SOME OBSERVATIONS ON STATE REGULATION OF MULTISTATE TAKEOVERS—CONTROLLING CHOICE OF LAW THROUGH THE COMMERCE CLAUSE

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I. Introduction

Takeovers have fueled the most animated debate in corporate law in the last half century. The stakes are enormous: in our private economy, the raising and managing of capital are vitally affected by the ways in which the control of our national and international corporations is transferable in the marketplace.

Legislative activism in the takeover field dates back to the early 1960s. Concerned with certain abuses by tender offerors and by management and its allies, Congress made a limited effort in the Williams Act to protect investors by imposing certain disclosure, fairness, and equal treatment rules.[1] Apart from this limited foray, Congress was otherwise satisfied to leave the outcome of contests

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1. *See* Williams Act, Pub. L. No. 90-439, 82 Stat. 454 (1968) (codified as amended at 15 U.S.C.§§ 78 m(d)-(e), 78n (d)-(f) (1982)). More particularly, the disclosure requirements of the Williams Act are aimed at curbing abuses in tender offers. *See* 15 U.S.C. §§ 78m(e), 78n(d)-(f) (1982). The Securities and Exchange Commission (SEC) has adopted Rules, pursuant to Congress' delegation, to similarly curb abuses. *See* 17 C.F.R. §§ 240.13e-4 (Rule 13e-4), .14d-1 (Rule 14d-1), .14d-9 (Rule 14d-9) (1988).

The main fairness and equal treatment obligations are the following:

(a) SEC Rules 14d-3(b) and 14d-4(c) provide that the bidder must keep the offer open for at least 20 days. *See* 17 C.F.R. §§ 240.14d-3(b), .14d-4(c), .14e-1(a) (1988).

(b) Investors may withdraw shares tendered during the first 15 business days of the tender offer and if not purchased by the offeror, any time after 60 days from commencement of the offer. *See* 15 U.S.C. § 78n(d)(5) (1982); 17 C.F.R. 140.14d-7(a)(1) (1988).

(c) A tender offer must be addressed to all the holders of the particular class of securities. *See* 17 C.F.R. § 240.14d-10 (1988).

(d) The best price paid to any offeree must be paid to all. *See* 15 U.S.C. § 78n(d)(7) (1982); 17 C.F.R. § 240.14d-10 (1988).

(e) A purchase of fewer than all the shares tendered must be pro rata. *See* 15 U.S.C. § 78n(d)(6) (1982); 17 C.F.R. § 240.14(8) (1988).

for corporate control to market forces.[2] A distinctly different philosophy, however, permeated the state statutes which soon proliferated alongside the Williams Act. The antitakeover thrust of these statutes was evident: tender offers and other control acquisitions which were unapproved by management, i.e., were "hostile," were subjected to costly and burdensome notice, filing, waiting and approval requirements which not only delayed and penalized the acquisition but made the outcome quite unpredictable.[3] A constitutional conflict between the Williams Act and state schemes of regulation became inevitable. In 1982, in *Edgar v. MITE Corp.*,[4] the Supreme Court struck a blow to the free market by invalidating, on commerce clause grounds, an Illinois statute which injected state authorities into the arena of hostile takeovers, including those involving foreign corporations.[5]

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2. As originally introduced, the Williams Act was aimed principally at the perceived abuses of the corporate "raiders." 11 CONG. REC. S28,258-59 (1965). But the final text, substantially due to the proddings of the SEC, cut back some of the restrictions applicable to bidders and added a significant array of devices to limit abuses by the opponents of tender offers, especially management. The basic idea was to promote investor autonomy as part of corporate democracy and, at the same time, to increase corporate efficiency and accountability by preserving the tender offer mechanism. *See Senate Comm. on Banking and Currency, Hearings on S. 510, Before the Subcomm. on Securities*, 90th Cong., 1st Sess. 15-25, 116-25, 161-96 (1967); S. REP. No. 550, 90th Cong., 1st Sess. 2-3 (1967); H.R. REP. No. 1711, 90th Cong., 2d Sess. 3-4 (1968).

The Supreme Court has taken notice of this legislative history. In Rondeau v. Mosinee Paper Corp., 422 U.S. 49, 58-59 (1975), the Court observed:

> By requiring disclosure of information to the target corporation as well as the Securities and Exchange Commission, Congress intended to do no more than give incumbent management an opportunity to express and explain its position. The Congress expressly disclaimed an intention to provide a weapon for management to discourage takeover bids or prevent large accumulations of stock which would create the potential for such attempts. Indeed, the Act's draftsmen commented upon the "extreme care" which was taken "to avoid tipping the balance of regulation either in favor of management or in favor of the person making the takeover bid."

See also Piper v. Chris-Craft Indus., Inc., 430 U.S. 1, 22, 30-35 (1977).

3. *See* Note, *State Regulation of Tender Offers*, 7 J. CORP. L. 603, 605-11 (1982) (discussing first generation antitakeover statutes which are now mostly defunct).

4. 457 U.S. 624 (1982).

5. *Id.* at 642-43. The statute applied to a tender offer, wherever made, for the stock of any corporation if either (a) at least 10% of the stock was owned by Illinois residents or (b) the corporation had two of the following three contacts with Illinois: incorporation, principal executive office or 10% of stated capital and paid-in-surplus. The plurality opinion by Justice White, joined by Justices Burger, Powell, Stevens, and O'Connor, declared the Illinois Act invalid for imposing a

A wave of invalidations on commerce clause, as well as on federal preemption grounds, followed in the lower federal courts.[6] Determined to circumvent *MITE* invalidations, many states moved to a second generation of statutes, the most restrained of which, like Indiana's "control share acquisition" statute,[7] apply only to domestic corporations and adopt a manner of regulation which purports to enable only the shareholders to veto takeovers, leaving both the state and corporate management out of the process.[8] Some other states, led by New York[9] and now joined by Delaware,[10]

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substantial burden on interstate commerce that outweighed its putative local benefits. *Id.* at 625, 646. The same Justices, with the exception of Justice Powell, also found the statute unconstitutional as regulating interstate commerce "directly" and thus being invalid per se. *Id.* at 642-43. Justices White, Burger, and Blackmun also found the Act to be preempted by the Williams Act, but Justices Powell and Stevens expressly disagreed and four Justices never addressed the question of preemption. CTS Corp. v. Dynamics Corp. of Am., 481 U.S. 69, 81 n.6 (1987).

6. *See, e.g.*, Mesa Petroleum Co. v. Cities Serv. Co., 715 F.2d 1425 (10th Cir. 1983); Telvest, Inc. v. Bradshaw, 697 F.2d 576 (4th Cir. 1983); Martin-Marietta Corp. v. Bendix Corp., 690 F.2d 558 (6th Cir. 1982); National City Lines, Inc. v. LLC Corp., 687 F.2d 1122 (8th Cir. 1982); Bendix Corp. v. Martin-Marietta Corp., 547 F. Supp. 522 (D. Md. 1982); Esmark, Inc. v. Strode, 639 S.W.2d 768 (Ky. 1982); Sharon Steel Corp. v. Whaland, 124 N.H. 1, 466 A.2d 919 (1983). *See* Block, Barton, Roth & Garfield, *State Takeover Statutes, reprinted in* 1 HOSTILE BATTLES FOR CORPORATE CONTROL 1986 (PLI Corporate Law and Practice Series) (D. Block & H. Pitt eds. 1986) (analyzing the scope and implications of the invalidations in these cases); Danilow & Bentley, *State Takeover Statutes After* MITE, 20 SEC. & COMMODITIES REG. 13 (Standard & Poor's Jan. 28, 1987) (discussing the constitutionality of second generation statutes that limit acquiror's voting rights).

7. IND. CODE ANN. §§ 23-1-42-1 to -11 (Burns Supp. 1988).

8. These statutes seek to avoid the problems discussed by the plurality in *MITE*; neither management nor the offeror is given "an advantage in communicating with the shareholders about the impending offer." *CTS*, 481 U.S. at 83.

9. Section 912 of the New York Corporation Law provides that if the original acquisition of control stock is not approved by the board of directors, the holder must wait for at least five years before entering into a business combination with the target company. Even after five years, it is not enough to obtain approval of the board then in office. The combination still requires either the approval of a majority of the disinterested shareholders or the payment of a "fair" price to the remaining shareholders. N.Y. BUS. CORP. LAW § 912 (McKinney 1986).

An unusual feature of this statute, which may raise additional commerce clause problems, because it impedes the interstate mobility of resources, is the prohibition in § 912(a)(13) against New York corporations from reincorporating in another state to escape the statute's restrictions. *See id.* § 912(a)(3). *See also* R. WINTER, GOVERNMENT AND THE CORPORATION 43-44 (1978).

10. DEL. CODE ANN. tit. 8, § 203 (1988). Under § 203, the acquiror of control stock without management approval is barred for three years from a business combination with the domestic target corporation, unless (a) prior to the date the acquiror became the owner of 15% or more of the outstanding voting stock, the

followed a more indirect approach by only obstructing the consolidation of power by the unapproved acquiror of controlling stock: combinations between the corporation and such a person are severely restricted for a number of years. Another category of restraints on corporate combinations either force the acquiror of control to buy out the remaining shareholders at high prices (as called for by the Pennsylvania and Indiana statutes) or impose "fair pricing" requirements on the second-step transaction of consolidation with the unapproved acquiror, thus strengthening the hand of the remaining shareholders in future squeeze-outs.[11] A few statutes follow a different

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board of directors approved of the transaction; or (b) after consummation of the transaction which makes it a 15% shareholder, it acquires 85% of the outstanding voting stock; or (c) the combination is subsequently approved by the board and by two-thirds of the total outstanding disinterested stock. The onerous task of qualifying under one of these exceptions and avoiding the application of § 203 becomes apparent. The 85% exception is premised on the consummation of the transaction and is not satisfied by an offer for 85% of the outstanding shares. Hence, even an offer for 100% of the stock may fail where the management owns, controls or at least influences a significant percentage of stock. Furthermore, by requiring approval by the board and two-thirds of the stockholders, the third exception imposes a formidable hurdle to a hostile acquiror. *Id.* § 203(a)(1), (2), (3).

Unlike most revisions to the Delaware General Corporation Law, significant opposition to this piece of legislation developed within the Corporation Law Section of the Delaware Bar Association. *See Delaware Bar Group Votes to Restrict Hostile Takeovers*, 20 Sec. Reg. & L. Rep. (BNA) 19 (Jan. 8, 1988). *See also* Goldman, *Delaware Anti-Takeover Legislation is Needed*, Nat'l L.J., Feb. 8, 1988, at 31, 34, 38; Mendelsohn & Berg, *Anti-Takeover Bill Would Shift Balance of Power*, Nat'l L.J., Feb. 8, 1988, at 38, 40-42. The significance of Delaware's joining the antitakeover movement in so far as multistate companies are concerned cannot be exaggerated. Of the Fortune 500 Companies for 1986, more than 50% are Delaware corporations, representing more than 50% of total equity and more than 55% of corporate revenues. More than 45% of all companies listed on the New York Stock Exchange are incorporated in Delaware. Mendelsohn & Berg, *supra*, at 38.

Various state statutes reflect an anticombination approach. *See, e.g.*, ARIZ. REV. STAT. ANN. §§ 10-1211, 10-1221 to -1223 (1987); IND. CODE ANN.§ 23-1-43-18 (Burns Supp. 1988); MINN. STAT. ANN. § 302A.673 (West 1987). *See* Kozyris, *Corporate Wars and Choice of Law*, 1985 DUKE L.J. 1, 78-82 (1985) (describing comparable provisions incorporated in the laws of Maryland and Pennsylvania).

