only to the state's corporations. Dissenter rights statutes, which also guard against coercive takeover techniques, would be analyzed similarly and would probably be upheld unless they were found to directly conflict with the Williams Act or exceed their jurisdictional reach by applying to nonresident corporations.

Although every state takeover statute has some type of disclosure component, five states have enacted specific registration and disclosure statutes.[214] The disclosure requirements for these statutes are similar to the requirements of the Williams Act but are more detailed and extensive.[215] These statutes do not substantially favor the offeror or target management in a takeover contest,[216] nor do they place a significant burden on interstate commerce.[217] Consequently, these disclosure statutes should be generally upheld as constitutional because they provide an added enforcement dimension on disclosure

---

210. *See* Sargent, *supra* note 207, at 13.

211. *See Limited Third Generation*, *supra* note 2, at 430.

212. *See* Romano, *The Political Economy of Takeover Statutes*, 73 VA. L. REV. 111, 118 (1987). *See also supra* note 90.

213. One commentator has argued that the *MITE* decision was decided on a narrow interpretation of the commerce clause instead of a *Pike*-based balancing test. *See* Regan, *supra* note 173, at 1283. *CTS* appears to reinforce this view, especially since *Pike* was not cited by the Court (except when it discussed the procedural posture of the case). *See* CTS Corp. v. Dynamics Corp. of Am., 107 S. Ct. 1637 (1987).

214. HAW. REV. STAT. §§ 417E-1 to -11 (Supp. 1985); IDAHO CODE §§ 30-1501 to -1514 (Supp. 1985); MINN. STAT. ANN. §§ 805B.01-.13 (West Supp. 1986); NEB. REV. STAT. §§ 21-2418 to -2430 (1983); TENN. CODE ANN. §§ 48-5-101 to -114 (Supp. 1986).

215. *See, e.g.*, IDAHO CODE § 30-1503(5)(c) (Supp. 1987) (requiring information concerning the possible economic impact the proposed tender offer will have on the state).

216. *See Limited Third Generation*, *supra* note 2, at 432.

217. *Id.* at 431.

that is not available at the federal level, and they do not have either preemption or commerce clause pitfalls.[218]

B. Delaware's Takeover Statute

Presently, at least thirteen states have enacted some form of third generation takeover statute after *CTS* in order to limit hostile corporate mergers and acquisitions through tender offers.[219] Delaware has recently passed antitakeover legislation[220] which prevents completion of a takeover for three years once an acquirer obtains 15% of a publicly held corporation's stock (making the acquirer an "interested stockholder")[221] unless: (1) the target board of directors

---

218. *See id.* at 432-33. *See generally* Comment, *supra* note 24 (discussing the beneficial aspects of these statutes).

219. These states include Arizona, Florida, Louisiana, Massachusetts, Minnesota, Missouri, Nevada, North Carolina, Oklahoma, Oregon, Utah, Washington, and Wisconsin. Mendelsohn & Berg, *supra* note 22, at 41, col. 4, n.5. *See, e.g.*, MASS. GEN. L. ch. 110C, § 7 (Supp. 1987) (Massachusetts takeover statute modeled on the Indiana statute but applying to corporations that primarily operate in the state in addition to companies incorporated in Massachusetts); MO. REV. STAT. § 351.407 (Supp. 1988) (Missouri takeover statute modeled on the Indiana control share acquisition statute); N.C. GEN. STAT. §§ 55-90 to -98.1 (1987) (North Carolina takeover statute modeled on the Indiana statute).

Recently, the Court of Appeals for the First Circuit granted preliminary injunctive relief by ruling that certain provisions of the Massachusetts law are probably preempted by the Williams Act and appear to violate the commerce clause. Hyde Park Partners, L.P. v. Connolly, 839 F.2d 837 (1st Cir. 1988). *See also First Circuit Upholds Preliminary Relief Barring Operation of Mass. Takeover Law*, 20 Sec. Reg. & L. Rep. (BNA) 235 (Feb. 12, 1988); WASH. REV. CODE § 23A.50 (1988) (banning "certain business transactions" between an acquirer and a target company; apparently, only Boeing Co. presently falls within the scope of this statute). These third generation statutes, like their predecessors, are usually passed by overwhelming margins in respective state legislatures. Since the target management lobbies for the bill against little or no opposition, the statutes are passed easily and without controversy. *See* Romano, *supra* note 212, at 138-39.

220. The Delaware takeover law is entitled "Business Combinations With Interested Stockholders." *See* DEL. CODE ANN. tit. 8, § 203 (1988).

