REGULATING THE REGULATORS: LIMITATIONS UPON A STATE'S ABILITY TO REGULATE CORPORATIONS WITH MULTISTATE CONTACTS

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I. Introduction

The affairs of American corporations frequently contact numerous states. For example, a corporation may conduct business and have shareholders, employees and creditors in several states. For this reason numerous states could be said to have an "interest" in regulating the affairs of a corporation. It has generally been agreed, however, that certain corporate affairs should be governed by one uniform set of rules, as opposed to multiple regulation by all interested states. Courts therefore have to select the law of one of the interested states to govern corporate "internal affairs," those issues that require one uniform set of rules. Because a corporation historically has been viewed in American law as the creation of the state of incorporation, and because a corporation would therefore be certain what law governed its internal affairs, courts have normally applied the law of that state to questions pertaining to corporate "internal affairs." This has been referred to as the "internal affairs doctrine." This doctrine was initially regarded as a limit upon a forum's jurisdiction; the only courts deemed to have jurisdiction over a corporation were the courts of the state of incorporation, the jurisdiction in which the entity was created.¹

The internal affairs doctrine is no longer regarded as a limit upon jurisdiction; it is now considered a choice of law rule. Some courts have recently exhibited a tendency to reject this doctrine even as a

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(181)
choice of law rule if the subject corporation has much more substantial contacts with the forum than the state of incorporation, or if the subject matter is one which logically permits the application of multiple regulatory schemes. The vast majority of courts, however, continue to apply the law of the state of incorporation to internal affairs matters, regardless of the level of contacts the corporation has with the forum or the state of incorporation, since it is considered vital that a corporation know what law governs its internal affairs. The problem which results from this policy is that corporations are frequently governed by the law of a state with which the corporation has minimal contacts. Corporations are able to avoid the corporate law of its commercial domicile by incorporating or re-incorporating elsewhere.

A number of states have recently adopted statutes which purport to regulate various activities of foreign corporations with which they have significant contacts. Many of these regulated activities could be considered questions pertaining to corporate internal affairs. This article will discuss the wisdom and constitutionality of these attempts by states to regulate various activities of foreign corporations, as well as potential problems which could result from such statutes. It will then be suggested that “pseudo-foreign” corporation laws are a means pursuant to which certainty can be retained in corporate choice of law while allowing the commercial domicile to regulate the internal affairs of corporations in more instances.

II. History of Regulation of Corporations With Multi-State Contacts

During the 18th and 19th centuries, the corporation laws of many states were quite restrictive. For example, many such corporation laws limited the amount of assets a corporation could own. Many significant corporate transactions required the approval of all directors and shareholders. States then began to modify their statutes and make them less restrictive. (Such less restrictive corporation

2. See generally Oldham, supra note 1, at 93-98.


statutes have been termed “enabling” or “pro-management” statutes, depending upon one’s point of view.) Professor Hurst has noted that at the beginning of the 20th century our attitude toward economic regulation was laissez-faire; a societal judgment was made that corporations should be unfettered in their attempt to spur economic growth.\(^6\) The Depression in the 1930’s, abuses by corporate management after the Second World War and a prolonged period of prosperity have catalyzed another change in attitude toward corporate regulation. Many commentators urge that state corporation laws should be made more restrictive.\(^5\)

One obstacle to a state’s attempt to make its corporate law more restrictive has been the internal affairs doctrine. This doctrine has been applied in Anglo-American courts so that the “internal affairs”\(^7\) of a corporation are governed by the law of the state of incorporation, regardless of the contacts, if any, the corporation has with that state.\(^6\) What has frequently occurred is that corporations

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5. See J. Hurst, supra note 3, at xii.


7. “Internal affairs” have been defined as follows: “[A] corporation’s internal affairs are involved whenever the issue concerns the relations inter se of the corporation, its shareholders, directors, officers or agents.” Restatement (Second) of Conflict of Laws § 313, Comment a (1971). The court in North State Copper & Gold Mining Co. v. Field, 64 Md. 151, 154, 20 A. 1039, 1040 (1883) suggested the following definition:

Where the act complained of affects the complainant solely in his capacity as a member of the corporation, whether it be as stockholder, director, president or other officer, and is the act of the corporation, whether acting in stockholders meeting, or through its agents, the board of directors, then such action is the management of the internal affairs of the corporation. . . .

Examples of corporate internal affairs include rules pertaining to when dividends may be declared, the duties and liabilities of officers and directors, standards for indemnification of officers and directors, the proper procedure for electing directors, and standards for the level of approval required for mergers and other types of reorganizations. The exact scope of what constitutes a question pertaining to an internal affair of a corporation is somewhat imprecise; a court wishing to apply local law to a question involving a foreign corporation may find that the issue does not pertain to the internal affairs of the corporation. See, e.g., Toklan Royalty Corp. v. Tiffany, 193 Okla. 120, 141 P.2d 571 (1943).

Matters which clearly do not constitute corporate internal affairs include those relating to the execution of contracts by a corporation, the commission of torts by a corporation or its agents, and the conveyance of property. See generally Baraf, The Foreign Corporation—A Problem in Choice of Law Doctrine, 33 BROOKLYN L. REV. 219, 235 (1957); Reese & Kaufman, The Law Governing Corporate Affairs: Choice of Law and the Impact of Full Faith and Credit, 58 Colum. L. REV. 1118, 1124 (1958).

8. No distinction is generally made between a foreign corporation having substantial contacts with a state or states other than the forum and a foreign corpo-
have incorporated (or reincorporated) in jurisdictions with the least restrictive corporate law then in existence.9 A state is obviously therefore not encouraged to make its corporate law more restrictive; domestic corporations may then reincorporate out of the state and new corporations will incorporate elsewhere rather than in the state. States will thereby lose charter fees9a and lose any power to regulate the internal affairs of such corporations. Most states have attempted to make their corporation laws approximately as "enabling" as the least restrictive state law then extant. If one state has adopted a new type of "enabling" provision or amended the corporation code in some way to make it less restrictive, other states commonly follow suit.10 This 20th-century trend toward a decreasingly restrictive corporate law has been termed the "Gresham's Law" of corporate law.11

ration which has almost all of its contacts with the forum. The law of the state of incorporation traditionally has been applied to all foreign corporations. See, e.g., Lancaster v. Amsterdam Improvement Co., 140 N.Y. 576, 35 N.E. 964, 25 N.Y.S. 309 (1894); Demarest v. Grant, 128 N.Y. 205, 28 N.E. 645 (1891); Nicholson v. Franklin Brewing Co., 82 Ohio St. 94, 91 N.E. 991 (1910); Cochran v. Shetler, 286 Pa. 228, 133 A. 232 (1926); see generally Latty, supra note 1, at 145-50.

9. Charles A. Beard made these findings regarding attempts by New Jersey to make its corporations code more restrictive:

Under the leadership of Woodrow Wilson, after he was challenged by Theodore Roosevelt to reform his own state, the legislature of New Jersey passed a series of laws doing away with corporate abuses and applying high standards to corporations. What was the result? The revenues of the state from taxes on corporations fell. Malefactors moved over to other states. In time the New Jersey legislature repealed its strict and prudent legislation, and went back, not quite, but almost to old ways . . . .

Hearings on S. 10 Before the Subcomm. of the Senate Comm. on the Judiciary, 75th Cong., 1st Sess. 326 (1937).

Similar frustration is reflected in the following portion of the report of the Corporation Law Revision Committee of New Jersey:

It is clear that the major protections to investors, creditors, employees, customers, and the general public have come, and must continue to come, from federal legislation and not from state corporation acts. . . . Any attempt to provide such regulations in the public interest through state incorporation acts and similar legislation would only drive corporations out of the state to more hospitable jurisdictions.


9a. The importance of charter fees to states such as Delaware is discussed in Oldham, supra note 1, at 105, n.78.


11. "Gresham's Law" has been generalized to stand for any situation where the cheap drives out the valuable or the good. See Kaplan, Foreign Corporations and Local Corporate Policy, 21 VAND. L. REV. 433, 437 (1968). See generally Oldham, supra note 1, at 104-10. Another term used to describe this trend has been corporate "charter mongering." See, e.g., Wall St. J., January 10, 1977, at 14, col. 6 (remarks by Professor Neil Jacoby of UCLA).

For a general discussion of examples of Gresham's law of state corporations codes, see Cary, supra note 4; Folk, supra note 4; Jennings, supra note 4; Latty,
California and New York have attempted to rectify the more extreme abuses of state corporate law shopping (and stem the "Gresham's Law" of corporation modes) by enacting laws which purport to regulate the internal affairs of technically foreign corporations whose "commercial domicile" (or "social seat") is located in California or New York, respectively. These statutes will be summarized and discussed below. They address a significant problem in contemporary corporate choice of law—the regulation of a corporation having minimal contacts with its state of incorporation and a majority of its contacts with another state.