11. IND. CODE ANN. § 23-1-42-11 (Burns Supp. 1988); PA. STAT. ANN. tit. 15, § 1910 (Purdon Supp. 1988).

Some version of the "fair pricing" approach is used by a number of states. *See* CONN. GEN. STAT. § 33-366 (1988); FLA. STAT. ANN. § 607.108 (West 1987); GA. CODE ANN. §§ 14-2-232 to -235 (Supp. 1988); ILL. ANN. STAT. ch. 32, para. 7.85 (Smith-Hurd 1988); KY. REV. STAT. ANN. §§ 271A.396-.399 (Michie/Bobbs-Merrill Supp. 1987); LA. REV. STAT. ANN. §§ 12:132-:134 (West Supp. 1988); MD. CORPS. & ASS'NS CODE ANN. §§ 3-601 to -603 (1987); MICH. COMP. LAWS ANN. § 451-905 (West Supp. 1987); MISS. CODE ANN. §§ 79-25-1 to -29 (1987);

path and regulate the tender offer itself directly through substantive rules that prohibit acquisitions absent certain disclosure[12] or require completion within a certain period of time.[13] Finally, as a last resort, many states reduce the liability of directors who take antitakeover measures[14] and enlarge the obstructionist weaponry placed in their hands in the form of a more flexible business judgment rule and more discretionary categories of securities.[15]

In conclusion, the success of antitakeover forces at the state level has been virtually complete. At the present time, most states have some significant device in their laws burdening transfers of control securities opposed by management and no state has adopted any provision that enhances such transfers.[16]

These attempts to find a constitutionally acceptable method to control interstate takeovers at the state level met with a first round of success in the long-awaited Supreme Court decision of *CTS Corp. v. Dynamics Corp. of America*,[17] which upheld an Indiana statute that

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N.J. REV. STAT. §§ 49:5-1 to :5-19 (1988); N.C. GEN. STAT. §§ 55-75 to -79 (1987); PA. STAT. ANN. tit. 15, §§ 1910(B), (D), (E) (Purdon 1987); WASH. REV. CODE ANN. § 23A.08.425 (1987).

12. *See, e.g.*, MASS. GEN. LAWS ANN. ch. 110D, §§ 2, 3 (West 1988).

13. *See, e.g.*, NEV. REV. STAT. § 78.3772(1) (1987).

14. *See Limitation of Director Liability—Legislative Directions*, 30 CORP. J. 197 (CT Corp. System, Summer 1987) (discussing 25 new statutory provisions limiting director liability, motivated, at least in part, by the antitakeover trend). *See also* Hanks, *State Legislative Responses to the Director Liability Crisis*, 20 SEC. & COMMODITIES REG. 23 (Standard & Poor's Feb. 11, 1987); Hanks, *Update on State Legislative Responses to the Director Liability Crisis*, 21 SEC. & COMMODITIES REG. 23 (Standard & Poor's Feb. 10, 1988). *See also* Veasey, Finkelstein & Bigler, *Responses to the D & O Insurance Crisis*, 19 SEC. & COMMODITIES REG. 263 (Standard & Poor's Dec. 24, 1986) (discussing indemnification and insurance possibilities).

15. These types of provisions are becoming standard in the recent antitakeover statutes. They expand the authority of directors to resist changes or potential changes in control of the corporation, provide for flexible purchase options that offer a great deal of holder discretion, and bring reasonable and good faith antitakeover responses within the shield of the business judgment rule. *See, e.g.*, OHIO REV. CODE ANN. §§ 1701.13, .16, .59, .95 (Anderson 1988). *See also* IDAHO CODE §§ 30-1602, -1610 (Supp. 1988); PA. STAT. ANN. tit. 15, § 1910 (Purdon 1988).

16. *See* CTS Corp. v. Dynamics Corp. of America *and Trends in Takeover Regulation*, 30 CORP. J. 223 (CT Corp. System, Autumn 1987) (discussing recent legislative developments); Pamepinto & Heard, *New State Regulation of Corporate Takeovers*, Nat'l L.J., Sept. 21, 1987, at 26-28 (same).

17. 481 U.S. 69 (1987). The majority opinion by Justice Powell was joined by Chief Justice Rehnquist, and Justices Brennan, Marshall, and O'Connor. *Id.* at 71. Justice Scalia concurred in part in a separate opinion. *Id.* at 94. Justices

made the voting rights of transferred control stock contingent on the approval of the disinterested shareholders of Indiana corporations. The statute was found not to excessively burden interstate commerce and not to be preempted by the Williams Act.[18] Both aspects of *CTS* deserve careful analysis and exploration. The "no-preemption" holding, which is the more controversial because it raises the basic question of how far the protectionism of the state antitakeover statutes can coexist with the free market philosophy of the Williams Act, will not be discussed in the present article.[19]

White, Blackmun, and Stevens dissented. *Id.* at 97.

The case has already received extensive commentary. The bibliography should include: Buxbaum, *The Threatened Constitutionalization of the Internal Affairs Doctrine in Corporation Law*, 75 CALIF. L. REV. 29 (1987); Cox, *The Constitutional "Dynamics" of the Internal Affairs Rule—A Comment on* CTS Corporation, 13 J. CORP. L. 317 (1988); Langevoort, *The Supreme Court and the Politics of Corporate Takeovers: A Comment on* CTS Corp. v. Dynamics Corp. of America, 101 HARV. L. REV. 96 (1987); Oesterle, *Delaware's Takeover Statute: Of Chills, Pills, Standstills, and Who Gets Iced*, 13 DEL. J. CORP. L. 879 (1988); Pinto, *The Constitution and the Market for Corporate Control: State Takeover Statutes After* CTS Corp., 29 WM. & M. L. REV. 699 (1988); Regan, *Siamese Essays: (I)* CTS Corp. v. Dynamics Corp. of America *and Dormant Commerce Clause Doctrine; (II) Extraterritorial State Legislation*, 85 MICH. L. REV. 1865 (1987).

18. *CTS*, 481 U.S. at 94.

19. The facial reading of the Indiana statute by the *CTS* majority and the acceptance of the proffered transparent rationale by Indiana of protecting "shareholder autonomy" rather than focusing on the statute's clear purpose and effect which was to enhance management power, enabled the Supreme Court to by-pass the statute's obvious conflict with the "neutrality" and "level-playing-field" philosophy of the Williams Act. The Court justified its action by noting "that the Williams Act would pre-empt a variety of state corporate laws of hitherto unquestioned validity if it were construed to pre-empt any state statute that may limit or delay the free exercise of power after a successful tender offer." *Id.* at 85. That is, it could lead to the invalidation of many traditional provisions of corporate law (e.g., staggered boards and cumulative voting), many of which enable management to pursue antitakeover action. *See* Langevoort, *supra* note 17, at 100, 106, & 108-10.

See Kozyris, *Corporate Takeovers at the Crossroads: Drawing the Lines Between Federal and State Authority at the Transferability Features of "Interstate Stock,"* 36 U.C.L.A. L.J. (forthcoming, Aug. 1989). This article articulates a proposal to protect the free markets in the securities, and control of our national and international corporations without preemption, by defining through federal law the "transferability" features of stock traded in the interstate market. The proposal draws a bright line between federal and state authority, thus producing certainty and reducing litigation. The area allocated to federal law is limited along traditional lines, focusing on securities regulation. Thus, the entire field of internal corporate affairs is left to state law. Federal law is made effective, however, by insulating the free and effective transferability of interstate stock against encroachment not only under the antitakeover statutes themselves but also by "private" corporate action, e.g., poison pills, taken under the vastly enabling clauses of general corporate law. *Id.*

Instead, the emphasis here will be placed on the commerce clause holding of *CTS*. On this occasion, a more systematic study of commerce clause doctrine and of constitutional jurisprudence will be attempted as it affects choice of law for corporate internal affairs in general[20] and for antitakeover devices in particular. The main issue is the extent to which states other than the state of incorporation may apply their laws to the transfer of control of multistate corporations which have some local contacts. A second issue is the scope of state authority to regulate multistate transactions in securities.

II. THE STRENGTHENING OF THE LAW OF INCORPORATION IN *CTS* AND THE NOTION OF "INCONSISTENT REGULATION"

In deciding that Indiana was free to restrict the transfer of control of its corporations in interstate commerce, the *CTS* majority had to take a position (or at least make certain assumptions on a number of controversial aspects of dormant commerce clause doctrine) limiting state power to regulate interstate transactions even in the absence of federal legislation.[21] First, the Court did not read the clause so narrowly as to strike down only legislation that discriminated against or singled-out interstate commerce. Thus, other types of burdens must be evaluated against the claimed local ben-

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20. The two most recent and comprehensive studies of corporate choice of law were both published in 1985. *See* Kozyris, *supra* note 10; DeMott, *Perspectives on Choice of Law for Corporate Internal Affairs*, 48 LAW & CONTEMP. PROBS. 161 (Summer 1985). The present article is intended to update, supplement, refine, and extend these studies, assessing the significance of *CTS* and its progeny. Not only will the doctrine thus be enriched, but also practical implications of major importance will be pursued, especially in the antitakeover context.

21. The Court of Appeals for the First Circuit recently stated that:

> [p]erhaps the most eloquent and comprehensive analysis of dormant Commerce Clause doctrine was provided by Justice Jackson in *H.P. Hood & Sons v. DuMond*, 336 U.S. 525, 69 S. Ct. 657, 93 L.Ed. 865 (1949). In that opinion, he wrote for a majority of the Court:
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> "While the Constitution vests in Congress the power to regulate commerce among the states, it does not say what the states may or may not do in the absence of congressional action, nor how to draw the line between what is and what is not commerce among the states. Perhaps even more than by interpretation of its written word, this Court has advanced the solidarity and prosperity of this Nation by the meaning it has given to these great silences in the Constitution."

Hyde Park Partners, L.P. v. Connolly, 839 F.2d 837, 843 (1st Cir. 1988) (quoting H.P. Hood & Sons v. DuMond, 336 U.S. 525, 534-35 (1949)).

efits.[22] Second, by using this weighing process as the single method of evaluation, the *CTS* majority appeared to continue the retreat from the differentiation between "direct regulation" of extraterritorial conduct, which is prohibited per se, and "indirect effects" on interstate commerce which may be counterbalanced by local interests.[23] Third, the fact that the challenged statute pursued a regulatory objective rather than enhanced the freedom of commerce did not, as such, "burden" interstate transactions: the commerce clause apparently does not embody a free market philosophy so as to make economic protectionism suspect.[24] This lack of economic orientation, however, when coupled with the abolition of the formal distinction between regulating "conduct" and producing "effects," creates a big gap in dormant commerce clause doctrine. What is there in the dormant commerce clause beyond shielding interstate activities from negative differential treatment, such as discrimination or singling-out? By what criteria are we to decide whether an

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22. The most forceful argument against using a burden-benefit balancing test has been made in Regan, *The Supreme Court and State Protectionism: Making Sense of the Dormant Commerce Clause*, 84 MICH. L. REV. 1091 (1986). Professor Regan limits his attack principally to "movement of goods" cases. *Id.* at 1098-101, 1177, 1185-91. Professor Regan recognizes that in other contexts, e.g., transportation, taxation, especially where there is a constitutional interest in uniformity, balancing may be required to avoid inconsistent or excessive regulation. *Compare id.* at 1184-86 *with* Regan, *supra* note 17, at 1881-84.

23. The preference for a single test to govern both direct regulation and indirect burdens is illustrated in a 1983 Supreme Court case. *See* Arkansas Elec. Coop. Corp. v. Arkansas Pub. Comm'n, 461 U.S. 375, 379 (1983) (signaling a retrenchment from the holding in Pike v. Bruce Church, Inc., 397 U.S. 137 (1970)). *See* L. TRIBE, AMERICAN CONSTITUTIONAL LAW 408-09 (2d ed. 1988) (commenting favorably on this retrenchment).

It is to be remembered that four Justices in *MITE* had concluded that the Illinois statute was also invalid because it directly regulated out-of-state transactions. This makes the *CTS* abandonment of the distinction even more significant. *Compare MITE*, 457 U.S. at 640 *with CTS*, 481 U.S. at 90-93.