221. The statute defines an "interested stockholder" and applies the definition retroactively (the statute became law on February 2, 1988 but affects transactions on or subsequent to December 23, 1987). "Interested stockholder" is defined as follows:

> "interested stockholder" means any person (other than the corporation and any direct or indirect majority-owned subsidiary of the corporation) that (i) is the owner of 15% or more of the outstanding voting stock of the corporation, or (ii) is an affiliate or associate of the corporation and was the owner of 15% or more of the outstanding voting stock of the corporation at any time within the 3-year period immediately prior to the date on which it is sought to be determined whether such person is an

approves of the merger or acquisition prior to the acquirer becoming an interested stockholder; (2) the acquirer gains control of the board of directors and wins the vote of two-thirds of the shares that it does not own at the annual meeting or in a special election; or (3) the acquirer can buy 85% of the shares in a single transaction, excluding the shares held by directors who are officers and certain employee stock plans.[222] In essence, the statute prevents business combinations

---

interested stockholder, and the affiliates and associates of such person; provided, however, that the term "interested stockholder" shall not include (x) any person who (A) owned shares in excess of the 15% limitation set forth herein as of, or acquired such shares pursuant to a tender offer commenced prior to, December 23, 1987, or pursuant to an exchange offer announced prior to the aforesaid date and commenced within 90 days thereafter and continued to own shares in excess of such 15% limitation or would have but for action by the corporation or (B) acquired said shares from a person described in item (A) of this paragraph by gift, inheritance or in a transaction in which no consideration was exchanged; or (y) any person whose ownership of shares in excess of the 15% limitation set forth herein in [sic] the result of action taken solely by the corporation; provided that such person shall be an interested stockholder if thereafter he acquires additional shares of voting stock of the corporation, except as a result of further corporate action not caused, directly or indirectly, by such person. For the purpose of determining whether a person is an interested stockholder, the voting stock of the corporation deemed to be outstanding shall include stock deemed to be owned by the person through application of paragraph (8) of this subsection but shall not include any other unissued stock of such corporation which may be issuable pursuant to any agreement, arrangement or understanding, or upon exercise of conversion rights, warrants or options, or otherwise.

DEL. CODE ANN. tit. 8, § 203(c)(5) (1988).

222. The heart of the statute is the freeze-out provision which provides: Notwithstanding any other provisions of this chapter, a corporation shall not engage in any business combination with any interested stockholder for a period of 3 years following the date that such stockholder became an interested stockholder, unless:

(1) Prior to such date the board of directors of the corporation approved either the business combination or the transaction which resulted in the stockholder becoming an interested stockholder;

(2) Upon consummation of the transaction which resulted in the stockholder becoming an interested stockholder, the interested stockholder owned at least 85% of the voting stock of the corporation outstanding at the time the transaction commenced, excluding for purposes of determining the number of shares outstanding those shares owned (i) by persons who are directors and also officers and (ii) employee stock plans in which employee participants do not have the right to determine confidentially whether shares held subject to the plan will be tendered in a tender or exchange offer;

(3) On or subsequent to such date the business combination is approved by the board of directors and authorized at an annual or special meeting

including merger, sale of assets, or transfer of stock[223] between an interested stockholder and the target for the moratorium period unless the target board approves or another exception applies.[224] As a result, the freeze-out statute inhibits the effect of synergistic gains derived from takeovers by delaying their realization to the acquirer for at least three years.[225] The statute applies to all publicly traded Delaware

---

> of stockholders, and not by written consent, by the affirmative vote of at least 66-2/3% of the outstanding voting stock which is not owned by the interested stockholder.

DEL. CODE ANN. tit. 8, § 203(a) (1988). The proposed Delaware legislation is modeled upon a stricter New York takeover freeze-out statute passed in 1985 which prevents any hostile takeover for a five-year period unless certain supermajority or management approval provisions are met. *See* N.Y. BUS. CORP. LAW § 912(d)(4) (McKinney 1986).

223. DEL. CODE ANN. tit. 8, § 203(c)(5) (1988).

224. There are other situations in addition to the three main exemptions above whereby the moratorium provision will not apply: (1) the corporation's original certificate of incorporation contains a provision exempting itself from the statute; (2) the board of directors elects within 90 days of enactment of the statute to opt out of the statute; (3) a majority of shareholders elect to amend the certificate of incorporation or bylaws to opt out of the statute, but such an amendment will not apply for one year nor will it apply to any interested stockholder of the corporation prior to its adoption; (4) the corporation does not have a class of voting stock listed on a national securities exchange or has 2,000 or less stockholders of record; (5) a stockholder became an interested stockholder inadvertently; (6) an interested stockholder proposes a business combination with a third party who has not been an interested shareholder within three years, and the board of directors approves of the transactions. *Id.* §§ 203(b)(1)-(6). In addition, there are other ways to avoid the statute's freeze-out restriction such as undertaking a proxy contest prior to an acquirer becoming an interested stockholder or taking over the company without the board's approval, selling its assets, and dividing them among the remaining shareholders *pro rata*. *See* Goldman, *Delaware Anti-Takeover Legislation Needed*, Nat'l L.J., Feb. 8, 1988, 31, 34, col. 3. Though the supermajority provision guards against management entrenchment, Delaware corporate law has always given directors the lead in representing stockholders when there was a proposed acquisition of the corporation. *See* Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985); Ivanhoe Partners v. Newmont Mining Corp., 535 A.2d 1334 (Del. 1987). Still, the Delaware courts have qualified the business judgment rule in the context of the takeover; the board of directors must show the reasonableness of a defensive strategy and thereby prove that it was acting in the corporation's and not its own interest. *See* Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986); Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985). *See* Goldman, *supra*, at 38, col. 4, nn.5-6 (citing studies which support proposition that management's defensive tactics create greater gains for stockholders).