III. LAW GOVERNING CORPORATIONS WITH MULTI-STATE CONTACTS

A. General Choice of Law Rules

California and New York have adopted statutes which expressly require the application of certain sections of the law of the forum to the activities of foreign corporations having a certain level of contacts with the state. Absent such a statute, courts generally apply the law of the state of incorporation to the internal affairs of a foreign corporation even if the corporation has substantial contacts with the forum and minimal contacts with the state of incorporation. However, if the law of the state of incorporation conflicts with an important policy of the state or if the foreign corporation conducts all or almost all of its business in the forum, a court might apply the law of the forum, even without a statute requiring such treatment.

supra note 4; Schwartz, supra note 9; Law for Sale, supra note 9. Examples of the increasingly "enabling" and pro-management profile of state corporate law can be seen both in the chronology of the enactment of state law provisions sanctioning broader indemnification rights of corporate insiders (see Oldham, supra note 1, at 108) and the enactment of state takeover laws. In both instances, a few states adopted such laws and then a number of other states quickly adopted similar provisions.


14. See generally Latty, supra note 1, at 145-50.


16. See, e.g., Mansfield Hardwood Lumber Co. v. Johnson, 263 F.2d 748 (5th Cir. 1959) (court applied Louisiana law to determine the duty of insiders of a Delaware corporation where the corporation transacted almost all of its business in Louisiana); Blazer v. Black, 196 F.2d 139 (10th Cir. 1952) (court applied
The internal affairs doctrine is a legacy of the "vested rights" approach to choice of law questions. This approach geographically conceptualizes the rights of parties resulting from a transaction or occurrence with multi-state contacts. The rights of parties are said to "vest" in the place where they are "created." Pursuant to the vested rights approach, the law of the vesting state must then be applied to govern those rights, regardless where an action upon them is brought. Under the vested rights approach, the general nature of the action is first "characterized" (as a "torts" or "contract" action, for example). A choice of law rule (connecting factor) has evolved for each general type of "action"; all choice of law questions of the same type are treated in the same manner. Once the action is characterized, the application of the appropriate connecting factor leads to the identification of the state where the rights of the parties

Kansas law to determine the duty owed by an officer of an Illinois corporation which did substantially all of its business in Kansas); Int'l Ticket Scale Corp. v. United States, 165 F.2d 339 (2d Cir. 1948) (court applied the law of New York to the question of the legality of a dividend distributed by a Delaware corporation); Weede v. Iowa S. Util. Co., 231 Iowa 784, 2 N.W.2d 372 (1942), aff'd sub nom. State v. Bechtel, 239 Iowa 1298, 31 N.W.2d 853 (1948), cert. denied sub nom. Bechtel v. Thatcher, 337 U.S. 918 (1949) (court applied Iowa law to govern the recapitalization of a Delaware corporation which did substantially all of its business in Iowa); German-Am. Coffee Co. v. Diehl, 216 N.Y. 57, 109 N.E. 875, 152 N.Y.S. 1113 (court applied New York law to the legality of a dividend to be paid by a New Jersey corporation whose principal place of business was New York); McQuade v. Stoneham, 230 A.D. 57, 242 N.Y.S. 548 (1930), rev'd on other grounds, 263 N.Y. 323, 189, N.E. 234 (1934) (New York law was applied to a question regarding the removal of an officer of a New Jersey corporation whose principal place of business was New York).

These cases sometimes refer to "equal treatment" legislation enacted by the various states as an additional reason for the application of forum law. Such equal treatment statutes generally provide that foreign and domestic corporations shall be treated equally and that foreign corporations shall bear the same burdens and responsibilities as domestic corporations. See, e.g., Tex. Bus. Corp. Act, Ann. art. 8.02 (Vernon 1975). If taken literally, it could be argued that these provisions require foreign corporations to be governed by local corporation law. See Latty, supra note 1, at 157. See generally Coleman, Corporate Dividends and the Conflict of Laws, 63 Harv. L. Rev. 433, 444 (1950); Kaplan, supra note 11, at 470-71. Such equal treatment statutes have rarely been construed by courts.

In some cases involving local creditors of foreign corporations, courts have held that certain creditor protection provisions contained in the local corporation code (such as the liability of shareholders for certain types of corporate debts) applied to all foreign corporations licensed to do business in the state. See, e.g., Joncas v. Krueger, 61 Wis. 2d 529, 213 N.W.2d 1 (1973).


19. "Characterization" consists of classifying a matter within one of the established categories of cases. See A. Robertson, Characterization in the Conflict of Laws (1940); Cook, "Characterization" in the Conflict of Laws, 51 Yale L.J. 191 (1941); Morse, Characterization: Shadow or Substance, 49 Colum. L. Rev. 1027 (1949).
“vested,” and the laws of that state govern substantive questions presented by the action. For example, all tort questions are said to be governed by the law of the state where the alleged “wrong” occurred. Similarly, questions concerning the internal affairs of a corporation have traditionally been decided by reference to the corporation code of the state of incorporation, since the rights and duties regarding such affairs were said to “vest” therein.

Because the law selected pursuant to the vested rights approach frequently is that of a state with little or no interest in regulating the parties or transaction involved, recent choice of law decisions in many subject areas have exhibited a growing dissatisfaction with the vested rights approach; a number of courts now consider such factors as the various state interests underlying the laws of the states having contacts with the matter 20 and the contacts between the parties involved and the various states. 21 These “governmental interest analysis” and “Second Restatement” approaches have generally not been applied to questions pertaining to the internal affairs of corporations, however. Courts have generally continued to apply the internal affairs doctrine.

This is because there is general agreement that a corporation must be certain what corporate law governs its internal affairs. The internal affairs doctrine provides this desired certainty. If the corporate law governing a corporation would be determined on an ad hoc basis by courts based upon what state had the most significant contacts with the corporation or based upon which interested state’s policy would be advanced by the application of its law in each situation, corporations would not be sure which law governed their behavior, thereby severely burdening commerce. The question addressed by this article is whether there is a way certainty in corporate choice of law could be maintained while attempting to insure that the state with the most significant contacts with the corporation could regulate it.

B. Statutory Choice of Law Rules

It was mentioned above that California and New York have adopted certain choice of law rules regarding the application of local law to foreign corporations having certain contacts with the state. California’s law provides that its law shall apply to such corporations


"to the exclusion of the law of the state of incorporation." 22 Other states have attempted to ensure the application of the internal affairs doctrine through legislative enactment. For example, Delaware's corporation code provides that its law shall govern the internal affairs of all Delaware corporations. 23

Such statutes must normally be adhered to by local courts, unless the enforcement of such a statute would be unconstitutional. 24 These choice of law provisions are obviously not binding upon foreign courts, however; they would apply normal conflict of laws rules.

IV. CONSTITUTIONAL LIMITS

Clearly the corporate law of the state of incorporation should govern a corporation whose principal contacts are with that state (such a corporation will be referred to herein as a "domestic" corporation). The matter is less clear regarding corporations having less substantial contacts with the state of incorporation. For example, commentators frequently advocate that the law other than that of the state of incorporation should apply to a corporation which has approximately 80 percent or more of its contacts with a foreign state (such a corporation will be referred to herein as a "technically foreign" corporation). 25 A number of commentators also advocate the application of foreign corporate law to a corporation with 50 to 80 percent of its contacts with a state other than the state of incorporation (such a corporation will be referred to herein as an "arguably foreign" corporation). 26 Corporations which do not have 50 percent of its contacts with any one state will be referred to herein as "national" corporations.

22. CAL. CORP. CODE § 2115(a) (West Supp. 1980).
23. DEL. CODE ANN. tit. 8, § 121(b) (1974).
26. See generally Baraf, supra note 7; Kaplan, supra note 11; Latty, supra note 1; Oldham, supra note 1.
The application of the law of a state other than the state of incorporation to technically foreign and arguably foreign corporations raises certain constitutional questions. The argument could be made that this would violate the due process and full faith and credit clauses, or that, because a corporation will not be certain what law governs its internal affairs, an impermissible burden upon interstate commerce would result. These constitutional questions will be addressed below.

A. Due Process Clause

Early Supreme Court cases discussing the limitations imposed by the Constitution upon choice of law decisions suggested that the due process clause required the application of the vested rights choice of law approach. Later cases made it clear that it is constitutionally permissible under the due process clause for a court to apply the law of any state that has a reasonable connection with the matter in controversy. Recent Supreme Court cases hold that the due process clause only proscribes a state from applying its law to a matter with which it has no significant contacts.

27 U.S. Const. amend. XIV, § 1: "No state shall . . . deprive any person of life, liberty, or property, without due process of law . . . ."