24. *CTS*, 481 U.S. at 94 (opinion of the Court), 94-96 (Scalia, J., concurring in part and concurring in the judgment). *See also* Regan, *supra* note 17, at 1871-73. *Cf.* Exxon Corp. v. Governor of Md., 437 U.S. 117, 127 (1978) (upholding Maryland statute that prohibits gasoline producers or refiners from operating retail service stations within a state does not violate commerce clause, because commerce clause does not protect particular retail market structures but rather the interstate market).

Again, the contrast with *MITE* is manifest. In *MITE*, Justice White hinted that the commerce clause protects the freedom of takeovers in the interstate securities markets because they provide opportunities to shareholders to sell their shares at a premium and lead to a reallocation of economic resources to the highest valued use. *See MITE*, 457 U.S. at 643-44.

antitakeover statute "burdens" interstate commerce and how are we to know that the "weight" of such burdens is greater than the local "benefits" obtained?

The answer would appear to lie, as suggested by Professor Horowitz some years ago, in the core notion of "facilitation" of interstate transactions.[25] This should include, for example, the facilitation of the interstate mobility of resources (goods, assets, capital, management, even labor).[26] Closer to our topic, it should include the freedom from multiple regulation of interstate activities whose parts may be dispersed among the various states but which are inherently unitary, such as internal corporate affairs, including changes of control. This penumbral interpretation of the dormant commerce clause is congruent with the basic premise of its "positive" aspects that the United States is one market and that interstate commerce belongs to the federal realm and should be regulated uniformly.

A careful examination of *CTS* shows that it is the facilitation approach that forms its commerce clause holding and explains its emphasis on the unity of the subject regulated.[27] The Indiana Act was upheld because it did not create an "impermissible risk of inconsistent regulation."[28] This conclusion was not problematic be-

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25. Horowitz, *The Commerce Clause as a Limitation on State Choice-of-Law Doctrine*, 84 HARV. L. REV. 806, 817-23 (1971). *See* Collins, *Economic Union as a Constitutional Value*, 63 N.Y.U. L. REV. 43 (1988). *Cf.* Regan, *supra* note 22, at 1184-86 (discussing how the existence of an effective transportation network links the states); and Regan, *supra* note 17, at 1882-84 (discussing importance of transportation and communication infrastructure for the economy and its constitutional significance to the political union).

26. *See* Buxbaum, *Federalism and Company Law*, 82 MICH. L. REV. 1163, 1168-80 (1984). *Cf.* Cox, *supra* note 17, at 339 (discussing the appropriate scope of federal regulation of commerce and the Supreme Court's role as federal regulator). *See also MITE*, 457 U.S. at 646 (Powell, J., concurring). Justice Powell expressed concern about the imbalance of power between national and multinational conglomerates on the one hand and local targets on the other, and suggested that the "general public interest" of a state to impede the movement of the headquarters of its corporations to the large metropolitan centers in support of its regulation of tender offers is unpersuasive. This kind of state motivation is the archetype of the "economic balkanization" which must be stopped if our interstate markets are to be integrated. *Id. See CTS*, 481 U.S. at 97 (White, J., dissenting); Lewis v. BT Inv. Managers, Inc., 447 U.S. 27 (1980); Cox, *supra* note 17, at 342-43; Langevoort, *supra* note 17, at 117; Regan, *supra* note 22, at 1093-98; Regan, *supra* note 17, at 1871.

27. *CTS*, 481 U.S. at 87. *See infra* note 35. *See also* Kozyris, *supra* note 10, at 49-50.

28. *CTS*, 481 U.S. at 89.

cause the *lex incorporationis* as the "single law" of the corporation is consecrated by a long tradition in choice of law and rests on constitutional underpinnings, especially under the full faith and credit clause.[29] The Court had to grapple only with a positive application of the *lex incorporationis* and needed only to confirm the authority of Indiana to apply its law in the particular circumstances. The more difficult question of when, if ever, the application of another law may be tolerated as not constituting "inconsistent regulation" by another state or as not being excessively burdensome was not before the Court and was not addressed. The Court hinted that this may occur only in the "rarest situations."[30]

This suggests that neither *CTS* nor *MITE* directly constitutionalize the *lex incorporationis*. Of course, both cases assume and refer approvingly to this choice of law rule but this is only in a commerce clause balancing context and not under the stricter full faith and credit clause. The Court recognizes that the state laws "regulating corporate governance . . . necessarily affect certain aspects of interstate commerce [because large corporations] have shareholders in many States and shares that are traded frequently";[31] in other words, such laws operate extraterritorially.[32] But the Court is

29. *See infra* note 36.

30. *CTS*, 481 U.S. at 90.

31. *Id.* at 89-90.

32. Whether simple "extraterritoriality," i.e., application of state law beyond the authority of the particular state, raises a specific commerce clause problem is disputed in the legal literature. Professor Regan takes a negative view arguing instead that anti-extraterritoriality or, more simply, territoriality is "one of those foundational principles of our federalism which we infer from the structure of the Constitution as a whole." Regan, *supra* note 17, at 1885. While the Regan explanation is quite persuasive as to why no single constitutional clause adequately supports such a principle, the discussion suffers from his failure to explore the international context, where the issue of extraterritoriality has received the most extensive systematic study to date. His assumption also suffers from his reliance on the questionable assumption that, for some intrinsic reason, state authority is presumably territorial rather than personal and that in-state "conduct," rather than "effects," support regulation. *Cf. id.* at 1876-79, 1899 (presenting these views). Professor Regan's concern with lack of authority to regulate extraterritorial conduct, coupled with his resignation to the fiction that internal corporate affairs are "located" in the state of incorporation, tend to strengthen the dominance of the *lex incorporationis* even beyond *CTS*. *Cf. CTS*, 481 U.S. at 1876-79, 1897 (discussing importance of *lex incorporationis*). *Cf. Hyde Park Partners*, 839 F.2d at 845 (discussing "intra-state corporate governance"). In a recent federal case involving the takeover of a foreign company by another foreign company, a motion for preliminary injunction was derived on the ground that the tender offer rules of the Williams Act are inapplicable extraterritorially. The court concluded that it

satisfied that the burden imposed out-of-state by virtue of the global application of corporate internal affairs law is more than outweighed by the long-standing power and interest of the incorporating state to regulate the internal affairs of its own corporations.[33] Thus, such state authority is taken into account by way of justification and it is not given constitutional sanctification.[34]

Strong doctrinal and practical reasons support the single law principle in interstate matters requiring uniform treatment and the reinforcement of the *lex incorporationis*. Internal corporate affairs should

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lacked subject matter jurisdiction under both the "conduct" and "effects" tests of extraterritoriality where the alleged fraud was only incidentally connected with the United States and there were only a few United States shareholders who were excluded from the offer. The fact that the target had substantial United States holdings was not found to constitute a relevant contact in this respect. The SEC had urged the court to find that the offer had substantial effects in the United States, supporting jurisdiction, but that a worldwide injunction should not be granted because of the overwhelming nature of the foreign connections. *See* Consolidated Gold Fields, PLC v. Anglo American Corp. of S. Africa Ltd., 698 F. Supp. 487, 496-97 (S.D.N.Y. 1988).

See Brilmayer, *The Extraterritorial Application of American Law: A Methodological and Constitutional Appraisal*, 50 LAW & CONTEMP. PROBS. 11 (1987) Brilmayer's article further explores the relationship between choice of law and extraterritoriality, correlating the RESTATEMENT (SECOND) OF CONFLICTS (1971) with the RESTATEMENT (REVISED) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 721 (1988), and explores the due process roots of the territoriality principle, and saying that legal overextension most likely impinges upon some person's property and liberty interests. Brilmayer, *supra*, at 24-28.

Significantly, the *CTS* majority avoids the use of the word "extraterritoriality." This noteworthy abstension is to be contrasted with *MITE*, where Justice White had condemned the "sweeping extraterritorial effect" of the Illinois statute in the context of the "direct" regulation of interstate commerce. *MITE*, 457 U.S. at 642-43.

33. *CTS*, 481 U.S. at 89.

> No principle of corporation law and practice is more firmly established than a State's authority to regulate domestic corporations. . . .This beneficial free market system depends at its core upon the fact that a corporation—except in the rarest situations—is organized under, and governed by, the law of a single jurisdiction, traditionally the corporate law of the State of its incorporation. . . . A State has an interest in promoting stable relationships among parties involved in the corporations it charters . . . .

Id. at 89-91. *See also id.* at 96-97 (Scalia, J., concurring) (discussing "sacrosanct" authority of a state over the structure of domestic corporations).

34. In a similar vein, the SEC interprets *CTS* to mean that the *lex incorporationis* is not automatically valid but must operate consistently with the prohibition against excessive burdens on interstate commerce. *See* Salant Acquisitions Corp. v. Manhattan Indus., 682 F. Supp. 199 (88 Civ. 686) (S.D.N.Y. 1988). *Salant* was a challenge to the constitutionality of the New York antitakeover statute. The case was eventually settled without a decision on the merits.

be subjected to a unitary, cohesive, consistent, predictable, equal, and continuous regime of regulation. The rights, powers and obligations of many persons in many capacities over long periods of time are so delicately intertwined, connected and balanced within the corporation that any interference in any part is bound to have repercussions elsewhere and to affect the complexion of the whole. Giving preference to the law of incorporation as the single law not only increases certainty and facilitates planning but also gives effect to the mutual, voluntary compact made between the state and the organizers of the corporation and their successors.[35]

These perceptions and considerations explain why the proposition that the state of incorporation has the power to regulate internal corporate affairs globally and irrespective of the location of the particular corporate contacts is virtually axiomatic in American conflicts law.[36] Indeed, many states expressly include the *lex incorporationis*

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35. *See* Hart v. General Motors Corp., 129 A.D.2d 179, 184-85, 517 N.Y.S.2d 490, 493 (1987) (discussing the significance of voluntary choice of law of incorporation by the parties); Kozyris, *supra* note 10, at 49-51 (authorities therein present arguments supporting the *lex incorporationis* and the single law rule). *See also* Ratner & Schwartz, *The Impact of* Shaffer v. Heitner *on the Substantive Law of Corporations*, 45 BROOKLYN L. REV. 641, 665-74 (1979). *But see* Sargent, *Do the Second-Generation State Takeover Statutes Violate the Commerce Clause?*, 8 CORP. L. REV. 3, 19-20 (1985) (questioning the argument that considerations of efficiency and predictability justify the strict internal affairs doctrine). *Cf.* Rogers v. Guaranty Trust Co., 288 U.S. 123, 130 (1933) (discussing, as settled, the rule of looking toward the state law of a corporation's domicile to answer questions of management and internal affairs).

In the most articulate corporate choice of law case reported, the Supreme Court of Delaware, not surprisingly, cogently explained the merits of the *lex incorporationis* and defended its constitutional roots. *See* McDermott Inc. v. Lewis, 531 A.2d 206, 215-17 (Del. 1987).

36. *See* Kozyris, *supra* note 10, at 15-26 (discussing the prevalence of the *lex incorporationis* in the United States, both in creating the corporate personality and in governing the internal corporate affairs). In some continental countries, this law may be trumped by the law of the state where the "actual seat" of the corporation is located; but this card can be effectively played only by the state where such seat is located so that, by its own terms, it is unavailable to other states or against genuinely multistate or multinational corporations. Thus, the exception bears some resemblance to the "pseudo-foreign" corporation exception in American law. The pseudo-foreign corporation has been defined as a corporation "whose existence, apart from the legal fact of foreign incorporation, is confined to one state." DeMott, *supra* note 20, at 166 (citation omitted). *See infra* note 65. *See also* Kozyris, *supra* note 10, at 51-55. *Cf.* Convention Relating to the Mutual Recognition of Companies and Legal Persons, Common Mkt. Rep. (CCH) § 6255, at 5211 (1968); Draft Convention Concerning Recognition of the Legal Personality of Foreign Companies (Sociétiés), Associations, and Foundations, *reprinted in* 1 AM.

in their statutes[37] and all states have been applying their law to their own corporations without hesitation or reservation. It is further quite remarkable that this mechanical proposition has been basically left alone even by the subjectivist, antirule, parochialist conflicts theories that have become fashionable in recent years.