225. *See* Note, *supra* note 198, at 233. In this note, the author analyzes the effect of New York's freeze-out statute under the "inefficient management" and "synergistic gain" theories of takeovers. *See id.* at 232-33. *See also* Andre, *supra* note 199, at 870-75 (discussing different theories of takeovers).

corporations, though the board of directors may decide within 90 days of the statute's enactment to opt out of its protection.[226]

Though its impact will be extensive because of Delaware's place as the predominant state of incorporation, the takeover statute has enough "out" provisions that its practical effect on takeovers will be somewhat limited.[227] Moreover, the statute is not as protectionist as other state takeover legislation because most Delaware corporations have neither their principal place of business nor substantial assets in the state.[228] Yet, the statute will certainly inhibit takeovers, especially hostile ones where the target management resists the acquisition. Consequently, the takeover statute greatly increases the insulation of current corporate management.[229] Ultimately, the Delaware takeover statute will probably have a negative impact on the U.S. economy by reducing the competitiveness that takeover activity generates.[230]

Previously, Delaware had no history of significant bias in favor of takeovers, which is probably one reason why many potential targets are incorporated in Delaware.[231] Yet, despite initial hesitation in

---

226. *See* DEL. CODE ANN. tit. 8, § 203(b)(2) (1988). The opt-out provision provides target management with a dilemma: if the board does not opt out, stockholders might claim that they will be deprived of selling their shares at a premium to the highest bidder; on the other hand, if the board does opt out, stockholders might claim that the company is rejecting a protection endorsed by the state. In most instances, there appears little reason for directors to opt out of the takeover law. *See Delaware Proposal Poses New Dilemmas for Directors*, 3 Corp. Counsel Weekly (BNA) 2 (Jan. 13, 1988).

227. *See* Herzel, *Delaware's Battle Over Anti-Takeover Legislation*, Nat'l L.J., Feb. 8, 1988, at 42, col. 4. Still, the Delaware statute will likely preempt the operation of other state takeover laws that assert jurisdiction on a basis other than the situs of incorporation. *See* Mendelson & Berg, *supra* note 22, at 42, col. 1 n.11.

228. *See* Langevoort, *supra* note 206, at 109 n.62.

229. *See* Bandow, *Curbing Raiders Is Bad for Business*, N.Y. Times, Feb. 7, 1988, at F2, col. 1.

230. *See* Mendelson & Berg, *supra* note 22, at 38, col. 4. *See also* Ginsburg & Robinson, *The Case Against Federal Intervention in the Market for Corporate Control*, Winter/Spring 1986 BROOKINGS REV. 9, 11-14 (arguing that takeovers foster national economic growth). *But see* Lipton, *supra* note 43, at 20-23 (discussing threats to local interests); Lipton, *Takeover Bids in the Target's Boardroom: A Response to Professors Easterbrook and Fischel*, 55 N.Y.U. L. REV. 1231, 1233 (1980) ("economic benefits of takeovers are debatable").

231. *See* Romano, *supra* note 212, at 141. Delaware did enact a narrow takeover statute in 1976 that contained a 20-day precommencement notice prior to a tender offer. *See* Goldman, *supra* note 22, at 31, col. 4. Nevertheless, the statute was eventually repealed on July 1, 1987. *Id.* at 31, 34, cols. 4, 1.

joining the post-*CTS* bandwagon of takeover legislation,[232] the Corporation Law Section of the Delaware Bar Association eventually drafted a bill modeled after New York's 1985 freeze-out statute.[233] The Section eventually approved of a compromise version[234] which was sent to the Delaware legislature in January 1988 and was signed into law on February 2, 1988, by Governor Michael Castle.[235] Through its moratorium provision, the statute prevents buyers from taking control of a target and selling its assets to pay off loans used in the acquisition.[236] Like fair price and dissenter rights statutes, the freeze-out statute aims primarily at preventing two-tiered tender offers which threaten back-end shareholders with a freeze-out merger and a possible inadequate consideration for their shares.[237] In attempting to

---

232. *See* Black, *Why Delaware is Wary of Anti-Takeover Law*, Wall St. J., July 10, 1987, at 18, col. 3. Initially, the Corporation Law Section of the Delaware Bar Association considered whether a control share acquisition statute would be appropriate for Delaware; however, the section rejected the proposal in June 1987 because of uncertainty of such a statute's operation and effect on a large scale in a state like Delaware. *See* Balotti & Finkelstein, *A Proposed Delaware Takeover Statute*, 2 INSIGHTS at 35 (Feb. 1988). *See generally* Sontag, *A Takeover Law Grows in Delaware*, Nat'l L.J., Apr. 11, 1988, at 1, col. 1, 19-20, cols. 1-4 (discussing the development of the Delaware statute).

233. N.Y. BUS. CORP. LAW § 912 (McKinney 1986). The freeze-out provision attempts to limit takeovers by regulating transactions between acquirers and targets rather than regulating the acquisition of target stock (and voting rights) as does the control share acquisition statute. Balotti & Finkelstein, *supra* note 232, at 35.