In Richards v. United States, 369 U.S. 1, 15 (1962), the Supreme Court stated that:

[where more than one state has sufficiently substantial contact with the activity in question, the forum State, by analysis of the interests possessed by the States involved, could constitutionally apply to the decision of the case the law of one or another state having such an interest in the multi-state activity. Similarly, the opinion in Clay sanctioned the application of forum law, emphasizing that the forum had “ample contacts with the present transaction . . . .” 377 U.S. at 183. Professor Leflar proposes that due process requires that a state have a “substantial connection” with the transaction. See Leflar, The Converging Limits of State Jurisdictional Powers, 9 J. F. Prac. L. 282, 292 (1960). In some instances the application of forum law has been deemed a violation of due process even though the state has a significant contact with the parties or the transaction involved. See John Hancock Mut. Life Ins. Co. v. Yates, 299 U.S. 178 (1936); Hartford Accident & Indem. Co. v. Delta & Pine Land Co., 292 U.S. 143 (1934); Home Ins. Co. v. Dick, 281 U.S. 397 (1930); Aetna Life Ins. Co. v. Dunken, 265 U.S. 389 (1924). In these cases the contacts between the forum and the transaction occurred late in the chronology of the transaction, and it has been considered unfair to the party resisting the application of the law of the forum to apply such law. One commentator has stated that these cases stand for the rule that, if the contact between the state and the transaction was “so late in the history
The Court's more flexible approach to choice of law decisions is reflected in *Watson v. Employers Liability Assurance Corp.* In that case the plaintiff, a resident of the forum, brought an action against the insurer of the manufacturer of a product which had injured her. A clause in the insurance policy barred a direct action by the injured party against the insurance company. This clause was valid under Massachusetts law, the state where the insurance contract was executed, and the law of Illinois, the principal place of business of the manufacturer, but invalid under the law of the forum. The forum applied local law and held the clause of the contract to be invalid. The insurer argued that this violated due process. The Supreme Court deemed this choice of law determination constitutional since "more states than one may seize hold of local activities which are part of multi-state transactions and may regulate to protect interests of its own people." It was noted that the forum had an interest in protecting its injured residents.

*Clay v. Sun Insurance Office, Ltd.* evidences a similar approach. In that case a forum resident brought suit against a foreign insurance company, the manufacturer of a device connected with the plaintiff's injury. The claim was brought upon the manufacture's insurance. The court held that the insurance policy was invalid under the forum's law because the insured had "acted, a seriously

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company under a policy which he had purchased while residing in another state. A provision in the policy limited the period (after an insured loss) during which actions under the policy could be brought. This limitation was valid in the state where the contract was executed but invalid under the law of the forum. The Supreme Court held that the application of the law of the forum was constitutional, since the forum had “ample contacts with the transaction.”

The discussion above shows that the application of the law of the state of commercial domicile rather than the state of incorporation to a technically foreign or arguably foreign corporation would not violate the due process clause, since the state of commercial domicile would have significant contacts with the corporation.

It is unclear what actually constitutes “sufficient contacts” to justify the application of the forum’s law under the due process clause. Arguably foreign and technically foreign corporations frequently have minimal contacts with the state of incorporation. The most significant contact may be an agent for service of process and a post office box. Such corporations may have no employees, do no business and have no stockholders which reside in the state of incorporation. In such instances, it may be a violation of the due process clause to apply the law of the state of incorporation to such corporations.

It has been suggested that the state tender offer laws may, to the extent that they purport to govern offers made by an out of state

34. Id. at 183.

35. The term “commercial domicile” will be used herein as a short-hand reference to the state with which a technically foreign or arguably foreign corporation has a majority of its contacts. It is not suggested herein that the concept of “domicile” is otherwise useful in discussing corporate choice of law. See generally Restatement (Second) of Conflict of Law § 11, Comment 1 (1971).

36. It apparently does not constitute a sufficient contact if one of the parties to an action is a non-resident domiciliary of the forum. See Home Ins. Co. v. Dicks, 281 U.S. 397 (1930). (Of course, it could be argued that, since the insured did not move to Texas until after the alleged loss, this contact should not be considered.)

One source of confusion as regards due process analysis is the cavalier way in which courts interchangeably employ the terms “contact” and “state interest.” These obviously are two different concepts—a contact refers to a connection with the transaction, while an “interest” refers to the fact that a state policy will be advanced by the application of its law to the transaction. Certain due process cases repeatedly refer to the fact that due process requires a state to have an “interest” in the application of its law. See, e.g., Aldens, Inc. v. Packed, 524 F.2d 40, 42-43 (3rd Cir. 1975). Most cases and commentators agree, however, that the appropriate test for due process should be phrased in terms of “contacts” rather than an “interest.” See generally Weintraub, supra note 30, at 490.

37. One reason for the requirement that a state have some contact with the matter in dispute is so that the parties are not unfairly surprised by the application of the law of a state with no connection with the transaction. Since it could hardly be said that the application of the law of the state of incorporation would result in “unfair surprise,” this suggests that a court would not deem this is a violation of due process.
offeror to shareholders residing outside the state, violate due process.\(^{38}\)
The regulating state in such instances obviously has no contact with the
out of state offer made to the non-resident shareholder. It could
be argued that, as a result of the contacts between the corporation and
the state, the state has sufficient contacts with the corporation so that
it would not be unconstitutional to regulate activities affecting the
corporation which occur outside the state. It is submitted that such
a determination would be best made under the full faith and credit
standard to be set forth below.\(^ {39}\) It would appear that, unless the
extraterritorial application of state tender offer laws would be required
by full faith and credit pursuant to the standard set forth below, an
attempt by a state to extraterritorially regulate tender offers made
outside the state to non-resident shareholders of foreign corporations
should be deemed to violate due process.

B. Full Faith and Credit Clause\(^ {40}\)

The full faith and credit clause provides that a state must give
full faith and credit to the “public Acts, Records and judicial Pro-
ceeding of every other State.”\(^ {41}\) Although the phrase “public Acts,
Records and judicial Proceedings” has been construed to include
statutes\(^ {42}\) as well as judicial decisions,\(^ {43}\) the Supreme Court has
rarely held that full faith and credit requires the application of the law
of one state in the courts of another, and the Court has become in-
creasingly reluctant to so hold. The cases in which the Supreme
Court has held that choice of law determinations violated full faith
and credit pertain to three subject areas: Workmen’s compensation
laws, shareholder assessments and fraternal benefit insurance associa-
tions.\(^ {44}\)

\(^{38}\) See E. Aranow, H. Einhorn & G. Berlestein, Developments in Tender
Offers for Corporate Control 231 (1977) [hereinafter cited as Tender Offers
for Corporate Control]; Note, Security Law and the Constitution: State Tender
Offer Statutes Reconsidered, 88 Yale L.J. 510, 528 (1979) [hereinafter cited as
Security Law and the Constitution].

\(^{39}\) See notes 41-71 and accompanying text infra.

\(^{40}\) “Full Faith and Credit shall be given in each State to the public Acts,
Records, and Judicial Proceedings of every other State. And the Congress may
be general Laws prescribe the Manner in which such Acts, Records and Pro-
ceedings shall be proved, and the Effect Thereof.” U.S. Const. art. IV, § 9.

\(^{41}\) Id.


\(^{43}\) See, e.g., Carroll v. Lanza, 349 U.S. 408 (1955).

\(^{44}\) In addition to these three subject areas, the Supreme Court has sometimes
held that it is a violation of the full faith and credit clause for a state to refuse
to provide a forum for a suit based upon a foreign wrongful death statute. See
First Nat’l Bank v. United Airlines, Inc., 342 U.S. 396 (1952); Hughes v. Fetter,
In the area of workmen’s compensation, the Supreme Court has held that full faith and credit requires the application of the workmen’s compensation act of the state where the employment contract was entered into if the law of that state attempted to provide an exclusive remedy.\textsuperscript{45} The Court has since retreated from this approach and has more recently held in a number of cases that even if the employment contract was executed outside the forum, it is constitutionally permissible for the forum to apply its law to a workmen’s compensation question if the forum has a substantial interest in the transaction.\textsuperscript{46}

\textit{Bradford Electric Light Co. v. Clapper,}\textsuperscript{47} \textit{Pacific Employers Insurance Co. v. Industrial Accident Commission,}\textsuperscript{48} and \textit{Carroll v. Lanza}\textsuperscript{49} each consider full faith and credit limitations upon choice of law in workmen’s compensation cases. In \textit{Clapper} the employee in question normally worked in Vermont (and resided there). He was sent on a short assignment to New Hampshire where he was killed in an accident; the employee had no contacts with New Hampshire other than the fact that he was sent there on a brief work assignment.\textsuperscript{50} Suit was brought in New Hampshire and New Hampshire law was applied to the matter. The Supreme Court found this to be a denial of full faith and credit to the law of Vermont.

In \textit{Pacific Employers}, an employee who resided and customarily worked in Massachusetts was temporarily transferred to California to work on a project. After being involved with this California project for a short time, the employee was injured and subsequently treated in that state. The employee obviously incurred medical bills from California doctors. Suit was later brought in California regarding the injury and the court applied California’s workmen’s compensation law and not the law of Massachusetts. The Supreme Court held that this application of California law did not violate the full faith and credit clause. In such a situation, since the employee had been working in California a significant period of time, and since there were California creditors of the employee, the state had a significant interest in applying its law.\textsuperscript{51}

\textsuperscript{47} 285 U.S. 145 (1932).
\textsuperscript{48} 306 U.S. 493 (1939).
\textsuperscript{49} 349 U.S. 408 (1955).
\textsuperscript{50} The facts of this case are more fully set forth in Bradford Elec. Light Co. \textit{v. Clapper,} 51 F.2d 992 (1st Cir. 1931).
\textsuperscript{51} \textit{See generally} Kirgis, \textit{supra} note 30, at 113.
Carroll involved an injury to an employee who normally resided and worked in Missouri. The employee was sent to Arkansas to do some work and was injured during the course of that work. Mr. Carroll was taken to a hospital in Missouri; presumably there were no medical creditors in Arkansas (other than possibly for an ambulance). Mr. Carroll had been actively involved in the Arkansas project for at least two months prior to the date of injury.