Professor Buxbaum is critical of the *lex incorporationis* aspect of *CTS* and has suggested that the dormant commerce clause is not the best source of authority to control the "inconsistent" regulation of internal corporate affairs because its fundamental function is to operate vertically, that is, to safeguard the national power over interstate commerce from state encroachment, rather than to restrain the states from horizontally overextending their powers over each other.[38] This point is well taken in so far as it supports the notion that national commerce, including national corporate affairs, needs the affirmative attention of Congress.

The basic idea that legislative authority should be so distributed that the source of regulation is of the same dimension as that of the activity regulated is quite sound. The positive aspects of the commerce clause are indeed based on a policy that matters should be regulated nationally in a uniform way, not locally on a piecemeal basis. There is no question that Congress has plenary power to adopt a full set of corporate law principles or minimum standards or at least an opt in federal corporate statute for multistate entities.[39] The argument that such power should be exercised is quite persuasive: neither in logic nor in policy does it make a great deal of

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J. COMP. L. 277 (1952). See also Article 58 of the Treaty Establishing the European Economic Community (Rome Treaty), Common Mkt. Rep. (CCH) § 1491, at 1335 (1968), which includes among the "community" companies entitled to the crucial right of establishment throughout the European Economic Community (EEC), those that are organized under the laws of a member state and have their registered offices within the community, i.e., those that meet only the formal requirements of the *lex incorporationis*.

37. *See, e.g.*, Kozyris, *supra* note 10, at 26-30 (discussing statutory support for the rule of *lex incorporationis*).

38. Buxbaum, *supra* note 17, at 34-36.

39. *See* Boyer, *Federalism and Corporation Law: Drawing the Line in State Takeover Regulation*, 47 OHIO ST. L.J. 1037, 1038-56 (1986) (discussing congressional power in this area with extensive historical and conceptual tracing, including Congressional reticence to enter this field); Fiflis, *Of Lollipops and Law—A Proposal for a National Policy Concerning Tender Offer Defenses*, 19 U.C. DAVIS L. REV. 303, 308 (1986) (opining that multistate entities should be governed by broad national internal affairs legislation); Woodward, *How Much Indiana's Anti-Takeover Law Cost Shareholders*, Wall St. J., May 5, 1988, at 32, cols. 3-6 (discussing federal regulation of internal affairs based on an opt in concept).

sense for national or even world-wide enterprises, such as General Motors, to be governed by the law of Delaware. The need for coherence in the law governing such enterprises is clearly recognized in the EEC where one of the major steps for the implementation of the Common Market is the harmonization of the corporate law of the states and the eventual creation of a form of a Societas Europea for multistate enterprises.[40] Professor Buxbaum proposes recourse to the full faith and credit clause instead of the commerce clause to help sort out the issues of national uniformity raised by internal corporate affairs.[41] To be sure, this clause has a role to play in promoting national uniformity and Professor Buxbaum is in good company in recognizing this.[42] The single law principle and the primacy of the *lex incorporationis* were clearly grounded on full faith and credit in a line of old cases involving fraternal benefit associations culminating in *Order of United Commercial Travellers v. Wolfe*,[43] the last Supreme Court case to require adherence by one state to the law of another state, there, the law of the state of incorporation. The logic of these cases extends to commercial corporations.[44] But the proposal that the commerce clause should be left completely out of the picture is less plausible where interstate

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40. The form of the Societas Europea will be governed by an EEC statute and will be made available only to enterprises operating in more than one member state of the EEC. This project received new impetus on June 8, 1988 with the approval by the commission of a new text which was submitted for comment to the Parliament, the Council, and the States, in preparation of the unification of the internal market by 1992. Bulletin of the EEC (Supp. Mar. 1988, Comm. (88) 320).

41. Buxbaum, *supra* note 17, at 35, 43-47.

42. *See* Kozyris, *supra* note 10, at 33-35, 38 n.181, 49-52 & 55-61. Numerous authorities support recourse to full faith and credit analysis. *See* R. WEINTRAUB, COMMENTARY ON THE CONFLICT OF LAWS 553-54, n.90 (3d ed. 1986); Boehm, *State Interests and Interstate Commerce: A Look at the Theoretical Underpinnings of Takeover Legislation*, 36 WASH. & LEE L. REV. 733, 754 (1979); Cox, *supra* note 17, at 319; DeMott, *supra* note 20, at 190-97; Hay, *Full Faith and Credit and Federalism in Choice of Law*, 34 MERCER L. REV. 709 (1983); Horowitz, *supra* note 25; Reese & Kaufman, *The Law Governing Corporate Affairs: Choice of Law and the Impact of Full Faith and Credit*, 58 COLUM. L. REV. 1118 (1958); and Weintraub, *Due Process and Full Faith and Credit Limitations on a State's Choice of Law*, 44 IOWA L. REV. 449, 478-79 (1959).

On the other hand, Brainerd Currie has argued against the full faith and credit notion, suggesting that national uniformity, however desirable, is a matter of policy which should be pursued by Congress, not the courts. B. CURRIE, SELECTED ESSAYS ON THE CONFLICT OF LAWS 188, 253-59, 271-82 (1963).

43. 331 U.S. 586 (1947).

44. *See McDermott, Inc.*, 531 A.2d at 215-19 (expressing clearly and thoroughly *lex incorporationis* logic).

commerce is vitally affected and state-by-state regulation may seriously disrupt it. The main problem with the Buxbaum proposal, however, lies not so much in its doctrinal direction as in the narrow scope that he gives to the full faith and credit clause in the legislative sphere and in his belief that the credit due to judgments under the clause could operate on an ad hoc basis adequately to meet the recognized needs of predictability, continuity, uniformity and equal treatment for internal corporate affairs.

Whether we operate in a commerce clause or in a full faith and credit clause mode in this area, the key notion that triggers constitutional scrutiny is the "inconsistent regulation" of matters that require uniform treatment. Professor Buxbaum is apparently not convinced that internal corporate affairs constitute a single, integrated, independent subject.[45] Without such foundation, Professor Buxbaum is quite willing to tolerate the application of different state laws to different issues of internal affairs or even to the same issues arising between different parties or at different times or places and to delegate continuity and unity solely to the res judicata effect of judgments won by those parties that pursue litigation in the courts.[46] These judgments, which would bind the litigants and their

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45. This opinion is illustrated by Professor Buxbaum's categorization of substantive internal affairs rules according to degree. *See* Buxbaum, *supra* note 17, at 37. Buxbaum's view permits him to disregard, as trivial, differing state code provisions that grant shareholder rights, such as the right to inspect the corporation's stock ledger, the existing list of stockholders, and the corporate records. For Buxbaum, such differences "hardly can be dignified with a burden analysis [called for] under the commerce clause, let alone with the kind of dilemma analysis necessary under the full faith and credit clause." *Id.* at 37-38.

46. Buxbaum, *supra* note 17, at 36-43. A similar but more limited position advocated twenty years ago in Kaplan, *Foreign Corporations and Local Corporate Policy*, 21 VAND. L. REV. 433 (1968), had no impact on legislative and judicial practice. Literally thousands of cases continue to apply routinely the *lex incorporationis*. The handful of cases that can be cited as supporting some deviation from it have all involved "pseudo-foreign" corporations: Norlin Corp. v. Rooney, Pace Inc., 744 F.2d 255 (2d Cir. 1984); Wilson v. Louisiana-Pacific Resources, Inc., 138 Cal. App. 3d 216, 187 Cal. Rptr. 852 (1982); Western Airlines, Inc. v. Sobieski, 191 Cal. App. 2d 399, 12 Cal. Rptr. 719 (1961) (oft-cited case, where the corporation was not only pseudo-foreign, but had also submitted to California's generalized authority as a condition for the prior intrastate sale of its securities); State ex rel. Weede v. Iowa S. Utils. Co. of Del., 231 Iowa 784, 2 N.W.2d 372 (1942), *aff'd sub nom.* State ex rel. Weede v. Bechtel, 239 Iowa 1292, 31 N.W.2d 853 (1948), *cert. denied*, 337 U.S. 918 (1949) (involving the financial requirements for the issuance of securities by a local public utility). *See infra* note 65 (discussing "pseudo-foreign" corporations). Of these cases, only *Wilson*, in its alternative holding, develops a more flexible doctrine which would support a piecemeal intervention

successors and assigns, as well as perhaps some parties similarly situated and the corporation, would help solve the only real problem of "inconsistency" recognized by Buxbaum in this area of the law; namely, the situation where one state commands what the other prohibits. The choice between the two would be made in each case through litigation.[47]

If this trivialization of "inconsistency" were accepted, the applicable law to each internal affairs issue of the typical multistate corporation would be in constant flux. The courts would be constantly burdened with determinations about the res judicata scope of prior decisions and with factual findings on the evolving corporate circumstances supporting the application of another law and with decisions on the inner compatibility of the amalgam of cumulatively applicable provisions. Corporate parties would be encouraged to rush to the courts to shop for a favorable law applicable to any particular issue and have it frozen, at least for a while, for themselves and for those in privity with them. This goes beyond deviating from the single law principle only in the "rarest situations" as envisaged in *CTS* and is not reflective of the traditional prevalence of the *lex incorporationis* in practice. Indeed, it is fundamentally contrary to the very notion that internal corporate affairs is one subject which needs uniform regulation over time, place, and persons and that interference with any part of it, however discreet or apparently insignificant, imbalances the whole.

The acceptance of the unity of internal corporate affairs[48] leads to a much broader definition of inconsistency, which is also closer to the Supreme Court's perception of the function of the commerce clause and the full faith and credit clause in this field. Under this definition, "inconsistency" is present every time the same issue of internal corporate affairs is treated differently by the potentially applicable laws. This inconsistency, of course, starts with the irreconcilable conflict situation, e.g., where one state mandates cumulative voting whereas another state requires straight voting. But it does not stop there. It extends to the permissive-mandatory conflict, where the state of incorporation permits the choice of what another state requires, e.g., again cumulative versus straight voting.

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in the internal affairs of foreign corporations in the manner espoused by Buxbaum and Kaplan.

47. Buxbaum, *supra* note 17, at 40-43, 45-47, 50-52.

48. *See* Kozyris, *supra* note 10, at 49; *supra* text accompanying note 35.

The fact that most states allow within their corporate law a wide range of options to the incorporating parties does not mean that there is a standing invitation to other states to fill the "gaps" by mandatory provisions.

To return to the cumulative voting example, the states that allow, but do not require it, have made a choice either favoring corporate governance under majoritarian principles, protecting minority interests in other ways, or under an enabling philosophy, leaving it to the organizers or shareholders to decide what fits their needs in matters of voting. The superimposition of another state's mandatory cumulative voting rules contradicts one or more of these three choices. Inconsistency even reaches the simplest "two-hurdles" situation, where the lower requirements of the state of incorporation, e.g., on directorial fiduciary duties or on shareholder inspection rights, are automatically satisfied where a higher standard from another state is complied with. Such lower requirements, presumably deliberately chosen and not the result of neglect or indifference, constitute part of a finely tuned, balanced system of corporate governance and are contradicted by the superimposition of stricter provisions.