234. *See Delaware Bar Group Fails to Resolve Debate Over Proposed Takeover Statute*, 2 Corp. Counsel Weekly (BNA) 1 (Dec. 23, 1987) (discussing the events which resulted in the 15% figure for designation of an "interested stockholder").

235. There were two versions of the takeover law: the House bill (H.B. 396), which was the one that became law, had the opt-out provision; in contrast, the Senate bill (S.B. 11) required a shareholder vote to opt into the statute's protection. *See* Balotti & Finkelstein, *supra* note 232, at 36. There was also a great deal of debate on whether the statute would operate retroactively or not in order to protect Texaco Inc. from Carl Icahn who had made moves to take control of the company. Eventually, the legislature set a retroactive date of December 23, 1987. Labaton, *Debate Over a New Takeover Law*; N.Y. Times, Feb. 1, 1988, at D4, col. 2. The bill passed the Delaware Senate, 19 to 1, and sailed through the state's House of Representatives unanimously; the bill was signed into law by Governor Castle the following week. *See* Labaton, *Delaware Takeover Curb Near*, N.Y. Times, Jan. 29, 1988, at D1, col. 6. Governor Castle, who had supported the legislation throughout, said the law was intended "to curb leverage financing and those abusive deals that result in the breakup of companies." He added, "Companies and takeover artists have to learn that they have a certain responsibility to the community." Labaton, *supra*, N.Y. Times, Feb. 1, 1988, at D4, cols. 2-3.

236. *See* Goldman, *supra* note 224, at 34, col. 2.

237. *Id.* at 34, col. 2. It is well established that in a two-tier offer the consideration offered in the second step merger is valued at a lower price than the price paid in the first step. *See* Bebchuk, *The Pressure to Tender: An Analysis and a Proposed Remedy*, 12 DEL. J. CORP. L. 911 (1987).

avoid the coercive nature of these takeover tactics, the Delaware law places negotiating power in the board of directors in an attempt to equalize the premiums of front-end bids against the losses of back-end bids.[238]

As to its constitutionality, the Delaware takeover law does not resemble the control share acquisition statute upheld in *CTS*, and the statute was immediately challenged upon its becoming law.[239] Unlike the Indiana statute in *CTS*, the Delaware statute appears to give management rather than shareholders more involvement in determining the desirability of a takeover bid.[240] Consequently, the takeover statute might be susceptible to preemption under the Williams Act because it violates the neutrality between the offeror and management relative to shareholders.[241] However, the Delaware statute seems to reconcile itself with *MITE* and *CTS* because the statute does not attempt to extend its scope beyond its incorporated companies, and it does give shareholders some autonomy in determining the outcome of the takeover bid. Though Delaware's takeover statute has a far greater impact on corporate America than does Indiana's control share acquisition statute, Indiana's law is clearly more restrictive on its face. While Delaware's legislation has many exceptions to its three-year moratorium delaying a takeover, Indiana's statute provides a "one shot, life-or-death vote" by the shareholders which

---

238. Goldman, *supra* note 224, at 34, cols. 2-3. *See supra* note 224 (concerning the role of directors in Delaware corporate acquisitions and mergers).

239. In the first case to reach the merits of the Delaware takeover statute, the United States District Court for the District of Delaware, per Chief Judge Schwartz, denied injunctive relief and upheld the constitutionality of the law. BNS Inc. v. Koppers Co., 683 F. Supp. 458 (D. Del. 1988). The court, in a well-reasoned opinion, noted that *CTS* stands for the notion that "states have a legitimate interest in regulating tender offers, despite the significant influence such regulation has over the transfer of securities and the so-called market for corporate control." *Id.* at 468-69. The court relied on *CTS* to find that § 203 was not preempted by the Williams Act because both laws could coexist. *Id.* at 470. Moreover, the court found that the Delaware freeze-out statute did not discriminate against out-of-state offerors nor did it create a risk of inconsistent regulation among the states. *Id.* at 472. *See also* RP Acquisition Corp. v. Staley Continental, Inc., 686 F. Supp. 476 (D. Del. 1988) (following the *BNS* holding and reasoning despite the SEC's statistical arguments).

240. *See* Langevoort, *supra* note 206, at 113-14. In this discussion, the author speculates on how the New York takeover statute, which is analogous to the one Delaware has passed, might be struck down on preemption grounds because it may depart from the Williams Act policy of self-determination and give target management too much power. *Id.* at 113-14 n.75.

241. *Id.*

absolutely bars the takeover.[242] In sum, the Delaware freeze-out statute probably passes constitutional muster under the internal affairs doctrine employed in *CTS* because it only attempts to regulate the corporations that are chartered in the state.[243]

C. *Federal Preemption?*

The *CTS* Court appears to defer to Congress in allowing them to specify what type of state regulatory schemes regarding takeovers are within their domain under the police power.[244] Since there was no conflicting provision[245] or obstacle frustrating the Williams Act imposed by the Indiana statute, the Court found no preemption of the state statute by the federal law. In many respects, *CTS* represents a judicial response to allow states to impose more stringent standards for corporate takeovers than the Williams Act. States do have an interest in preventing the corporate form from becoming a shield for unfair business dealing.[246] Nevertheless, the public perception that insider trading and takeover bids are inextricably linked distorts reality because most persons who acquire securities through a tender offer are unlikely to be insiders unless management supports the offer.[247] Moreover, many tender offers are likely to take place within six months and the loser will dispose of its shares within that time.[248] Overall, the national nature of the securities market requires enforcement by the SEC rather than policing by the individual states