He later filed suit in Arkansas regarding his injury and the court applied Arkansas law and not the workmen's compensation law of Missouri. The Supreme Court held that the application of Arkansas law in this instance did not violate the full faith and credit clause, since Arkansas had "a legitimate interest" in regulating the matter. The Court determined that "the state where the tort occurs certainly has a concern in the problems following in the wake of the injury. The problems of medical care and of possible dependants are among these, as [Pacific Employers] emphasizes."

Two commentators have made different attempts to reconcile Clapper, Pacific Employers and Carroll. Professor Weintraub suggests that Carroll and Pacific Employers substantially erode Clapper and possibly overrule it sub silencio. Professor Kirgis suggests that the cases are reconcilable. He argues that in Clapper the state of injury had a minimal interest in applying its law to compensate wrongful death victims, since the injured employee left no dependants and did not reside in the state. Kirgis argues that in Pacific Employers and Carroll the state of injury had a greater interest in the application of its law. In Pacific Employers, the injured employee incurred medical bills and apparently resided in California, while Mr. Clapper did not reside in New Hampshire and apparently did not receive any medical care there. Similarly, Kirgis argues that in Carroll the injured employee had resided in Arkansas and generally had more substantial contacts with that state than Mr. Clapper had with New Hampshire.

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52. It is unclear whether Mr. Carroll lived in Arkansas or commuted to work from Missouri. See generally Carroll v. Lanza, 116 F. Supp. 491, 494-501 (W.D. Ark. 1953).
53. Id.
54. See 349 U.S. at 413.
55. Id.
56. See Weintraub, supra note 30, at 471-73; but see id. at 477-78.
57. See Kirgis, supra note 30, at 113. See generally Currie, The Constitution and Choice of Law: Governmental Interests and the Judicial Function, 26 U. Chi. L. Rev. 9, 26-27 (1958). Professor Kirgis does not discuss the fact that Mr. Clapper was killed in New Hampshire and that certain expenses could have resulted therefrom, such as ambulance or mortician fees.
58. See Kirgis, supra note 30, at 123.
59. Id. at 124.
Regardless whether Clapper is perceived as being essentially overruled by Carroll and Pacific Employers or whether Clapper is still considered to require that a forum must have some interest in regulating a transaction before it may apply its law to the transaction, no full faith and credit problem would be presented as a result of the application of the law of the commercial domicile of a technically foreign or arguably foreign corporation to its internal affairs, since that state would clearly have such an interest.

Three Supreme Court cases involving shareholder assessments are more difficult to reconcile. Broderick v. Rosner\(^6^0\) involved a bank which was incorporated in New York and had all of its business offices located in New York. A majority of the depositors, creditors and stockholders of the bank probably were residents of New York. Only 557 of the over 20,000 shareholders of the bank lived in New Jersey.\(^6^1\) New York law at that time permitted a corporation's shareholders to be subject to assessment. An administrative determination was made in New York that the corporation's shareholders were subject to assessment. New Jersey had enacted a law which barred suits based on foreign assessment statutes, and pursuant to that law a New Jersey court refused to hear a suit based on the New York assessment determination. The Supreme Court held that full faith and credit required New Jersey to allow the suit based on the New York determination.\(^6^2\)

Broderick could be explained on the basis that in personam jurisdiction existed over the New Jersey resident in the New York proceeding due to the shareholder's relationship to the corporation (an implied consent notion), and that full faith and credit should be given to the New York administrative determination. It also could be argued that the case stands for the broad rule that full faith and credit requires the application of the law of the state of incorporation to questions pertaining to the internal affairs of a corporation (or at least shareholder assessments). A third interpretation of the case is that it merely represents a situation in which New Jersey had a minimal interest in the application of its law while New York had an overwhelming interest in the application of its law. The language of the Broderick decision does not clearly indicate which is the correct interpretation. The Court held that the matter in dispute was so

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60. 294 U.S. 629 (1935).
61. See id. at 638-640.
62. Converse v. Hamilton, 224 U.S. 243 (1912), involves an analogous situation, except a judicial determination was made in the first state, as opposed to the administrative determination in Broderick. The Court held that this assessment must also be granted full faith and credit.
"peculiarly within the regulatory power of . . . the state of incorporation . . . that no other state properly can be said to have any public policy thereon." 63

It has been argued that the full faith and credit clause requires the application of the law of one state where it is clear that uniform national regulation of an issue is required. 64 Consequently, if Broderick stands for the proposition that questions pertaining to shareholder assessments require uniform national regulation, the law of the state of incorporation is the law which must be applied.

The Supreme Court held in Pinney v. Nelson 66 and Thomas v. Matthiessen 66 that a court may apply local law which sanctions assessment of shareholders of foreign corporations, although the law of the state of incorporation proscribes such an assessment. These cases involved suits initiated in California by California creditors against shareholders of foreign corporations both of whose charters expressly authorized the corporation to do business in California. The Court justified its holdings on the questionable ground that since the charters of both corporations expressly referred to the corporation doing business in California, the shareholders had contracted with reference to California corporate law. 67 The corporations were incorporated elsewhere and conducted a significant amount of business outside of California; this was not mentioned by the Court. It is unclear whether Pinney and Thomas are limited to situations in which a corporation expressly refers in its charter to business in states other than the state of incorporation.

It is difficult to reconcile an expansive reading of Broderick with Thomas and Pinney. Unless Broderick inferentially overruled Thomas and Pinney, or unless Pinney and Thomas are limited to situations in which a corporation's charter expressly addresses the fact that the corporation will do business outside of the state of incorporation, it appears that Broderick must be limited to its facts. Professor Currie has suggested that the decision in Broderick resulted from the fact that New York had a clear interest in the application of its law to protect creditors of New York banks, while New Jersey had no legitimate interest in the application of its law. 68 Another

64. See generally Kirgis, supra note 30, at 120; Weintraub, supra note 30, at 455.
65. 183 U.S. 144 (1901).
66. 232 U.S. 221 (1914).
commentator has suggested that *Broderick* holds “that a state may not deny recovery on foreign facts when its own domestic law would award recovery on parallel facts occurring within its own borders.”

Professor Currie suggests that the teaching of *Broderick* is that if one state has a substantial interest in the application of its law and the forum has no legitimate interest in the application of local law, the full faith and credit clause requires the application of the law of the former. Professor Baraf has suggested that the teaching of *Broderick*, Thomas and Pinney is that a state can regulate—consistently with full faith and credit—the internal affairs of a foreign corporation with which it has a substantial connection.

The application of the law of a state other than the state of incorporation to a question pertaining to the internal affairs of an arguably foreign or technically foreign corporation would not violate the rule of *Broderick*, Thomas and Pinney as set forth in the preceding paragraph. The law of the forum could be applied in such a situation to a foreign corporation with which it has substantial contacts, since the state would have a legitimate interest in the application of its law.

Certain cases involving fraternal benefit insurance associations have held that the law of the state in which the organization was formed must be applied to questions regarding these organizations.

One commentator has argued that these cases stand for the proposition that in certain instances where uniform national regulation is needed, full faith and credit requires the application of the law of a certain forum. The question which obviously arises is whether the rationale of these cases would extend to the “internal affairs doctrine” and questions pertaining to corporate internal affairs. Although it is not clear, it is generally thought that the rationale of these cases would not extend to the internal affairs doctrine. In any event,


71. See Baraf, supra note 7, at 247.


73. See Weintraub, supra note 30, at 478-79.

74. Some commentators have attempted to distinguish full faith and credit requirements applicable to fraternal benefit societies from those applicable to corporations. It has been suggested that the decisions in these fraternal benefit society cases resulted from attempts by the Supreme Court to protect the solvency of the financially unstable fraternal benefit organizations. See Note, Full Faith and Credit: Preferential Treatment of Fraternal Insurers, 57 YALE L.J. 139, 141 (1947).
these cases have been severally limited, if not overruled sub silencio by subsequent decisions.\textsuperscript{76}

Professor Kirgis has proposed the following formulation of the full faith and credit limitation upon choice of law by a forum: A forum shall be able to apply its law to a transaction or occurrence unless (i) another state has an interest in applying its law that is overwhelming in comparison with the interest of the forum or (ii) there is an overwhelming reason to decide all similar cases according to one legal system, and a state other than the forum clearly should be bellwether.\textsuperscript{76} It is submitted that this standard is both workable and consistent with precedent. Pursuant to the first standard set forth above, a forum would not be proscribed from applying its law to arguably foreign or technically foreign corporations, since no other state would have a greater interest in the application of its law. The second standard proposed by Kirgis may apply to the regulation of corporations with multi-state contacts. It has been suggested that a number of questions pertaining to the internal affairs of a corporation require uniformity of regulation.\textsuperscript{77} Most commentators who adhere to this view assume that the law governing such questions should always be the law of the state of incorporation.\textsuperscript{78}

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\textsuperscript{76} Professor Baraf contends that fraternal benefit organizations are distinguishable from regular corporations due to their "prerequisites for entry into membership, the multifarious purposes for which organized, the pecuniary policies it must pursue and the 'non-fraternal' procedures of 'corporate democracy.'" Baraf, supra note 7, at 244.