While in *CTS* it was not necessary for the Supreme Court to refine the notion of "inconsistency," there are clear signals that subjecting the corporation to more than one internal affairs regime would generate inconsistency regardless of whether such cumulation produces contradictory results. The Supreme Court's virtual canonization of the *lex incorporationis* and its understanding that exceptions to the single law principle occur only in the rarest situations[49] leave no room for even the routine application of potentially compatible provisions. In the few post-*CTS* cases dealing with antitakeover statutes which were made applicable to foreign corporations, the lower courts also took the view that mere cumulation established inconsistency. These courts invalidated provisions which created a "risk" of subjecting internal affairs to "different requirements"

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49. *CTS*, 481 U.S. at 89. "So long as each State regulates voting rights only in the corporations it has created, each corporation will be subject to the *law of only one State.*" *Id.* (emphasis added). "[The] beneficial free market system depends at its core upon the fact that a corporation—*except in the rarest situations*—is organized under, and governed by, the law of *a single jurisdiction, traditionally the corporate law of the State of its incorporation.*" *Id.* at 90 (emphasis added). "As long as a State's corporation law *governs only its own corporations* . . . it should survive this Court's scrutiny . . . ." *Id.* at 95 (Scalia, J., concurring) (emphasis added).

without examining whether cumulative compliance was feasible.[50]

The notion of "inconsistency as difference" adumbrated in *CTS* and the subsequent cases is not novel but reflects commerce clause doctrine which has been developed by the Supreme Court over the years in other interstate fields, especially transportation. In *Southern Pacific Co. v. Arizona ex rel. Sullivan*,[51] Arizona imposed maximum limits on the length of trains passing through the states. It was clear from the facts that interstate carriers could comply with these requirements either by reconstituting the coaches at the state border or by simply operating shorter trains since no state mandated longer trains. In holding the regulation unconstitutional as impeding on the free flow of commerce, the Supreme Court stressed two elements: first, that the law controlled the operations of the carrier both "within and without the state,"[52] thus operating extraterritorially; and second, under these circumstances, there was a "practical necessity" that the regulation be prescribed by a "single body."[53] The length of trucks rather than trains was at issue in *Raymond Motor Transportation, Inc. v. Rice*.[54] Wisconsin limited the length of trucks to fifty-five feet. No state law prohibited short trucks, therefore, the law created no irreconcilable conflict. Nevertheless, under the standard articulated in *Southern Pacific*, the Court held the regulations invalid.[55] A similar type of control by Iowa (prohibition of long double trailer trucks) was held unconstitutional for the same reasons in *Kassel v. Consolidated Freightways Corp. of Delaware*[56] with emphasis on the increased cost of compliance.[57] The relevance of these cases

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50. *See infra* notes 114-18 & 123.

51. 325 U.S. 761 (1945).

52. *Id.* at 773.

53. *Id.* at 775. The court's commerce clause analysis involved weighing the asserted safety purpose of the regulation against the degree of interstate commerce interference. *Id.* at 781-82.

54. 434 U.S. 429 (1978).

55. *Id.* at 443, 447. The Court recognized that the regulations imposed a substantial burden on the interstate movement of goods by requiring shippers to use shorter, less efficient trucks when transversing Wisconsin. *Id.* at 445. The Court thereafter held "that the challenged regulations violated the Commerce Clause because they place a substantial burden on interstate commerce and they cannot be said to make more than the most speculative contribution to highway safety." *Id.* at 447.

56. 450 U.S. 662 (1981).

57. The potential for subjecting activities to inconsistent regulations was cited in these three cases as the adverse affect on interstate commerce that necessitated each statute's invalidation. *CTS*, 481 U.S. at 88.

to deciding issues of "inconsistency" in the corporate field is quite apparent. In both the transportation and corporate fields (a) a single matter (size of interstate conveyances, internal affairs of multistate corporations), is regulated by more than one state on the basis of contacts that generate local interests; (b) the local regulation by each state has necessary effects upon out-of-state conduct; and (c) there is a practical need for a single regime of regulation. In addition, in the corporate field there is an even greater risk of generating incompatibility through cumulative controls. Although it may be possible to regulate the length of trains or trucks without affecting the other aspects of these conveyances, the nature of a corporation makes it difficult to regulate one aspect of internal affairs without imbalancing the total system.

In addition, two recent Supreme Court cases deserve special mention here as they undermine the extraterritoriality of regulating local transactions aimed at protecting local interests and fortifying the single source concept. The first case is *Brown-Forman Distillers Corp. v. New York State Liquor Authority*,[58] where New York required local liquor distributors simply to affirm that their out-of-state pricing policies were consistent with certain New York standards.[59] It was obvious that, as a practical matter, a distributor had a choice of either complying with the New York standards extraterritorially or not doing business in New York at all. Even though there was no indication that these standards were incompatible with any other potentially applicable rules of other states, and there was no question that New York had a legitimate basis for legislating in this area, the Court held that the requirements imposed "inconsistent obligations" in violation of the commerce clause.[60] The Court stressed that New York impermissibly sought to force the local distributors to limit activities in other states which were lawful there, thus indirectly controlling liquor prices elsewhere.[61] The second case is

58. 476 U.S. 573 (1986).

59. *Id.* at 576. The New York statute required the distributors to file a schedule of prices along with an affirmation that prices set forth therein were not higher than the lowest price at which the item would be sold to purchasers in other states. *Id.*

60. *Id.* at 583.

61. *Id.* at 583-84. The Court relied heavily on the case of Baldwin v. G.A.F. Seelig, Inc., 294 U.S. 511, 521-22 (1935), where New York had unsuccessfully attempted to influence out-of-state prices of milk sold in New York in a manner more direct than price affirmation. The earliest case where the "single national

International Paper Co. v. Ouellette,[62] where the issue was not commerce clause compatibility but federal preemption under the Clean Water Act. In holding that only one state, at the source upstream, could superimpose its regulatory standards on the federal standards and that neither choice of law nor the cumulation of compatible laws was permissible, the Court emphasized the practical necessity and wisdom of only one state law governing a single water source.[63]

One further thought should be articulated here, relating to the possible use of the full faith and credit that is due judgments to reduce the uncertainties over what internal affairs rules govern particular multistate corporations. As already explained, Professor Buxbaum has suggested that a stream of litigation pursued by private parties and the corporation over time and place could eventually provide an amalgam of compatible standards broadly binding under principles of res judicata.[64] While the nonlegislative aspect of this clause is also potentially useful in fixing the applicable law to internal corporate affairs, a better idea is to employ it in exactly the opposite direction than that envisaged by Professor Buxbaum so as to underwrite, rather than undermine, the *lex incorporationis*! To begin with, it can be persuasively argued that the corporate charter itself, constituting a governmental document which internally purports to be subject to the law of the state of incorporation, is a "public record" of a state which must be respected throughout the United States. If further games are to be played through judgments, however, the indicated approach would be for the corporate organizers to go to the courts right at the outset and obtain a declaratory judgment, as is done in some European countries, to the effect that the corporation is validly formed and governed by the *lex incorporationis*. This document would have the full force of res judicata and would bind all corporate parties and their successors on all internal affairs issues in the state of incorporation and elsewhere.

The conclusion in this section is that the United States tradition of applying a single law to internal corporate affairs, normally that

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standard" idea under the dormant commerce clause surfaced is Cooley v. Board of Wardens, 53 U.S. (12 How.) 298 (1852). In *Cooley*, the Court stated that "the power to regulate commerce, embraces a vast field, containing not only many, but exceedingly various subjects . . . some imperatively demanding a single uniform rule, operating equally . . . ." *Id.* at 318.

62. 479 U.S. 481 (1987).

63. *Id.* at 812-13.

64. *See supra* notes 46, 47.

of the state of incorporation, which had been perceived to have constitutional underpinnings emanating from the full faith and credit clause, has now been reinforced by interpreting the commerce clause to preclude the imposition of multiple regulations to the corporation by the various states of contact. However, this does not suggest that the *lex incorporationis* has become fully constitutionalized. The next two sections will explore where a departure from the *lex incorporationis* may be justified and analyze the implications of the various state antitakeover statutes.

III. THE POTENTIAL EXCEPTIONS TO THE *LEX INCORPORATIONIS*

A. The Pseudo-Foreign Corporation

The most important exception, whose continuing viability should not be significantly affected by *CTS*, involves the "pseudo-foreign" corporation, an entity which, except for a paper record, is in all important respects (shareholdings, management, operations, etc.) domestic to one state.[65] Cutting through the facade of the foreign incorporation and asserting global authority to regulate the internal affairs of this entity may constitute a frontal assault on the *lex incorporationis*. However, because it purports to replace, not to supplement, the governing regime, it does not offend the single law principle and does not offend the dormant commerce clause through cumulative regulation. Furthermore, because there is nothing real extending from one state into another that deserves recognition in the interest of national unity, ignoring the law of incorporation should not be deemed to run afoul of the full faith and credit clause either. The breadth of this category may be debatable but it should shield statutes like section 2115 of California's Corporation Code which applies the core of California's internal affairs law, including the provisions which can be conscripted in antitakeover strategy, to the exclusion of the law of the state of incorporation, to those foreign

65. RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 302, comment (g) (1971). *See* Kozyris, *supra* note 10, at 55-57 (discussing this exception). Among its supporters one should include, in particular, DeMott, *supra* note 20, at 166; Kaplan, *supra* note 46; Oldham, *Regulating the Regulators: Limitations Upon a State's Ability to Regulate Corporations with Multi-State Contacts*, 57 DEN. L.J. 345, 364-70, 375-79, 388-92 (1980); and Sargent, *supra* note 35, at 16-22 (1985). It has been suggested that the pseudo-foreign corporation exception should apply even where the entity has multistate contacts so long as they are concentrated in states having identical provisions in their law. *See* Horowitz, *supra* note 25, at 820.

corporations which are overwhelmingly domestic in three major respects and whose shares are not traded nationally.[66]

B. Blue Sky Securities Regulation in the Territorial Mode

Another enclave somewhat insulated from the *lex incorporationis* derives from the authority of a state to regulate local transactions involving the securities of foreign corporations wherever they are incorporated. Traditional wisdom holds that a state should be able to control the public distribution of all securities within its borders regardless of the affiliations of the issuing corporations.[67] The main reason why the exercise of this type of blue sky authority has not raised constitutional problems is that it is perceived as regulating sales "transactions" and as not implicating internal corporate affairs.

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66. CAL. CORP. CODE § 2115 (West 1988). Section 2115 applies only where a majority of the stock of the corporation, which is not traded nationally, is held in California and at least 50% of its business—measured by averaging payroll, assets and sales—is located in California. The section was first held unconstitutional both on commerce clause and full faith and credit clause grounds in Louart v. Arden Mayfair, No. C-192-091 (Sup. Ct. Los Angeles May 1, 1978) (eventually settled), and its enforcement was prohibited under Delaware law in Delaware. Palmer v. Arden Mayfair, Inc., No. 5549 (Del. Ch. July 6, 1978), *reprinted in* 4 DEL. J. CORP. L. 617 (1979). The section was, however, later upheld in Wilson v. Louisiana-Pacific Resources, Inc., 138 Cal. App. 3d 216, 187 Cal. Rptr. 852 (1982), in part on a "pseudo-foreign" corporation analysis. Both *Palmer* and *Wilson* involved the imposition of cumulative voting on corporations organized under laws which did not require or allow it.

67. *See* Kozyris, *supra* note 10, at 36 n.171, 39 n.183, (old Supreme Court cases upholding this blue sky authority); North Star Int'l v. Arizona Corp. Comm'n, 720 F.2d 578, 583 (9th Cir. 1983) (continuing validity of such laws is recognized); Petrites v. J.C. Bradford & Co., 646 F.2d 1033, 1036-37 (5th Cir. 1981) (same). *See* T. HAZEN, THE LAW OF SECURITIES REGULATION 221-22 (1985); Loss, *The Conflict of Laws and the Blue Sky Laws*, 71 HARV. L. REV. 209 (1957) (discussing validity of blue sky laws); Long, *The Conflict of Law Provisions of the Uniform Securities Act, or When Does a Transaction "Take Place in this State?" Part I*, 31 OKLA. L. REV. 781 (1978) (same).

A recent case serves as a reminder that blue sky authority is limited to intraterritorial distributions and that any excesses will run squarely into the commerce clause. In Arizona Corp. Comm'n v. Media Products, Inc., 158 Ariz. 463, 763 P.2d 527 (1988), it was held that the commerce clause was offended by the application of Arizona's securities' registration requirements to an interstate public offering of stock made from Arizona by a Delaware corporation having a base of operations in Arizona. The offering was made outside of the state and was restricted to nonresidents. Such registration both constitutes a direct regulation of and an indirect excessive burden on interstate commerce.