---

242. Smith & Furlow, *One View: Delaware Takeover Law is Constitutional*, 3 Corp. Counsel Weekly 8 (Feb. 10, 1988).

243. *See* Herzel, *supra* note 227, at 42, col. 4. *See generally* C. SMITH & C. FURLOW, GUIDE TO THE TAKEOVER LAW OF DELAWARE 138-39 (1988) (suggesting that recent decisions indicate state of incorporation as the primary jurisdictional basis for takeover statutes).

244. *Cf. CTS*, 107 S. Ct. at 1648 (longstanding prevalence of state regulation in this area indicates that Congress would have stated explicitly whether it intended to preempt these types of statutes).

245. Justice Scalia advocated sole use of this conflicting provision test in his concurrence. *See id.* at 1653. *See also* Rice v. Santa Fe Elevator Corp., 331 U.S. 218 (1947) (holding that the United States Warehouse Act preempted similar state legislation on warehouses).

246. *CTS*, 107 S. Ct. at 1648.

247. Committee on Federal Regulation of Securities, *Report of the Task Force on Regulation of Insider Trading Part II: Reform of Section 16*, 42 BUS. LAW. 1087, 1132 (1987).

248. *Id.*

despite the SEC's lack of formal statutory authority for many of its actions.[249]

Recently, several bills have been introduced in Congress which would modify or expand the Williams Act in order to update federal securities law in light of the increasing number of takeover bids.[250] The most prominent Senate bill, the Tender Offer Disclosure and Fairness Act,[251] introduced by Senator Proxmire, holds tender offers for thirty-five business days rather than the current twenty, requires bidders for in excess of 25% of the company's stock to acquire additional shares only through a public tender offer, prohibits greenmail, and provides criminal penalties for insider trading; nevertheless, it would not restrict state takeover legislation in any significant way.[252] The principal House bill introduced by Representatives Dingell and Markey sets up similar restrictions on tender offers, but appears more balanced as to management and offerors in that the bill requires bidders to make a tender offer to acquire more than 10% of a target's stock, imposes a one-share, one-vote requirement for stocks traded on national exchanges, prohibits golden parachutes during a tender offer, and requires shareholder approval of certain defensive tactics such as poison pills.[253] Most importantly, the bill would preempt any

---

249. *See* Langevoort, *supra* note 206, at 114. *But see* Cane & Taussig, *Hawaii's 1985 Take-over Legislation: Is it Constitutional?*, 8 HAW. L. REV. 391, 416 (1986) (discussing necessary additional enforcement dimension created by state statutes).

250. *See* S. 227, 100th Cong., 1st Sess. (1987); S. 521, 100th Cong., 1st Sess. (1987); S. 634, 100th Cong., 1st Sess. (1987); S. 678, 100th Cong., 1st Sess. (1987); S. 1323 100th Cong., 1st Sess. (1987); H.R. 2172, 100th Cong., 1st Sess. (1987); H.R. 2668, 100th Cong., 1st Sess. (1987).

251. *See* S. 1323, 100th Cong., 1st Sess. (1987); *Proxmire Introduces Tender Offer Bill, Announces Hearings, for Later This Month*, 2 Corp. Counsel Weekly (BNA) 2 (June 10, 1987).

252. *See* S. 1323, 100th Cong., 1st Sess. (1987); *Proxmire*, *supra* note 251, at 2. Senator Proxmire, who chairs the Senate Banking Committee, has strongly opposed any amendment which would impede the states' ability to enact takeover legislation. *Id.*

253. The bill would also require bidders to make a tender offer when they wish to obtain more than 10% of the target's stock and would require a simplified disclosure statement concerning the terms of the offer. *See* H.R. 2172, 100th Cong., 1st Sess. (1987) (Tender Offer Reform Act of 1987). *See also Dingell, Markey Introduce Bill to Eliminate Abuses in Tender Offers*, 2 Corp. Counsel Weekly (BNA) 1 (May 6, 1987). The other bill pending before the same House subcommittee, the "Securities Trading Reform Act of 1987," introduced by Representative Lent would add similar corporate control contest restrictions which would be amended to the Securities Exchange Act of 1934. The bill also would delegate authority to the SEC to preempt certain state statutes which limit shareholders' voting rights under its rule-making authority. *See* H.R. 2668, 100th Cong., 1st Sess. (1987).

state takeover statute that disenfranchised shareholders.[254] However, the stock market crash on October 19, 1987, prompted the House subcommittee to postpone work on tender offer legislation until February 1988, allowing time to reevaluate the current market picture.[255] Nevertheless, Congress's lack of consensus on how to react to Black Monday will probably prevent passage of any major legislation during 1988.[256]

Congress's ambivalence concerning the economic utility of takeovers makes it politically difficult to enact comprehensive federal tender offer legislation.[257] Comprehensive legislation is necessary to keep the federal securities regulation in tune with the sophisticated takeover techniques that have developed since passage of the Williams Act.[258] Yet, following the *CTS* decision, a majority of states have passed third generation statutes, which are essentially special interest legislation that benefits the local economy.[259] Since these state takeover statutes have an overwhelming impact on the national economy, Congress should respond to *CTS* by modernizing the ground rules governing tender offers and ensuring that the explicit neutrality between an acquirer and target management be maintained during an offer.[260]

---

254. *See* H.R. 2668, 100th Cong., 1st Sess. (1987).