\textsuperscript{78} See Kirgis, supra note 30, at 120.

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76. See \textit{Kirgis, supra note 30}, at 120.


In \textit{Shaffer v. Heiner}, 433 U.S. 186 (1977), Justice Marshall made the following statement regarding the internal affairs doctrine:

\begin{quote}
In general, the law of the State of incorporation is held to govern the liability of officers or directors to the corporation and its stockholders.

... The rationale for the general rule appears to be based more on the need for a uniform and certain standard to govern the internal affairs of a corporation than on the perceived interest of the State of incorporation.
\end{quote}

433 U.S. at 215, n.44.

78. See, e.g., \textit{Cary, supra note 4}, at 669; \textit{Kaplan, supra note 11}, at 445. Some commentators, however, suggest that it might be possible to apply the law of the commercial domicile of a foreign corporation if it has few contacts with its state of incorporation and substantial contacts with one state. See \textit{Coleman, supra note 16}, at 466; \textit{Horowitz, supra note 25}, at 819-20; \textit{Kirgis, supra note 30}, at 139-42; \textit{Reese & Kaufman, supra note 7}, at 1143.
Certain internal affairs do not seem to require uniform national regulation. States frequently regulate matters such as the ability of forum shareholders to review the shareholder list pertaining to foreign corporations or the type of reports and other information which must be given by a foreign corporation to shareholders residing in the state. In addition, New York enacted a statutory scheme in the early 1960's which provided that certain sections of New York law would govern pseudo-foreign corporations. Among the issues regulated are the liability of directors, the enforcement of dissenters' rights, indemnification of directors and the merger of domestic and foreign corporations. This scheme does not seem to have generated any significant problems; no cases construing the statute have been reported.

A number of commentators have argued that chaos would result if certain other internal affairs of corporations with multi-state contacts were governed by the laws of more than one state. Particularly troublesome are questions pertaining to distributions to shareholders, the issuance of shares, stockholders' voting rights, the minimum percentage of votes required to approve a reorganization, and the types of transactions in which dissenters' rights arise; a significant burden would be placed upon corporate activity if the standards for such actions were unclear. The corporate law of the various states provide different standards for various corporate acts.

For example, the corporation laws of many states provide that "distributions" (including dividends and share repurchases) may be paid out of "capital surplus"; certain other states also provide that even if a company does not have capital surplus it may make distributions out of earnings for the prior year. Contrastingly, California has adopted an entirely different approach which generally permits a corporation to make distributions either where there are retained earnings or if the company satisfies certain assets to liabilities ratios

79. See N.Y. BUS. CORP. LAW §§1315-20 (McKinney 1963 & Supp. 1979). New York pseudo-foreign corporations are subject to the following provisions of the New York corporations code: §1315 (the release of a list of shareholders to a shareholder upon demand); §1316 (voting trust records); §719, except subsection (a)(3) thereof (liability of directors); §720 (actions against a director or officer); §1318 (failure of foreign corporations to disclose information to shareholders); §623 (dissenters' rights); §626 (shareholder derivative actions); §627 (security for expenses in a derivative action); §§721-27 (indemnification of directors and officers); and §907 (merger of domestic and foreign corporations).

80. See generally Baraf, supra note 7, at 229-32; Halloran & Hammer, supra note 24, at 1324-27.


83. Id. §170 (1974).
after giving effect to the distribution. It is entirely possible that a corporation could satisfy the Delaware-type standard and not satisfy the California standard.

Other more significant conflicts between state corporate laws could result. For example, the laws of many states, including Delaware, make cumulative voting for directors optional. It is only permitted if such a provision is included in the corporation's articles or by-laws. Under California and Illinois law cumulative voting is mandatory. (This requirement is one of those applicable to California pseudo-foreign corporations pursuant to Section 2115.) Contrastingly, Massachusetts proscribes cumulative voting. Although it would be technically possible to have a Massachusetts corporation governed by Section 2115 of the California Corporation Code and thereby have the California Code make a provision mandatory that is prohibited by the law of the state of incorporation, the more common situation will be that a Delaware corporation will be governed by Section 2115. Such corporations rarely provide for cumulative voting in the articles or by-laws. Therefore, according to the law of the state of incorporation votes should not be cumulated, while Section 2115 of the California Corporation Code would require this if the corporation satisfied the Section 2115 tests. This probably would require the corporation to obtain a declaratory judgment prior to holding the shareholders' meeting regarding the procedure for counting votes for directors.

85. A corporation obviously could have earnings in a year and satisfy the Delaware standard for a nimble dividend and not have retained earnings or an adequate assets to liabilities ratio after giving effect to the distribution. Of course, the opposite could also occur. See Halloran & Hammer, supra note 24, at 1308.
89. For example, Arden-Mayfair, Inc. Inc. was a Delaware corporation which satisfied the standard set forth in § 2115 of the California Corporations Code for California pseudo-foreign corporations. At that time the board of Arden-Mayfair served staggered terms and directors were elected non-cumulatively. Louart Corporation, a major shareholder in Arden-Mayfair, sought to have all directors elected cumulatively at the annual shareholders' meeting pursuant to § 2115. See generally Louart Corp. v. Arden-Mayfair, Inc., No. C 192091 (L.A. Super Ct. June 30, 1977) (Minute Order). In this action, the California court held Cal. Corp. Code § 2115, insofar as it required cumulative voting and the annual election of directors, unconstitutional as applied to Arden-Mayfair. Louart Corp. v. Arden-Mayfair, Inc., No. C 192091 (L.A. Super Ct. Aug. 5, 1977) (Minute Order). See Findings of Fact and Conclusions of Law at 22-23, Louart Corp. v. Arden-Mayfair, Inc. (April 27, 1978) (on file with author). An action for declaratory judgment was filed in Delaware by the Chairman of Arden-Mayfair's Board of Directors while the California action was progressing. See Palmer v. Arden-Mayfair, Inc., No.
Another important difference among state corporate codes is the standard set forth for the approval of mergers and other reorganizations. Certain state laws require the approval of two-thirds of the shareholders to any such corporate reorganization;90 the laws of other states merely require majority approval.91 If it were unclear whether the corporation were governed by a law which required two-thirds approval or one which required majority approval, and if a reorganization would be approved by a majority but not two-thirds, again a declaratory judgment would probably be required to determine whether the reorganization had been appropriately ratified by the shareholders.

The discussion above suggests that significant problems would arise if the ability of a corporation to make distributions to shareholders and participate in reorganizations, as well as the procedure for electing directors, were governed by the laws of more than one state.92 It has been suggested by certain commentators that if this situation occurs the corporation merely must satisfy the most restrictive statute. This can be done in certain instances. Certain problems set forth above, however, cannot be so glibly dismissed. If the law of one regulating state provides for straight voting for directors and the other regulating state requires cumulative voting, there is no "most restrictive statute." Similarly, it would be unclear whether a reorganization would be approved if the law of one regulating state required majority approval, and the law of another state required two-thirds approval, and a vote of 55 percent of the shareholders would be obtained. Possibly the requirement of two-thirds approval could be considered the "most restrictive statute," but it appears as a practical matter there would be a considerable amount of time spent attempting to determine which statute would govern and whether the reorganization could go forward. The potential for substantial stock price fluctuations and the inevitable securities act lawsuits which would ensue from such fluctuations would make a securities lawyer cringe at such uncertainty.

It was argued above that certain questions pertaining to the internal affairs of a corporation require uniform national regulation. If this is true, the next question which must be addressed is what law

5549 (Del. Ch. July 6, 1978), reprinted in 4 Del. J. Corp. L. 617 (1979). In that case the Delaware court noted the California decision summarized above and ordered the annual meeting of Arden-Mayfair to be held under Delaware law.