The blue sky exception is reinforced by the explicit language in § 28(a) of the Securities and Exchange Act of 1934, 15 U.S.C. § 78bb(a) (1982), which protects it from federal preemption.

Such transactions, proposed to persons not presently within the corporate community, i.e., prospective stockholders, occur locally and involve mainly local citizens. Thus, both the territorial and the personal powers of the regulating state come into play. Moreover, a corporation wishing to avoid the regulation of a particular state may exclude it from its distribution and still complete its offering elsewhere.

The holdings in *MITE* and *CTS* should not be read to disturb this tradition. It should be stressed, however, that this enclaved blue sky regulation must be transaction oriented and clearly limited to local events not seeking to control the internal corporate requirements for the issuance or transfer of the securities everywhere. This caveat finds strong support in *United Air Lines, Inc. v. Illinois Commerce Commission*,[68] where the Illinois Supreme Court held that the state violated the commerce clause when it sought to subject the out-of-state issuance of the securities of a Delaware corporation qualified to do business in Illinois to the scrutiny of the Illinois Commerce Commission.[69] The Court went as far as holding that even the domestic portion of the distribution could not be regulated in this manner by Illinois because it would sanction the potential imposition of controls by each state of contact on a single, indivisible interstate act and this would be expensive, time consuming and burdensome.[70] The key difference between this type of regulation and the one that invokes the blue sky power of the state relates to its internal affairs versus its transactional nature.

C. *The* "De Minimis" *Exception, Perhaps?*

Beyond the "pseudo-foreign" corporation and the blue sky transaction exceptions, state power to interfere in the internal affairs

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68. 32 Ill. 2d 516, 207 N.E.2d 433 (1965). *See* United Air Lines, Inc. v. Nebraska State Regulation Comm'n, 172 Neb. 784, 112 N.W.2d 414 (1961) (similar holdings); State *ex rel.* Utils. Comm'n v. Southern Bell Tel. & Tel. Co., 228 N.C. 201, 217 S.E.2d 543 (1975) (same); Panhandle E. Pipe Line Co. v. Public Utils. Comm'n, 56 Ohio St. 2d 334, 383 N.E.2d 1163 (1978) (same).

69. *United Air Lines*, 32 Ill. 2d at 524-25, 207 N.E.2d at 437. The statute authorized public utilities to issue stock and other securities only upon receiving permission from the Illinois Commerce Commission. *Id.* at 518, 207 N.E.2d at 434.

70. *Id.* at 525, 207 N.E.2d at 438. The court commented that if Illinois could exercise its power to approve or disapprove the stock issuance of companies that transact business in Illinois, then so can all other states where those companies provide intrastate service. *Id.* Invalidating the statute, the court stated that "[t]he issuance of securities is a single, indivisible act [that] cannot be fractionalized and given portions allocated to specific States." *Id.*

of foreign corporations which have significant but not overwhelming local contacts is now more problematical than ever. The main reason why the general authority of a state to regulate local events (especially as they involve local people) must yield in the field of internal corporate affairs is that, because of the unity of the subject-matter, (a) it is not realistically possible to limit such regulation of multistate corporations to the local element, and (b) even apparently insignificant rules cannot be tampered with without creating the risk of imbalancing the corporate governance and organization. Consider the shareholder right of inspection of records, especially the corporate ledger, which is arguably the most amenable to differential regulation. If regulation by a state where some persons or records or other contacts are located is total, it obviously purports to change the rights and obligations of out-of-staters exercisable out-of-state in a manner inconsistent with the comparable provisions of the law of incorporation.[71] If, on the other hand, the state were to limit the reach of the regulation to local shareholders[72] or to local records, it would create different classes of shareholders and records, thus violating the corporate principles of identical treatment of these matters regardless of particular locations. This may run afoul of the full faith and credit and commerce clauses, as well as the privileges and immunities and equal protection clauses of the Constitution.[73] Furthermore, while the inspection of records seems trivial, and subjecting the corporation to different or, even the strictest rules, does not appear logistically very burdensome. There is little question

71. For example, CAL. CORP. CODE § 1600(d) (West 1988) applies California's inspection law to foreign corporations that have their principal offices or customarily hold board meetings in the state. In Valtz v. Penta Inv. Corp., 139 Cal. App. 3d 803, 188 Cal. Rptr. 922 (1983), the court, upholding the constitutionality of this provision, opined that inspection rights need not follow a uniform standard. *Id.* at 808, 188 Cal. Rptr. at 925. The court also assumed, without explanation, that the statute did not operate extraterritorially and dismissed a commerce clause challenge on grounds reflecting an extremely narrow reading of the clause, to wit, that the corporation's ability to do interstate business was not affected and that, in any event, it was a valid condition on the corporation's doing business in California. *Id.* at 808-09, 188 Cal. Rptr. at 925-26. It is respectfully submitted that this decision is plainly wrong on all counts. *See* Kozyris, *supra* note 10, at 70-71. The analysis of the impact of *CTS* in the text makes this all the more evident. *See also* Cox, *supra* note 17, at 352-53 n.189.

72. *See, e.g.*, N.Y. BUS. CORP. L. § 912(13)(B) (McKinney 1989), for corporations deriving the majority of their income from New York sources.

73. *See* Kozyris, *supra* note 10, at 71, n.349 (citing relevant authorities); Cox, *supra* note 17, at 352-53 n.189.

that a broader right could prove crucial where, for example, a major battle for control is being waged.

It is suggested that the only reliable way to justify the ad hoc intervention of the states of some significant contacts in corporate matters is to characterize the issues involved as principally not implicating internal affairs. For example, it may be reasonably argued that those New York provisions which apply New York law to foreign corporations doing the majority of their business in New York on such matters as unlawful dividends or loans to shareholders, or perhaps on the limitations on the indemnification and insurance of directors and officers, are principally aimed at external affairs. In other words, they are aimed at the protection of corporate outsiders, e.g., local creditors, and against asset depletion or managerial irresponsibility, rather than at the regulation of the intracorporate relationships. Likewise, the New York provisions relating to derivative actions and voting trusts, which apply to certain foreign corporations, may be characterized as procedural or administrative, and certain other matters may also have contract (voting trust agreements, proxies) or property (transfers of securities) aspects, and to that extent, they may be beyond the *lex incorporationis*.[74]

D. Using State Power Over the Conduct of Local Activities to Reach the Internal Affairs of Foreign Corporations

A speculative but intriguing question is whether, if at all, a state may use its leverage over the conduct of intrastate activities to extract global obedience to its corporate internal affairs laws by the entities involved. For example, may a state require foreign corporations qualifying to do business or selling securities intrastate

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74. *See* Kozyris, *supra* note 10, at 63-69 (discussing deviation from the *lex incorporationis* to protect important local interests). That these special instances of application of local law are viewed as not involving internal affairs matters is corroborated by the many New York cases which adhere to the *lex incorporationis* without perceiving any inconsistency with these statutory provisions. *See, e.g.*, Hausman v. Buckley, 299 F.2d 696 (2d Cir.), *cert. denied*, 369 U.S. 885 (1962); Skolnik v. Rose, 55 N.Y.2d 964, 445 N.Y.S.2d 182, 434 N.E.2d 251 (1982); Zion v. Kurtz, 50 N.Y.2d 92, 428 N.Y.S.2d 199, 405 N.E.2d 681 (1980); Rottenberg v. Pfeiffer, 59 A.D.2d 756, 398 N.Y.S.2d 703 (1977); Greenspun v. Lindley, 44 A.D.2d 20, 352 N.Y.S.2d 633 (1974), *aff'd*, 36 N.Y.2d 473, 330 N.E.2d 79 (1975); and Lewis v. Dicker, 118 Misc. 2d 28, 459 N.Y.S.2d 215 (N.Y. Sup. Ct. 1982).

to conform their charter and bylaws to local law?[75] There are many limitations and obstacles in the path of such an approach. First, it could not validly apply to corporations engaged only in interstate commerce.[76] Second, while a state may exclude foreign corporations,[77] it may not impose unconstitutional conditions on their entry[78] or otherwise regulate or burden their unrelated activities in interstate commerce.[79] While a state probably may require that intrastate activities be carried out only by entities whose internal affairs are subject to its laws, foreign corporations could escape most of the out-of-state reach of such a requirement by organizing a local subsidiary for the local component. However, the parent company, in its capacity as shareholder, would not be able to avoid the rules of the local state. Could the state perhaps go a step further and exclude foreign corporations not subject to its internal affairs laws from the ownership of shares in its domestic corporations?[80] Probably not. This type of approach comes too close to discriminating against or singling out out-of-state commerce, which is at the heart of what the commerce clause prohibits.[81]

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75. In fact, precisely the opposite approach prevails in state practice. For example, § 15.05(c) of the Revised Model Business Corporation Act, restating language that was part of the prior § 106, provides that the Act "does not authorize this state to regulate the organization or internal affairs of a foreign corporation authorized to transact business in this state." The Official Commentary indicates that these "affairs are governed by the state of incorporation even when the corporation's business and assets are located primarily in other states." *Compare* Revised Model Business Corp. Act § 15.05(c) (1984) *with* Model Business Corp. Act § 106 (1979).

76. *See* Eli Lilly & Co. v. Sav-On-Drugs, Inc., 366 U.S. 276 (1961).

77. Exclusion is allowed because a corporation is not a "person" within the privileges and immunities clause of the United States Constitution. Paul v. Virginia, 75 U.S. (8 Wall.) 168 (1868); Railway Express Agency, Inc. v. Virginia, 358 U.S. 434 (1931). *Cf.* German-Am. Coffee Co. v. Diehl, 216 N.Y. 57, 109 N.E. 875 (1915) (Cardozo, J.) (discussing the liability of officers, directors, and stockholders of foreign corporations that do business in the forum state). *See* Kozyris, *supra* note 10, at 61-62. *See also* Coffee & Schwartz, *The Survival of the Derivative Suit: An Evaluation and a Proposal for Legislative Reform*, 81 COLUM. L. REV. 261, 332-33 (1981); Kaplan, *supra* note 46, at 445.

78. Hale, *Unconstitutional Conditions and Constitutional Rights*, 35 COLUM. REV. 321 (1935) (standard reference work on this issue).

79. *See supra* notes 51-59, 63 and accompanying text (discussing cases where predominantly national interests in light of potential multistate regulation outweighed the interest of states with only incidental connections).

80. California's § 2115 takes care not to apply to the internal affairs of foreign parents which own the entire voting stock of a subsidiary. *See* CAL. CORP. CODE § 2115 (West 1988).

81. *See CTS*, 481 U.S. at 87.

The invalidation of the Ohio antitakeover statute is quite instructive on this point. The Ohio Foreign Business Acquisitions Act of 1988,[82] which was targeted at a tender offer by Canadian investors for Federated Department Stores, a Delaware corporation with significant Ohio contacts, required the approval of the Ohio Department of Development before a "foreign business" could acquire control of a "resident business."[83] In *Campeau Corp. v. Federated Department Stores*,[84] the Court had no difficulty in finding that the Ohio Act was unconstitutional on its face both because it discriminated against interstate and foreign commerce and also because it ran the risk of excessively burdening such commerce.[85]

This exploration of the choice of law implications for corporate internal affairs of the dormant commerce clause and the full faith and credit clause, as interpreted and applied in *CTS*, makes it possible now to pursue a more thorough inquiry into the validity of the various approaches used in state antitakeover legislation.

IV. CONSTITUTIONAL CHOICE-OF-LAW IN CORPORATE TAKEOVERS

A. *The Broad Shelter of the* Lex incorporationis

The most unequivocal statement that can be made in this field is that, leaving preemption aside, those state statutes which apply only to domestic corporations and which adopt the form of internal affairs regulations similar to Indiana's "control share acquisition"

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82. Substitute Senate Bill No. 359 (enacting new sections 1710.01-05 of the Ohio Revised Code, to remain in force between February 12, 1988 and July 1, 1988). *See Page's Ohio Revised Code Annotated, February 1988 Legislative Bulletin #2*, at 42 (Anderson 1988).