255. Representative Markey, who chairs the House Energy and Commerce Telecommunications and Finance Subcommittee, stated that he decided to hold off hearings on the bill "so that we can benefit from the lessons of 'Black Monday.' " *See Drafting of Reform Proposal is Set to Resume in February*, 2 Corp. Counsel Weekly 2 (Dec. 9, 1987).

256. *See Black Monday Unlikely to Spur Major Legislation This Year*, 20 Sec. Reg. & L. Rep. (BNA) 125, 156 (Jan. 29, 1988).

257. Langevoort, *supra* note 206, at 114.

258. *Id.* at 113. The author states that the drafters of the Williams Act could not have envisioned the variety of takeover techniques and defensive strategies that have since developed as well as the negative aspects thereof, and therefore, the Williams Act should be broadened in scope. *Id.*

259. *See id.* at 110. In addition, the nationwide impact of the Delaware takeover statute will force Congress to take notice of the expanding sphere of state takeover statutes and their effect on the national economy. *See* Mendelson & Berg, *supra* note 22, at 41, col. 2.

260. *See, e.g.*, H.R. 2668, 100th Cong., 1st Sess. (1987) (one of several bills to reform tender offer rules). The explicit neutrality statement is worded as follows:

> An issuer may implement a change in voting rights . . . whether by reason of State statute or articles of incorporation or bylaws . . . unless such change violates such rules, regulations, and orders the Commission may prescribe, in the public interest and for the protection of investors, to maintain and ensure the balance and neutrality between the competing

D. Commerce Clause Implications

The *CTS* Court appears to back away from the *Pike* balancing test in its dormant commerce clause analysis of the Indiana takeover statute. Instead, the Court applies the internal affairs doctrine in justifying the statute's limited but adverse impact on interstate commerce.[261] In contrast to *MITE* where the internal affairs doctrine is explicitly rejected,[262] *CTS* embraces the takeover statute based upon the state's fundamental right to govern its corporations whose very existence and attributes are a product of state law.[263] This internal affairs approach is augmented by a number of state interests, such as protecting resident shareholders and preventing unfair business dealing.[264] In a sense, the internal affairs doctrine makes the state of incorporation a surrogate for other states in providing shareholder protection.[265] Yet, the crux of the *CTS* commerce clause analysis is that the corporation is a creature of state law, and each state is not required to define its corporations' stock in the same manner.[266] The fact that the second generation statute was jurisdictionally limited, unlike the first generation statute in *MITE*, may be the key reason for applying the internal affairs doctrine in the former but not the latter.[267] Naturally, it is unavoidable that a state's corporate law has an extraterritorial impact since a corporation's stock is a primary

---

interests in tender offers and requests and invitations for tender.

Id. at 103(3). This provision apparently gives the SEC express regulatory authority to preempt state takeover statutes that encroach upon this neutrality.

261. *See generally* Buxbaum, *supra* note 194 (discussing the Indiana statute's limited application). *See also* McDermott Inc. v. Lewis, 531 A.2d 206 (Del. 1987). In this case, the Delaware Supreme Court reaffirmed the internal affairs doctrine concluding that it is "mandated by constitutional principles, except in the 'rarest situations.' " *Id.* at 217 (citations omitted). The case cites *CTS* as strong support for the proposition that "the commerce clause mandates that a state apply the internal affairs doctrine to disputes involving corporations organized under the laws of a sister state." *Id.* at 217 n.12.

262. *MITE*, 457 U.S. at 645. The Court continued "[t]hat [internal affairs] doctrine is of little use to the State in this context. Tender offers contemplate transfers of stock by stockholders to a third party and do not themselves implicate the internal affairs of the target company." *Id.* (citation omitted).

263. *CTS*, 107 S. Ct. at 1652.

264. *Id.* at 1651-52.

265. BLOOMENTHAL, *supra* note 128, § 20.07, at 587-88.

266. *CTS*, 107 S. Ct. at 1652. *See* Cox, *The Constitutional "Dynamics" of the Internal Affairs Rule—A Comment on* CTS Corporation, 18 J. CORP. L. 317, 352 (1988) (describing corporate codes as a "product" to compete for corporate consumers for charters).

267. Buxbaum, *supra* note 194, at 33.

vehicle for financing interstate and international business operations.[268] In addition, there is no state administrative role as in the Illinois statute struck down in *MITE*;[269] rather, stockholders are given autonomy to collectively decide whether a takeover bid is desirable.[270] Thus, the *CTS* Court shifts away from the use of the *Pike* balancing test in *MITE*, adopting instead a more traditional corporate law approach which utilizes the internal affairs doctrine. Since the *CTS* decision views stock as created by the corporation and the corporation is defined by state law, other types of statutes which inhibit rapid acquisitions, such as moratorium, supermajority, or fair price, might logically be permissible in light of *CTS*.