92. See generally Halloran & Hammer, supra note 24.
this should be. Possibly the most logical result would be the adoption of a federal corporation law for truly national corporations.\(^{93}\) It will be mentioned below, however, that for a number of reasons the enactment of a federal corporation law appears both unlikely and unwise. For national and domestic corporations, the law of the state of incorporation therefore should be applied to questions pertaining to the internal affairs of such corporations; this should be required by full faith and credit. Certainty in choice of law would result from such a policy, and no other state would have an overwhelming interest in regulating such a corporation.\(^{94}\)

Contrastingly, it does not appear that there is a persuasive rationale for applying the law of the state of incorporation to technically foreign corporations and probably also arguably foreign corporations.\(^{94a}\) The state of commercial domicile would have a much greater interest in applying its law to such corporations than the state of incorporation. The mention of such an idea always causes corporate lawyers to shriek in unison “but what about certainty in corporate choice of law?” There are a number of persuasive responses to this rejoinder. It seems a bit absurd to sacrifice all policy concerns in the area of corporate choice of law on the altar of certainty. Moreover, it has been noted that in a number of cases such uncertainty could be rectified by reincorporating in the state of commercial domicile.\(^{96}\) In addition, as a practical matter certainty does not exist at the present time regarding questions pertaining to the internal affairs of technically foreign corporations; courts sometimes apply local law to such corporations.\(^{96}\) It would appear that a statutory scheme whose scope and timing procedures are clearly defined would eventually result in at least equal (and probably greater) certainty in the area of corporate

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93. Although certain commentators have suggested such a statute throughout the twentieth century, (see Brabner & Smith, Federal Incorporation of Business, 24 Va. L. Rev. 159 (1937); Reuschlein, Federalization—Design for Corporate Reform in a National Economy, 71 U. Pa. L. Rev. 91 (1942); Snapp, National Incorporation, 5 Ill. L. Rev. 414 (1911)), the idea seemed to be advanced by many individuals in the early 1970’s. See generally Henning, supra note 4; Jennings, supra note 6; Schwartz, supra note 6; Note, Federal Chartering of Corporations: A Proposal, 61 Geo. L.J. 89 (1972). See generally Oldham, Book Review, supra note 10.

94. Brainerd Currie has noted that if certainty of result were the only concern relevant to choice of law, a good choice of law rule would be to apply the law of the interest state first in alphabetical order. See Currie, The Verdict of Quiescent Years: Mr. Hill and the Conflict of Laws, 28 U. Chi. L. Rev. 258, 279 (1961).

94a. See, e.g., Horowitz, supra note 25, at 817-18; Kirgis, supra note 30, at 140-42; Oldham, supra note 1.


96. See Oldham, supra note 1, at 93-98.
choice of law for technically foreign and arguably foreign corporations and advance more sensible policies. (Of course, statutes such as some of the takeover laws of certain states which apply to any corporation whose “principal place of business” is in the state, or which has “substantial assets” in the state, without defining these terms, should obviously be avoided.) For example, the California scheme has incorporated filing procedures and specific rules regarding the time during which California law will govern pseudo-foreign corporations and the sections of California law which will govern them. Admittedly some uncertainty has resulted regarding what law applies to such corporations, at least during the interim period while such statutory schemes become accepted. It is presently unclear whether courts of the state of incorporation will enforce pseudo-foreign corporation laws of another jurisdiction.

It should be noted that the application of the law of the state of incorporation to the internal affairs of a technically foreign corporation

97. Such a scheme may actually increase the certainty of the law applicable to technically foreign corporations, since at the present time it is somewhat unclear whether the state of the commercial domicile would apply local law or the law of the state of incorporation to questions pertaining to the internal affairs of such a corporation. If it would be accepted that full faith and credit requires the application of the pseudo-foreign corporation law of the commercial domicile of a pseudo-foreign corporation rather than the law of the state of incorporation, this would definitely increase certainty in corporate choice of law regarding pseudo-foreign corporations.

98. See Kirgis, supra note 30, at 141-42. Many civil law countries do not follow the rule that the law of the place of incorporation governs a corporation’s internal affairs. See generally Latty, supra note 1, at 167 n.134. In these countries the law either of the “social seat” (le siege social) or the principal place of business (le centre d’exploitation) applies to such questions. See id.; 2 E. Rabel, The Conflict of Laws 33-35 (2d ed. 1960); Vagts, The Multinational Enterprise: A New Challenge for Transnational Law, 83 Harv. L. Rev. 740 (1970); Note, The “Nationality” of International Corporations Under Civil Law and Treaty, 74 Harv. L. Rev. 1429 (1961). Latty notes that this choice of law rule evolved as a result of England’s relatively lax corporation laws in the 19th century. Businesses apparently were chartered in England and then conducted business in France and other parts of Europe. See Latty, supra note 1, at 166 n.130.

A corporation’s “social seat” is generally said to be the place of its “central administration.” The determination of a corporation’s social seat normally depends upon where its executive offices are located and where shareholders and directors’ meetings are held. See Hadari, The Choice of National Law Applicable to the Multinational Enterprise and the Nationality of Such Enterprises, 1974 Duke L.J. 1, 7-9. Although in some instances a corporation’s “social seat” is unclear (see Latty, supra note 1, at 168), the civil law choice of law rule for corporations has generally been a workable approach. See generally 2 E. Rabel, supra; Latty, supra note 1, at 166-72; Vagts, supra.


100. It was noted above that in the litigation relating to the election of directors of Arden-Mayfair, Inc., even though Arden-Mayfair satisfied the standard for a California pseudo-foreign corporation set forth in California’s code, a Delaware court held that the Arden-Mayfair annual meeting of shareholders should be held pursuant to Delaware law. See Palmer v. Arden-Mayfair, Inc., No. 5549 (Del. Ch. July 6, 1978), reprinted in 4 Del. J. Corp. L. 617 (1979).
or an arguably foreign corporation may constitute a violation of the full faith and credit clause, since the state of commercial domicile has an overwhelming interest in regulating the corporation as compared to the state of incorporation.\textsuperscript{101}

The enforceability of the California and New York pseudo-foreign corporation choice of law statutes currently depends, as a practical matter, upon the state in which suit is brought.\textsuperscript{102} If suit is brought in the state of incorporation, the forum will probably apply its law and not the pseudo-foreign corporation statute,\textsuperscript{103} while if suit is brought in the state of commercial domicile, the forum will probably apply its pseudo-foreign corporation law, unless it is deemed unconstitutional.\textsuperscript{104} This obvious forum-shopping problem (and the related burden upon commerce) could be greatly ameliorated, and certainty in corporate choice of law regarding pseudo-foreign corporations could be greatly advanced, by establishing a rule that if a corporation has minimal contacts with its state of incorporation and has substantial contacts with a state that has adopted a pseudo-foreign corporation law (thereby showing its interest in applying its law to such corporation), and the foreign corporation satisfies the test for jurisdiction incorporated in the pseudo-foreign corporation law, full faith and credit should require the application of the law of the commercial domicile rather than the state of incorporation.

The uncertainty which would remain under the formulation suggested above would be whether the corporation had "significant contacts" with the state of incorporation. To alleviate this uncertainty, if the state of commercial domicile has enacted a law which attempts to assure that only corporations whose commercial domiciles are within that state are governed by that law,\textsuperscript{105} full faith and credit should require the application of such a law to the exclusion of the law of the state of incorporation, regardless of the contacts between the corporation and the state of incorporation.

\textsuperscript{101} See Kjrgis, \textit{supra} note 30, at 142 n.87; Oldham, \textit{supra} note 1, at 119.

\textsuperscript{102} See Oldham, \textit{supra} note 1, at 123-30.


\textsuperscript{105} California's statutory scheme would fall within this group of statutes, since it considers a number of factors in connection with the determination and requires that the average of these contacts exceed 50% and that a majority of the shareholders reside in California.

To the extent that the various state tender offer laws purport to govern a foreign corporation with "substantial assets" in the state or which has its "executive office" or "principal place of business" within the state, such laws are obviously undesirable. These terms are both vague, since they are undefined, and do not ensure that the state will have the dominant interest in regulating the corporation.
It has been noted that different forums have utilized different tests to establish whether they have a substantial interest in regulating foreign corporations. For example, the various state tender offer laws consider such factors as the number of shareholders and the number of employees which reside in the state, whether the corporation has its principal executive offices in the state, the amount of assets in the state, and the amount of the revenues of the corporation derived from the state.\(^{106}\) The New York statutory scheme pertaining to the internal affairs of foreign corporations considers the percentage of the revenues of the corporation derived from New York.\(^{107}\) The California scheme considers the number of shareholders, employees, revenues and assets located in or generated in California.\(^{103}\)

It is certainly possible, for example, that a tender offer could be governed by the tender offer laws of two or more states. For example, when Great Western tendered for the shares of Sunshine Mining Company, it was initially considered possible that the tender offer would simultaneously be regulated by three state takeover laws.\(^{109}\) Under the formulation set forth above pertaining to state regulation of affairs of foreign corporations requiring uniform national regulation, full faith and credit is required to be given to only those state laws which made a reasonable attempt to limit their application to those corporations that had more than 50 percent of their contacts with the state. No state tender offer law approaches this standard. For this reason, state tender offer laws, insofar as they attempt to extraterritorially regulate tender offers pertaining to foreign corporations, should be deemed to violate due process, and the application of such laws would not be required by the full faith and credit clause. The tender offer law of the state of incorporation, if there is such a law, should be given full faith and credit by all states.\(^{110}\)

Contrastingly, the California scheme pertaining to certain internal affairs of pseudo-foreign corporations requires that a majority of the corporation's shareholders reside in California and that the

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106. See generally Tender Offers for Corporate Control, supra note 38, at 207.
109. See A Response to Great Western, supra note 99, at 888 n.125.
110. It could be argued that only the portions of the state tender offer law which require uniform national regulation should be given full faith and credit rather than the entire statutory scheme. This may be true in principle, but as a practical matter it would probably create a great deal of uncertainty as to which provisions must be given full faith and credit. For this reason it is submitted that the tender offer law of the state of incorporation should be given full faith and credit by all other states in its entirety. This general rule regarding full faith and credit to the tender offer law of the state of incorporation would be subject to the pseudo-foreign corporation exception discussed herein.
average of the corporation's property, payroll and sales located in or derived from California exceed 50 percent. This standard makes a reasonable attempt to limit the application of the statute to those corporations which California has the predominant interest in regulating. It is true that a state could employ different types of standards to determine whether it had the predominant interest in regulating a corporation. However, as long as the state standard considered more than one contact between the corporation and the state and required that the contacts with the state exceed 50 percent, on the average, before the law would apply, it would appear highly unlikely that a corporation would satisfy the jurisdictional requirements of more than one such statute.