83. OHIO REV. CODE ANN. § 1710.01(A), (B) (Anderson Supp. 1988) (now repealed).

84. 679 F. Supp. 735 (S.D. Ohio 1988).

85. *Id.* at 738. Special reference should also be made to Baltimore Gas & Elec. Co. v. Heintz, 582 F. Supp. 675 (D. Md. 1984), *rev'd*, 760 F.2d 1408 (4th Cir.), *cert. denied*, 474 U.S. 847 (1985). In *Baltimore Gas*, a Maryland statute which prohibited the acquisition anywhere by any corporation of more than ten percent of the stock of a domestic public utility was challenged and held to violate the dormant commerce clause as excessively burdensome on out-of-state activities. The court suggested, however, that the acquisition could have been subjected to less scrutiny. *See id.* at 679-82. *See also* Western Union Tel. Co. v. Public Serv. Comm'n, 127 Mich. App. 88, 338 N.W.2d 731 (1983). Insurance is the only state law field where the dormant commerce clause is made inoperative, because of federal legislation embodied in the McCarran-Ferguson Act. *See* 15 U.S.C. § 1011-15 (1983).

statute are beyond constitutional challenge.[86] The strength of the *lex incorporationis* is such that the link between a corporation and its state of formation is sufficient to support full internal affairs authority and any additional contacts that may be present, e.g., local shareholdings, are not indispensable but merely reinforcing.[87] A properly comprehensive interpretation of "internal affairs" should bring within this rule the bulk of the state antitakeover regimes currently in effect. The "attributes" of corporate shares,[88] extending not only to their voting rights[89] but also to the conditions of their transferability,[90] are undoubtedly included.

It follows that the *CTS* shield extends to Ohio's second-generation statute which is similar to Indiana's even though it does not require substantial local shareholdings and limits the transferability of stock directly rather than impair its voting rights.[91] It has been already so held in *Veere Inc. v. Firestone Tire & Rubber Co.*,[92] and one should not be surprised to see a reversal of *Fleet Aerospace Corp. v. Holderman*,[93] now on remand, where the statute had been held unconstitutional before *CTS*.

The same should hold true for the second most common form of regulation, the anticombination statutes such as those of Delaware and New York which manipulate the requirements for mergers or

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86. *See CTS*, 481 U.S. at 94.

87. The Indiana requirement that a substantial number of shareholders be Indiana residents was discussed only incidentally by the Supreme Court in a sentence beginning with the word "moreover." *CTS*, 481 U.S. at 93.

88. *Id.* at 94.

89. *Id.* at 90 n.12.

90. *Id.* at 90 n.12. *See* Kozyris, *supra* note 10, at 78-79.

91. OHIO REV. CODE ANN. §§ 1701.831(A), (E) (Anderson 1985).

92. 685 F. Supp. 1027 (N.D. Ohio 1988) (emphasizing that no rational seeker of control would accept shares without voting rights). Another difference from Indiana, which also was not found to be significant enough, was that under the Ohio statute the tender offeror must hold his offer open longer than the minimum period provided by federal law. *Id.* at 1031-32. This is illustrated by certain language in pre-*CTS* cases such as Van Dusen Air, Inc. v. APL Ltd. Partnership, 622 F. Supp. 1216, 1223-24 (D. Minn.), *vacated as moot*, No. 85-5285 (8th Cir. Nov. 26, 1985) ("acquisition of shares [in a tender offer] does not implicate the internal affairs of the target corporation [but] [t]he use of that power *once the shares have been acquired* may well be a proper subject of state regulation" is no longer persuasive).

93. 796 F.2d 135 (6th Cir. 1986), *vacated and remanded*, 107 S. Ct. 1949 (1987), *further remanded*, 848 F.2d 720 (6th Cir. 1988) (to consider issues of mootness). The Sixth Circuit affirmed the decision that the Ohio Control Share Acquisition statute both frustrated the objectives of the Williams Act and directly regulated interstate commerce in violation of the commerce clause. *Id.* at 139.

other corporate consolidations of domestic corporations to make hostile acquisitions less likely to succeed.[94] There is little question that these matters fall within internal affairs.[95] The Delaware statute has already been upheld[96] and the difference between it and the New York statute in terms of burdensomeness may have a bearing in the context of a preemption analysis but should not call for a different result under the commerce clause.[97] If shareholder approvals for transfers of control securities and heightened merger requirements fall within internal corporate affairs, then *a fortiori* such antitakeover statutory techniques should unquestionably come under the internal affairs rubric.[98]

The relatively common antitakeover statutes operating at the second-step of consolidating control by the acquiror, which require voting supermajorities or the payment of a high "fair" price to shareholders, which originated in Maryland and have proliferated,[99] and which are often also incorporated in anticombination statutes such as New York's,[100] present no problem of internal affairs characterization because, in reality, they are merger-type provisions of lesser impact.

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94. *See supra* notes 9, 10 (discussing the antitakeover statutes of New York and Delaware, respectively).

95. In *CTS*, the Court expressly referred to merger requirements as belonging to internal corporate affairs. *CTS*, 481 U.S. at 91.

96. *See, e.g.*, BNS Inc. v. Koppers Co., Inc., 683 F. Supp. 458 (D. Del. 1988) (involving preliminary injunction); RP Acquisition Corp. v. Staley Continental, Inc., 686 F. Supp. 476 (D. Del. 1988) (same); City Capital Assocs. Ltd. v. Interco Inc., Fed. Sec. L. Rep. (CCH) ¶ 94,079 (D. Del. 1988) (same). In *BNS*, the district court commented that "notwithstanding the pro-management tilt of the Delaware statute, Delaware's section 203 more probably than not is within the sphere of constitutional state regulation of tender offers." *BNS*, 683 F. Supp. at 470.

97. In Salant Acquisition Corp. v. Manhattan Indus., Inc., 682 F. Supp. 199 (S.D.N.Y. 1988), the SEC challenged the New York statute and aimed mostly at its inconsistency with the Williams Act, although the commerce clause argument was also included. *See* Brief of the Securities and Exchange Commission, *supra* note 34. The case was eventually settled.

98. These techniques include modifications of the business judgment rule to encompass the interests of constituencies other than the shareholders or to legitimize defensive action against takeovers, reduction of the liability or expansion of the indemnification of management in the same contexts, or extension of the available types of securities and of the conditions of their issuance by management. *See supra* notes 14, 15 and accompanying text.

99. *See supra* note 11.

100. *See supra* note 9.

B. *The Questionable Statutes of Tender Offer or Securities Regulation Controls*

A different situation is presented by those state statutes which force the acquiror of control to buy out the remaining shares on the same or better terms. For example, under Pennsylvania law, the acquiror of 30% of the total voting stock of a Pennsylvania corporation must buy any and all of the remaining shares, if offered by their holders, at a fair value, including any control premium.[101] Another provision with similar effects generates dissenters' rights at high prices, not when a merger is sought, but at the initial phase of control acquisition.[102] The only way to bring these provisions within the internal affairs definition is to accept the basic claim of their proponents that the mere acquisition of voting control without more is equivalent to a fundamental change within the corporation itself, a very dubious proposition indeed.

The intent and effect of the Pennsylvania statute is unmistakable: it is not to protect minority shareholders from oppressive exercise of control but to convert partial tender offers to total ones. In other words, it looks and operates as a regulation of tender offers and other securities transactions rather than as an internal affairs provision. While *CTS* recognized the legitimacy of the anticoercion rationale ostensibly pursued by some state antitakeover statutes,[103] it did not automatically sanction all means of pursuing it. More specifically, the method of control must be acceptable: the state must exercise either internal affairs authority over its corporations, which is very questionable in statutes like Pennsylvania's statute, or blue sky power over transactions within its territory, which is inapplicable in these instances.

This distinction between internal affairs and tender offer or securities regulation appears to underlie two recent cases invalidating, on commerce clause grounds, a Massachusetts and a Nevada antitakeover statute. In *Hyde Park Partners, L.P. v. Connolly*,[104] a

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101. PA. STAT. ANN. tit. 15, §§ 1910(B), (D), (E) (Purdon Supp. 1988). *See* Kozyris, *supra* note 10, at 80-82 (discussing the Pennsylvania approach more fully and citing relevant references). *See also* Danilow & Bentley, *supra* note 6, at 15 n.12; Langevoort, *supra* note 17, at 114 n.75.

102. *See, e.g.*, IND. CODE ANN. § 23-1-42-11 (Burns Supp. 1988). The Indiana statute which was upheld in *CTS* did include such a "dissenters' rights" feature, but its validity was not at issue and was not addressed by the Court. *See also, e.g.*, ME. REV. STAT. ANN. tit. 13-A, § 910 (Supp. 1988) (similar provisions).

103. *CTS*, 481 U.S. at 92.

104. 839 F.2d 837 (1st Cir. 1988).

Massachusetts provision which required prospective tender offerors to disclose their intent to gain control of a target before acquiring 5% of the stock or be prohibited from making a takeover bid within one year thereafter[105] was put to the test. In upholding a preliminary injunction against enforcement, the First Circuit reasoned that although it was neither discriminatory nor did it risk inconsistent regulation by different states, this type of statute does not pass commerce clause muster notwithstanding that it applies only to Massachusetts corporations. The court drew a sharp distinction between permissible state regulation of internal corporate governance, which is protected by *CTS*, and the "regulation of interstate transactions of goods" where the local benefits must outweigh the incidental burdens on interstate commerce.[106] Treating shares of stock as goods which are created by corporations and then sent into interstate commerce with various strings attached controlling their sale (conditions and prohibitions), the court took the position that the case came within the rationale of *MITE* and that it failed the balancing test of *Pike v. Bruce Church, Inc.*[107] Similarly, in *Batus, Inc. v. McKay*[108] a Nevada requirement that a tender offer for the shares of certain Nevada corporations be concluded within sixty days[109] was found to have a "great effect" on interstate commerce because it severely inhibited nationwide tender offers without serving any substantial state interest and, therefore, violated the commerce clause.[110]

Even those few antitakeover statutes which, under a blue sky mantle, limit themselves only to tender offers or acquisitions made within the territory of the state are not beyond challenge under the commerce clause. The regulation of securities *distributions* under traditional blue sky law, which aims principally at providing information to prospective buyers, i.e. persons outside the corporation, is clearly transaction-oriented and has, at best, a remote connection with internal affairs. Furthermore, its effect on what happens in

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105. *Id.* at 840 (citing Massachusetts Take-Over Bid Regulation Act § 3, MASS. GEN. L. ch. 110C, § 3 (Supp. 1988)).

106. *Id.* at 844-45.

107. *Id.* at 845, 848. "Where the statute regulates evenhandedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits." *Pike*, 397 U.S. at 142.

108. 684 F. Supp. 637 (D. Nev. 1988).

109. NEV. REV. STAT. § 78.3772(1) (1987).

110. *Batus*, 684 F. Supp. at 640.

other states is minimal since the corporation may avoid the regulation by excluding the state from its distribution. By contrast, the regulation of securities *acquisitions* typically controls corporate insiders, i.e., the current shareholders dealing with each other, and is really directed at the change of the control of the corporation, not at the particular transactions themselves. In addition, and quite importantly, it necessarily affects out-of-state transactions in the sense that the by-passing of a state where many shares are located may make the acquisition impossible or at least more difficult. It is for this latter reason that a Michigan antitakeover statute, interpreted to apply only to tender offers made in Michigan, was held to be inconsistent with the commerce clause in *Martin Marietta Corp. v. Bendix Corp.*[111] On the other hand, the portion of the Minnesota antitakeover statute which imposed certain disclosure obligations on tender offers for the shares of certain Minnesota-connected corporations (principal place of business and more than 20% of shareholders) addressed to Minnesota residents was upheld on the theory that the burden was minimal and the state interest quite substantial.[112]

C. *The Trouble with Statutes That Purport to Cover Foreign Corporations*

Some states, encouraged by the lenience towards the antitakeover statutes demonstrated in *CTS*, but unmindful of the concern expressed in *CTS* over the rise of "inconsistent" regulation, have sought to extend their controls to certain foreign corporations having substantial local contacts.[113] In all these instances, (a) the contacts

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111. 690 F.2d 558 (6th Cir. 1982). *See* Occidental Petroleum Corp. v. Cities Serv. Co., [1982-1983 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 99,063, at 95,037 (W.D. Okla. 1982). *See, e.g.*, NEB. REV. STAT. § 21-2431 to -2453 (Supp. 1988) (similar statutes, not yet tested in the courts); WIS. STAT. ANN. § 552.05(1) (West Special Pamphlet 1987) (same).