Though *CTS* views stock as defined by state corporate law, this approach underscores the practical significance of the fact that stock, as traded on the national securities exchanges, is an interstate commodity. The vast majority of tender offers involve individuals from different states: shareholders of publicly held corporations are usually scattered across many states and the tender offeror is often not located in the target's state.[271] As Justice White noted in his dissent, CTS's stock is bought and sold on the New York Stock Exchange, and investors nationwide trade CTS's shares daily.[272] Yet, these investors will be prevented from tendering their shares to a prospective purchaser who crosses one of the threshold levels if a majority of shareholders refuse to grant that purchaser voting rights.[273] Therefore, the Indiana statute effectively operates as a restraint on trade by withholding an integral part of stock ownership from investors trading on national securities exchanges.[274] Consequently, states may use takeover statutes etched in their own corporate law for "exploitative purposes, restricting the exit of assets or employment opportunities from their particular state."[275] Unlike blue sky laws which are pre-

---

268. BLOOMENTHAL, *supra* note 128, § 20.07, at 587.
269. *See* GILSON, *supra* note 43, at 1076.
270. *CTS*, 107 S. Ct. at 1651.
271. BLOOMENTHAL, *supra* note 128, § 20.07.
272. *CTS*, 107 S. Ct. at 1655 (White, J., dissenting).
273. *Id.*
274. *See id.*
275. Levmore, *supra* note 44, at 623. Third generation statutes have clearly been designed to "protect" important local companies from takeover bids by corporate raiders. Eight of the 14 states that have adopted third generation statutes responded to attempted or threatened takeover bids for local companies: Arizona (Greyhound Corp.); Delaware (Texaco); Florida (Harcourt Brace Jovanovich, Inc.); Massachusetts (Gillette Co.); North Carolina (Burlington Industries, Inc.); Min-

dominantly intrastate in nature, takewver statutes may create indirect exit barriers which will prevent corporate assets from leaving the state.[276] As a result, these assets which ultimately belong to investor shareholders of the corporation—many of whom are nonresidents—are effectively locked within the regulatory state, and the free transferability of interest in that corporation's stock is accordingly diminished. Moreover, another commerce clause problem posed by *CTS* is the threat of inconsistent regulation that third generation statutes might spawn resulting in "a crazy quilt of onerous rules on tender offers, thereby hamstringing shareholder rights and national securities markets."[277] Nonetheless, the *CTS* Court believed that the internal affairs doctrine would protect against the risk of inconsistent regulation, though, in so applying the doctrine, the Court treats equity securities in corporations as if they were not nationally and internationally traded commodities.

Clearly, the Indiana takeover statute upheld in *CTS* is protectionist in that: (1) the statute was adopted primarily to improve the competitive position of local, in-state economic actors (i.e., the target managements against tender offerors); and (2) the statute is sufficiently analogous to traditional instruments of protectionism like tariffs, quotas, and embargoes (by restricting transfer of voting rights to an acquirer).[278] The Indiana statute uses the state's interest in

---

nesota (Dayton-Hudson Corp.); Washington (Boeing Co.); and Wisconsin (G. Heileman Brewing Co., Inc.). *See* Editorial, *Expropriation at Home*, Wall St. J., Oct. 9, 1987, at 24, col. 1; *States Rush to Thwart Takeovers*, Chicago Tribune, June 28, 1987, § 7, at 4, col. 1. *See also* Sontag, *Takeovers Are on the Rise Again*, Nat'l L.J., Feb. 1, 1988, at 8, col. 2-3 (Icahn's acquisition of Texaco was thwarted by the Delaware freeze-out statute's retroactive provision); *North Carolina Legislature Responds to Attempted Takeover of Burlington*, 2 Corp. Counsel Weekly (BNA) 3 (June 17, 1987) (discussing three major pieces of North Carolina takeover legislation passed to frustrate a takeover attempt of Burlington Industries); *Arizona Anti-Takeover Bill Signed During Special Legislative Session*, 2 Corp. Counsel Weekly (BNA) 2 (Aug. 5, 1987) (discussing Arizona takeover bill proposed by Greyhound Corp. who claimed to be the target of a hostile takeover bid); *Washington Bill Aims to Protect Boeing*, 2 Corp. Counsel Weekly (BNA) 2-3 (Aug. 19, 1987) (discussing Washington statute enacted to prevent a hostile takeover of Boeing Co. by T. Boone Pickens).

276. Levmore, *supra* note 44, at 623. *See* Cox, *supra* note 266, at 335 (noting that Indiana's control share acquisition statute tends to preserve corporate assets within the state to benefit Indiana employees and communities though such protection is at the discretion of target management).

277. *Supreme Court Decision on Indiana Law Remains Prime Topic at Takeover Hearings*, 19 Sec. Reg. & L. Rep. (BNA) 1011 (July 10, 1987) (remarks of Rep. Rinaldo concerning the possible effect of the *CTS* decision).