A related problem concerns the appropriate law to apply to a technically foreign or arguably foreign corporation whose commercial domicile has not adopted a statute such as California's Section 2115. Certainty in choice of law becomes a concern in this situation. Possibly at some point it will become the accepted rule that, regardless whether the state of commercial domicile has adopted a pseudo-foreign corporation statute, the law of the commercial domicile applies to a pseudo-foreign corporation. If this occurs, such a rule could be applied and the corporation, if it were clearly a "tramp" pseudo-foreign corporation, would be certain what law would govern its internal affairs. Until such a rule evolves, however, in such a situation technically foreign and arguably foreign corporations should be governed by the law of their respective states of incorporation. Even if such a new choice of law rule would evolve regarding pseudo-foreign corporations, the problem would still exist as to what constituted a "pseudo-foreign" corporation; until a workable definition evolves or until the state of commercial domicile would adopt a pseudo-foreign corporation statute, management would be unsure which law governed the corporation's internal affairs.

111. See CAL. CORP. CODE § 2115 (West Supp. 1980).
112. It may be advisable for the statute to consider both the percentage of shareholders residing in the state as well as certain business contacts (such as assets in the state, principal executive offices in the state and revenue derived from the state) between the corporation and the state. If the statute would consider both types of contacts, it would be even less likely that a company could satisfy more than one of such laws.

Sunshine Mining Company, the target company in the Great Western litigation, is an interesting example of the fringe area of pseudo-foreign corporations. See Great W. United Corp. v. Kidwell, 439 F. Supp. 420 (N.D. Tex. 1977), aff'd, 577 F.2d 1256 (5th Cir. 1978), rev'd on other grounds sub nom. Leroy v. Great W. United Corp., 443 U.S. 173 (1979). Sunshine was a Washington corporation with no significant contacts with Washington. Its principal executive offices and more than 50% of its assets were located in Idaho, and it conducted a significant amount of business in New York (577 F.2d at 1262). Sunshine's main subsidiary was a Delaware corporation which conducted a great deal of its business in Maryland (439 F. Supp. at 423).
C. Commerce Clause

It has been argued that various state regulations of corporate affairs violate the commerce clause of the United States Constitution. For example, commentators have suggested that pseudo-foreign corporation laws and tender offer laws place an impermissible burden upon interstate commerce.

1. General Rules

It is somewhat difficult to predict whether courts will conclude that pseudo-foreign corporation laws or tender offer laws impose impermissible burdens on interstate commerce, both because few appellate courts have considered these questions and because the guidelines for what constitutes an "impermissible burden" on interstate commerce are vague and depend upon a number of considerations. United States Supreme Court opinions regarding the extent of the restriction on state power imposed by the commerce clause have frequently been stated in a manner that begs the question and provides little guidance. For example, the Supreme Court has frequently concluded that the burden imposed upon commerce by a state statute is "direct" or "indirect," depending upon whether the statute is to be upheld or deemed unconstitutional.

It is possible, however, to set forth some general rules regarding commerce clause limitations upon state regulatory power. If the state...
statute is deemed to discriminate against interstate commerce, or to favor local business vis-à-vis out of state business, such statutes are almost always found to be unconstitutional. Courts generally uphold state regulation if the subject matter is deemed one "of local concern" regarding that which Congress has not regulated. The trick, of course, is discerning when a matter is of "local," and not "national," concern. The Court has sometimes been quite expansive in its willingness to find the matter one "of local concern." For example, the Supreme Court has designated the regulation of the interstate marketing of the California raisin crop and pollution control of ships traveling upon the Great Lakes matters "of local concern."

Recent cases have stated that the validity of state statutes under the commerce clause will generally be determined by balancing the burden upon commerce against the local benefit derived therefrom. Professor Dowling has argued that a state regulation will only be deemed an impermissible burden upon interstate commerce when that burden exceeds its local benefits. In the famous case of Pike v. Bruce Church, Inc., the Supreme Court articulated the following standard of review of state statutes under the commerce clause:

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. . . . If a legitimate local purpose is found, then the question becomes one of degree. And the extent of the burden that will be tolerated will of course depend on the nature of the local interest involved, and on whether it could be promoted as well with a lesser impact on interstate activities.


126. Id. at 142. This test has been considered the appropriate standard for commerce clause review of state statutes in a number of cases. E.g., Great W. United Corp. v. Kidwell, 577 F.2d 1256, 1282-86 (5th Cir. 1978), rev'd on other grounds sub. nom. 443 U.S. 173 (1979).
The *Pike* standard suggests that the considerations relevant to a
determination as to whether a statute places an impermissible burden
on commerce are the nature and extent of the local benefit advanced,
the extent of the burden imposed upon interstate commerce by the
statute, and whether there is an alternative way of advancing the
state interest with a lesser impact on interstate commerce.

2. Burdens Upon Interstate Commerce

A. Pseudo-Foreign Corporation Laws

The different types of state regulatory statutes discussed herein
obviously impose different types of burdens upon interstate com-
merce. Pseudo-foreign corporation laws, such as California's Section
2115, currently do place a burden on interstate commerce, but pri-
marily only because it is now uncertain whether the internal affairs
of such a corporation would be governed by the law of the state of
incorporation or by California, its commercial domicile. If and when
it becomes settled that the internal affairs of pseudo-foreign corpora-
tions should be governed by the pseudo-foreign corporation law of
the commercial domicile (if such a law exists), rather than the law
of the state of incorporation, minimal burdens on interstate com-
merce would then result from pseudo-foreign corporation laws.

An example of the type of burden imposed by pseudo-foreign
corporation laws at the present time is reflected in the litigation invol-
ving Arden-Mayfair, Inc. In that case Arden-Mayfair was a Delaware
corporation that satisfied the California pseudo-foreign corporation
tests. It was unclear whether Delaware or California law governed
certain internal affairs of the corporation, including the method for
the election of its directors. Suits were initiated in both California
and Delaware to resolve, among other things, whether votes for di-
rectors should be cumulated.\(^{127}\) The California court concluded that
the California provision, as applied to Arden-Mayfair and the method
of its election of directors, placed an impermissible burden on inter-
state commerce and was therefore unconstitutional.\(^{128}\) The court
ordered that the election of directors of Arden-Mayfair be held pur-
suant to Delaware law.\(^{129}\) By the time the Delaware court reviewed
the matter, the California decision had been rendered; the Delaware

\(^{127}\) See generally Louart Corp. v. Arden-Mayfair, Inc., No. C 192091 (L.A.

5, 1977) (Minute Order).

June 30, 1977) (Minute Order).
court merely reiterated the California holding that elections should be held pursuant to Delaware law.\footnote{130}{See Palmer v. Arden-Mayfair, Inc., No. 5549 (Del. Ch. July 6, 1978), reprinted in 4 Del. J. Corp. L. 617 (1979).}

The Arden-Mayfair litigation presents the extreme example of the types of burdens currently imposed upon interstate commerce by the pseudo-foreign corporation laws. The law of one governing state there required a transaction to be carried out in one way, while the law of the other governing state required the transaction to be carried out in a significantly different manner. It was impossible to comply with both the Delaware and California standards; the directors either had to be elected cumulatively or pursuant to straight voting.

It was set forth above that other types of conflicts could result.\footnote{131}{See notes 81-93 and accompanying text supra.}

For example, it could be unclear which law (the law of the state of incorporation or the pseudo-foreign corporation law) governed the rules applicable to corporate reorganizations (and dissenters' rights relating thereto), corporate distributions and repurchases of a corporation's shares, and the legality of the indemnification of corporate officers or directors for expenses or damages (or amounts paid in settlement) in connection with a claim or legal action resulting from their association with the corporation.