112. Cardiff Acquisitions, Inc. v. Hatch, 751 F.2d 906 (8th Cir. 1984).

113. At least 10 states purport to extend their antitakeover laws to foreign corporations having substantial local contacts: Arizona, Florida, Idaho, Massachusetts, Nebraska, North Carolina, Ohio, Oklahoma, Tennessee, and Washington. *See* ARIZ. REV. STAT. ANN. § 10-1201(7) (Supp. 1988); FLA. STAT. ANN. § 607.110 (West Supp. 1989); IDAHO CODE § 30-1601(6) (Supp. 1988); MASS. GEN. L. ch. 110E, § 1 (Supp. 1989); NEB. REV. STAT. § 21-2442 (Supp. 1988); N.C. GEN. STAT. § 55-75 (Supp. 1987); OHIO REV. CODE ANN. § 1701.831 (Anderson 1985); OKLA. STAT. ANN. tit. 18, § 1148 (West Supp. 1989); TENN. CODE ANN. § 48-35-203(5) (Replacement 1988) (Supp. 1987); WASH. REV. CODE ANN. § 23A.50.020

used (business, offices, assets, shareholders, employees, or a combination thereof) are significant but not qualitatively or quantitatively predominant considering either another state may possess the same kind of superior contacts or at least the total out-of-state contacts may outweigh the in-state ones; (b) corporations whose stock is

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(Supp. 1989).

The genesis of the North Carolina statute is quite instructive on the purpose of such statutes. Two days after *CTS* was decided, the North Carolina Shareholder Protection Act was passed, requiring 95% shareholder approval for a business combination with an interested shareholder unless certain fair-price requirements were met. *See* N.C. GEN. STAT. §§ 55-75 to -79 (Supp. 1987). A week later, following a hostile bid for Burlington Industries, a major local employer incorporated in Delaware, the Act was amended to apply also to foreign corporations which had in the state (a) their principal place of business, (b) more than 40% of fixed assets, (c) more than 10% of their stockholders and (d) more than 40% of their employees. Two weeks later, an Indiana-type Control Share Acquisition Act was also adopted with similar, but not identical, foreign corporation provisions. *Id.* §§ 55-90 to -98. *See* CTS Corp. v. Dynamics Corp. of America *and Trends in Takeover Regulation, supra* note 16, at 229-33.

Arizona's law applies to foreign corporations which have in-state (a) their principal place of business or executive office, (b) at least $1 million of assets, and (c) more than 500 resident employees. *See* ARIZ. REV. STAT. ANN. § 10-1201(13) (Supp. 1988). Florida's criteria are: (a) 100 or more shareholders, (b) principal place of business, office or substantial assets, (c) more than 500 resident employees, (d) more than $5 million annual payroll to residents, and (e) 10% of stock owned by residents or 10% resident shareholders or more than 1000 resident shareholders. *See* FLA. STAT. ANN. § 607.109-110 (West Supp. 1988). The Idaho provisions focus on (a) at least 50 shareholders, (b) place of business or principal executive office in-state, (c) $1 million of local assets, (d) more than 500 resident employees, and (e) either more than 10% of shares or of shareholders resident in the state. IDAHO CODE §§ 30-1601 to -1614 (Supp. 1988). The Massachusetts law relies on similar contacts: (a) principal executive office, (b) at least 200 shareholders, (c) more assets and employees than in any other state, and (d) more than 10% of stock owned by residents or more than 10% resident shareholders. MASS. GEN. LAWS ANN. chs. 110D, E (West Supp. 1988). The same definitional approach was also adopted by Nebraska, in its Shareholders' Protection Act, NEB. REV. STAT. § 21-2442 (Supp. 1988). The Tennessee Business Combination Act enables a foreign corporation qualified to do business in the state to opt in to the protection of the antitakeover law if it meets two out of seven criteria (principal place of business, sales, fixed assets, shareholders, employees, production facilities, assets). TENN. CODE ANN. §§ 48-35-203 (Replacement 1988). Washington, seeking to cover only Boeing, puts the emphasis on the foreign corporation having at least 20,000 local employees, being more than half of its total employment, and also requires more property and assets in the state than outside as well as 10% of shares or shareholders or at least 5000 shareholders in the state. *See* WASH. REV. CODE ANN. § 23A.50.020 (Supp. 1988). *See also* Cox, *supra* note 17, at 354 n.194 (supporting the unconstitutionality of these statutes); Pinto, *supra* note 17, at 742-78 (suggesting balancing the law of incorporation with that of the state of predominant contacts provided the single law concept is not violated).

traded nationally are not excluded but are instead the main subjects of regulation; and (c) the purpose of the law is to regulate not the corporate governance of local entities but the change of control of national entities, principally in the interest of certain local constituencies. Thus, it is clear that these statutes extend beyond "pseudo-foreign" corporations, do not regulate only local transactions in a blue sky manner and are not "de minimis" in that their provisions concern the vital issue of change of control.

As was to be expected, the process of the invalidation of these statutes has already commenced. The first post-*CTS* case to address this issue, *TLX Acquisition Corp. v. Telex Corp.*,[114] involved an Oklahoma control share acquisition statute similar to Indiana's but extending also to those foreign corporations (a) which had 200 or more shareholders and their principal place of business, principal office, or substantial assets in the state and (b) more than 10% of their shareholders, or at least 10,000 shareholders were residents, or more than 10% of the shares were owned by residents of the state.[115] The court's conclusion that the unconstitutionality of the statute under the commerce clause was "certain" was grounded on the "impermissible risk of inconsistent regulation of tender offers and voting rights in stock by different states." The resulting burden on interstate commerce was found to be "excessive in relation to Oklahoma's interest in protection of resident shareholders and businesses. . . ."[116] In *Campeau Corp. v. Federated Department Stores*,[117] the Ohio statute which imposed extra regulations on "foreign businesses" taking over "resident" ones, the latter defined to include out-of-state corporations with substantial and significant (but not predominant) contacts with Ohio (assets, employees, taxes, principal place of business or office, shareholders), was also declared unconstitutional because it potentially exposed tender offers to "different requirements."[118]

An interesting question is posed by those antitakeover statutes which seek to avoid the challenge of burdening interstate commerce by expressly yielding to any "inconsistent provisions" of the law of the state of incorporation (Florida and North Carolina) or of the

114. 679 F. Supp. 1022 (W.D. Okla. 1987).

115. *See* OKLA. STAT. ANN. tit. 18, §§ 1145-1155 (West Supp. 1989).

116. *TLX Acquisition Corp.*, 679 F. Supp. at 1029.

117. 679 F. Supp. 735 (S.D. Ohio 1988).

118. *Id.* at 739. *See supra* note 85 (discussing discriminatory aspect of the statute).

state of the residence of a greater percentage of shareholders (Idaho). It has already been explained at length why, because of the unity of the corporate relationships, any difference in the regulation of any issue of internal affairs, not limited to conflicting mandates but extending to all cumulations including the filling in of any gaps left open for choice by the corporate parties, creates the prohibited risk of inconsistency.[119] A fascinating wrinkle is seen in the few statutes that apply to foreign corporations only on an opt in basis.[120] For example, Massachusetts and Tennessee make certain statutory provisions applicable only if called for by the foreign corporation's charter or bylaws.[121]

It would seem that the only way to avoid the inconsistency problem is to allow corporations to opt in only to the extent and in the manner permitted by the law of the state of incorporation. The requirement of voluntary adoption in accordance with the law of the state of incorporation is obviously not satisfied merely because a corporation may opt out, through management action, of the application of foreign law.[122] If the opt in statutes merely purport to empower certain corporate constituencies, e.g., the directors or shareholders, to supplement the law of incorporation through a procedure which is not itself provided in the law of incorporation, the dual regulation would disturb the single law idea. Neither Massachusetts nor Tennessee clarify that the choice must satisfy the requirements of the law of the state of incorporation and, therefore, some question remains about their validity.[123]

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119. *See supra* text accompanying notes 32, 48.

120. This approach reflects the "state as market participant" theory, in situations where the state merely makes its law available to private parties in competition with other states in the market for "charters." *See* Cox, *supra* note 17, at 353 n.190.

121. *See supra* note 113.

122. *See* Coffey, *The Future of Corporate Federalism: State Competition and the New Trend Toward De Facto Federal Minimum Standards*, 8 CARDOZO L. REV. 759, 773-74 (1987); Coffee, *Shareholders Versus Managers: The Strain in the Corporate Web*, 85 MICH. L. REV. 1, 93-103 (1986).

123. A challenge to the Massachusetts statute under the commerce clause was dismissed as premature where the corporation had not yet opted into it. *See* Nomad Acquisition Corp. v. Damon Corp., 701 F. Supp. 10 (D. Mass. 1988). In a recent federal district court opinion, the shareholder-protective pretensions of the anti-takeover laws were questioned. Chief Judge Wiseman imposed commerce clause scrutiny against all statutes that apply to foreign corporations and the opt in feature was not given any mitigating weight. Tyson Foods Inc. v. McReynolds, 700 F. Supp. 906, 910 (M.D. Tenn. 1988).

V. CONCLUSION

On the occasion of the many battles for corporate control, the courts and the commentators have had the opportunity to address the extent to which state antitakeover law may apply to transactions, relationships or persons which have out-of-state connections. While the main constitutional source of limitations on state power in this field is the commerce clause, certain other clauses, especially full faith and credit, reinforce the prohibitions against overreaching.

The present article first explored the strengthening of the *lex incorporationis* as the single source of rules to govern internal corporate affairs by cases such as *CTS Corp. v. Dynamics Corp. of America*. It was concluded that it is now clearer than ever that states other than that of incorporation are in principle prevented from applying their law on a piecemeal basis to foreign corporations having local contacts because this would disrupt the unity of the internal affairs field and constitute a burden on interstate commerce as "inconsistent regulation." Any difference in the regulation of any part of internal affairs raises the specter of inconsistency and it is not necessary to prove direct incompatibility. On the other hand, it should not be assumed that this single source of law has become fully underwritten by the Constitution: such exceptions as the "pseudo-foreign" corporation and the blue sky regulation of intrastate securities distributions remain viable.

While the trend in state law is unequivocally antitakeover and, thus, the selection of the applicable law is not as crucial as it would have been if there were policy conflicts, the variety of the approaches used requires a significant choice of regime to cover a particular takeover. It should be remembered that the "applicable" law in this context is not only the special antitakeover statutes but also all the enabling provisions in the general corporate law which make it possible for corporate constituencies to erect formidable barriers against takeovers.

Applying this analysis to the state antitakeover statutes, I am convinced that most current statutes, especially those of the control share acquisition, antimerger, fair exit price and management empowerment and protection type, fall within internal corporate affairs as they deal respectively with the transferability of stock, corporate consolidation and corporate governance. Consequently, so long as their reach is limited to domestic corporations, they should be beyond constitutional challenge. But those statutes which extend their rules to multistate foreign corporations, however significantly such entities

may be connected with the enacting state, are in serious jeopardy under both the commerce and the full faith and credit clauses as they create the risk of cumulative regulation of internal affairs. Furthermore, certain statutes of a different type which are aimed at the tender offer itself, rather than at the internal changes produced by it, such as those which call for the mandatory buy-outs or generate dissenters' rights at the acquisition level, run the risk of being characterized as regulating transactions in shares and, therefore, their extraterritoriality raises a serious problem of compatibility with the commerce clause.