278. *Cf.* Regan, *supra* note 173, at 1094-95 (defining protectionism and protectionist state statutes).

shareholder protection against the coercive effects of tender offers as a justification for protecting local businesses from hostile takeover bids.[279] The protectionist motivation behind many post-*CTS* takeover statutes runs contrary to the dormant commerce clause which has generally been interpreted as forbidding states from engaging in purposeful economic protectionism.[280] Furthermore, these statutes also impede the idea that a market for corporate control should exist in order to keep companies in the hands of efficient management.[281] The stock market crash of 1987 indicated the degree to which the 1980's bull market had come to rely on tender offers to maximize stock prices and oust inferior management.[282] In general, tender offers and corporate acquisitions promote the national economy by improving industrial efficiency, increasing shareholder profits, and generating greater corporate accountability.[283] These effects demonstrate the importance of takeovers to a competitive economic system of private enterprise which necessitates a free market for corporate control to uproot inefficient management and maximize shareholders' investments.[284] Nonetheless, the *CTS* Court rejected the "notion that the Commerce Clause protects the particular structure or methods

---

279. *See* Langevoort, *supra* note 206, at 107. One study suggests that the Indiana statute upheld in *CTS* cost shareholders of Indiana's publicly held corporations $2.65 billion amounting to a loss of more than 6% on the $41 billion total worth of all companies incorporated in Indiana. Woodward, *How Much Indiana's Anti-Takeover Law Cost Shareholders*, Wall St. J., May 5, 1988, at 32, col. 3.

280. *See* Regan, *supra* note 173, at 1094-95. In this extensive analysis, the author puts forward the thesis that the Court should invalidate state statutes that engage in economic protectionism under the dormant commerce clause solely because they are purposely protectionist. In general, the author argues that the Court is moving in this direction. *Id.* at 1099. Nevertheless, the Indiana statute in *CTS* effectively "labels" its corporation's stock through its voting rights provision by inhibiting purchases beyond the threshold levels. The Court does not acknowledge the potential impact of this labeling on the movement of securities in the interstate market.

281. *See* Coffee, *Regulating the Market for Corporate Control: A Critical Assessment of the Tender Offer's Role in Corporate Governance*, 84 COLUM. L. REV. 1145, 1162 (1984); *MITE*, 457 U.S. at 632 (opining that tender offers provide an important check on incumbent management and result in a more efficient company).

282. *See Will Delaware Fall?*, Wall St. J., Dec. 3, 1987, at 30, col. 1.

283. Mendelsohn & Berg, *supra* note 22, at 38, col. 4.

284. *Id.* The profits that shareholders have reaped through tender offers may be a major factor for the mid-1980's bull market. The SEC's chief economist, Kenneth Lehn, estimates that shareholders may have received up to $160 billion in profits from takeovers over the last five years. Sontag, *supra* note 275, at 8, col. 4. *See also* Cox, *supra* note 266, at 320 (discussing the market for corporate control as a result of the dual and separate nature of ownership and control in publicly held corporations).

of operation in a . . . market."[285] Since *CTS* applies the internal affairs doctrine, rather than the *Pike* test used in *MITE*, it is difficult to see how the Court could find a takeover statute unconstitutional under the commerce clause so long as it is based on the state's corporate law and applies only to its own corporations. Though *MITE* may still retain some vitality for striking down overreaching state takeover statutes on commerce clause grounds, the internal affairs doctrine in *CTS* gives the state of incorporation a wide degree of freedom to regulate control contests for its corporations.

V. CONCLUSION

The *CTS* decision reflects the Court's willingness to uphold state takeover regulation grounded upon each state's corporate law giving states a wide degree of latitude to enact takeover legislation. Despite some of the beneficial effects of these statutes, such as offeror disclosure and shareholder insulation from the coercive effects of tender offers, they prevent the free transfer of corporate assets from the present owners to the offeror. The purpose of the dormant commerce clause is to guard against trade barriers of this type that serve to protect local interests at the expense of the national economy. Most third generation takeover statutes severely restrict the market for corporate control and favor current management at the expense of nationwide investors. Though Delaware's takeover statute is less restrictive than other second or third generation statutes, it still inhibits the market for corporate control and thus hinders competition for corporate control. Congress should enact legislation to expand on the Williams Act and preempt state legislation which blatantly favors management against a tender offeror. In sum, the *CTS* holding gives states the freedom to enact takeover legislation amending their corporate laws even though these statutes are protectionist, insulate management from takeovers, and interfere with the free market by restricting competition for corporate control.

Mark A. Cronin

---

285. *CTS*, 107 S. Ct. at 1652 (quoting Exxon Corp. v. Governor of Md., 437 U.S. 117, 127, *reh'g denied*, 439 U.S. 884 (1978)). In contrast, the *CTS* dissent interprets *Exxon* as protecting the "interstate market" and thus comes to an opposite conclusion than the majority on the issue of market protection under the commerce clause. *Id.* at 1656 (White, J., dissenting). *See also* Cox, *supra* note 266, at 331 (noting that the Court reaffirmed its traditional post-*Lochner* view that the Constitution does not require the states to subscribe to any specific economic theory).