**B. State Tender Offer Laws\footnote{132}{See notes 225-57 and accompanying text infra for an extensive discussion of state takeover laws.}**

State takeover laws may impose greater burdens on interstate commerce than those resulting from the pseudo-foreign corporation laws. In addition to the uncertainty (also present regarding the pseudo-foreign corporation laws) as to which of two or more potentially conflicting state laws are applicable to the transaction, state takeover laws place a number of different types of burdens on commerce. Many takeover laws provide for more extensive disclosure than that required under the Williams Act.\footnote{133}{15 U.S.C. §§78m(d)-(e), 78n(d)-(f) (1976).} A significant number of state laws grant withdrawal rights to target company shareholders for periods exceeding that provided in the Williams Act, thereby making it less clear to the bidder how many shares are definitely tendered until a later date. State law pro rata repurchase requirements sometimes extend beyond the period set forth in the Williams Act, thereby forcing the bidder to buy more shares than he would have
intended in order to satisfy both the Williams Act pro rata repurchase requirements and the requirements of the various state laws.\textsuperscript{134}

It has also been alleged that during the period between the notice of intention to make a tender offer and the date the tender offer commences the market for target company securities will be highly unstable and might require the cessation of trading for that stock.\textsuperscript{135} If the exchange or the SEC suspends the trading of target company shares, the market for these shares obviously would dry up during that period. If trading is not suspended, however, there is normally a very active market for shares for which a tender offer is to be made.\textsuperscript{136}

It has been suggested that state takeover laws encourage bidders to use the “bear hug” tender offer approach. Pursuant to this approach, the bidder first makes a takeover proposal to target management. If target management does not approve the offer (thereby foreclosing taking advantage of the “friendly offer” exemption under most takeover laws), the bidder would then make a tender offer at a lower price to the shareholders.\textsuperscript{137} Another related suggestion is that, since state takeover laws tend to facilitate the entry of a third party bidder, the initial tender offer may be lower than what would otherwise have been made, in anticipation of further bidding.\textsuperscript{138}

By far the most significant burdens of the state takeover laws, however, result from the delay which they bring about.\textsuperscript{139} State takeover laws generally delay and prolong tender offers, since many require a waiting period between the required filing of a notice of

\textsuperscript{134} See notes 225-57 and accompanying text infra.


\textsuperscript{137} The district court in \textit{Great W. United Corp. v. Kidwell} voiced this concern. See 439 F. Supp. at 438.

\textsuperscript{138} This point was made by the circuit court in \textit{Great W. United Corp. v. Kidwell}. See 577 F.2d at 1283.

\textsuperscript{139} For example, one study found that, prior to the extensive enactment of state takeover laws, more than 3\% of all tender offers were completed twenty-two days after the announcement of the tender offer. See Ebeid, \textit{Tender Offers: Characteristics Affecting Their Success}, Mergers & Acquisitions, Fall 1976, at 24. Because of the waiting period and mandatory hold open period set forth in most state takeover laws, the average tender offer now takes much longer to complete.
intention to make a tender offer and the date upon which the offer commences, and require the offer to remain open longer than required under the Williams Act. In addition, a number of state takeover laws provide that the state securities commission must hold a hearing regarding the adequacy of disclosure in the tender offer document or the fairness of the terms of the offer, or both, upon request from target management. The tender may not commence until such hearings have occurred.\(^{140}\)

One result of this delay is that the offeror's expense for the tender offer are increased.\(^{141}\) Frequently tender offers are financed and the bidder must pay a daily commitment fee for the financing; the longer the tender offer remains open, the greater the financing fee. In addition, expenses to the bidder are increased by having to deal with the various state securities commissions and appear at any required hearings.

Another result of the waiting period is that it gives target management time to communicate its position to target shareholders as well as to engage in defensive tactics. A variety of defensive tactics may be attempted by the target company, including issuing additional shares to friendly shareholders, attempting to enter into a merger with a third party, or wooing another buyer.\(^{142}\) It is unclear whether these defensive tactics permit target management to defeat bidders more frequently in contested tender offers.\(^{143}\)

\(^{140}\) See notes 234-48 and accompanying text infra for a discussion of the provisions regarding such hearings and waiting periods.


\(^{143}\) It has been suggested that sometimes bidders do not actually make a tender offer after the announcement of an intention to make a tender offer, if target management actively engages in defensive tactics between the time the intention to tender is announced and the date the tender is to occur. See Steinbrink, Management's Response to the Takeover Attempt, 28 CASE W. RES. L. REV. 882, 889 n.28 (1978).

One study found that of the contested cash tender offers and exchange offers studied that were made from 1972 through 1975, 78% were either completely successful or partially successful. See Austin, Tender Offer Statistics: New Strategies Are Paying Off, MAcEs & ACquisitioNs, Fall 1975, at 11-14. A later study study conducted by the same writer found that the probability of success in connection with a contested tender offer decreased significantly during 1976 and 1977. It was found that of the 18 contested tender offers made in 1977 that were studied, only 10 were completely or partially successful; 45% were unsuccessful. Similarly, of the 26 contested tender offers made in 1976 that were studied, only 13 were completely or partially successful; 50% were unsuccessful. See generally Austin, Study Reveals Trends in Tactics, Premiums, Success Rates in Offers, N.Y.L.J., June 12, 1978, at 25, col. 3 [hereinafter cited as Trends in Tactics].

Professor Austin contends that these figures suggest that, because of the state takeover laws and the increasing use of defensive tactics by target management, it
A separate problem is created by the rights of the state securities commissions to hold hearings regarding the adequacy of the disclosure or the fairness of the transaction. These hearings may either be held upon motion by the commission itself or upon request by target management. A request for a hearing by target management is a defensive tactic frequently used to postpone a tender offer. The tender offer may not be made until the securities commission satisfies itself that the disclosure is adequate or the terms are fair, or both. In addition, if the state securities commission does not approve the transaction, it may seek to enjoin the tender.\footnote{144}

A significant result of the delays imposed by the state takeover laws is that the initial bidder is less frequently successful in a tender offer.\footnote{145} In a growing number of cases the initial bidder is defeated by a "white knight" third party bidder.\footnote{146} Again it is unclear whether

\[\text{is becoming increasingly difficult to make a successful tender offer. Another article}\]
\[\text{interprets this information differently, See generally A Response to Great Western,}\]
\[\text{supra note 99, at 872 n.2. This article notes that, of the contested tender offers}\]
\[\text{made during 1976 and 1977 deemed "unsuccessful" by Professor Austin, a third}\]
\[\text{party bidder frequently gained control of the target company. It is stated that of}\]
\[\text{the 18 tender offers made in 1977 that were studied by Austin, in 16 (88\%) of}\]
\[\text{these instances either the initial bidder or a third party bidder was partially or}\]
\[\text{completely successful. Similarly, of the 26 tender offers made in 1976 that were}\]
\[\text{studied by Austin, the initial bidder or a third party bidder was completely or}\]
\[\text{partially successful in 80\% of the offers. [These findings were made by the authors}\]
\[\text{of the cited article after they reviewed Professor Austin's basic research (cor-}\]
\[\text{respondence with Professor Austin on file with the author).]}\]

\[\text{It appears from the additional statistics noted in A Response to Great Western,}\]
\[\text{supra note 99, that Professor Austin overemphasizes the significance of the diminishing}\]
\[\text{success rate of the initial bidder in a contested tender offer. Without knowing}\]
\[\text{the percentage of instances during which a third party bidder gained control of}\]
\[\text{the target company in the contested tender offers studied by Austin during 1972}\]
\[\text{through 1975, however, it is impossible to know whether target management is}\]
\[\text{now more frequently successful in combating tender offers, or whether the only}\]
\[\text{change is that the initial bidder is now more frequently defeated by a third party.}\]

\[\text{144. For example, the terms of the proposed tender offer by APL Corporation}\]
\[\text{for the shares of Pabst Brewing were not approved by the Wisconsin Commissioner}\]
\[\text{of Securities. This reluctance on the part of the Wisconsin Commissioner of}\]
\[\text{Securities to approve the terms of the proposed tender offer significantly frustrat-}\]
\[\text{ed the ability of APL to make the tender offer. See generally Pabst Buys Stake Held by Suitor APL: Takeover Feud Ends, Wall St. J., October 23, 1979,}\]
\[\text{at page 19, col. 1 [Western Edition].}\]

\[\text{145. Of all contested tender offers occurring from 1972 through 1975 studied}\]
\[\text{by one commentator, 70\% were either successful (meaning that the number of}\]
\[\text{shares requested by the bidder were tendered) or partially successful (meaning}\]
\[\text{that the bidder accepted tenders for less than the number of shares requested).}\]
\[\text{See Austin, Tender Offer Statistics: New Strategies Are Paying Off, Mergers &}\]
\[\text{Acquisitions, Fall 1975, at 12-14. This commentator also studied contested tender}\]
\[\text{offers made during 1976 and 1977, and found that bidders were either partially or}\]
\[\text{completely successful in 1976 in only 50\% of the contested tender offers studied and}\]
\[\text{partially or completely successful in 1977 in 55\% of the contested tenders studied.}\]
\[\text{See Trends in Tactics, supra note 143, at 35, col. 1.}\]

\[\text{146. See generally Trends in Tactics, supra note 143, at 25. A third party}\]
\[\text{bidder not friendly to target management is sometimes referred to as a "grey}\]
\[\text{knight."}]}
target management is successful in retaining control in a greater percentage of contested offers because of the state laws.147

State takeover laws, in their current form, may dampen the interest of arbitrageurs in a tender offer. These speculators play a very important role in a tender offer.148 Arbitrageurs buy shares of a target company on the open market after a tender is announced and hope to receive the full tender premium for the shares within a short period after the arbitrage purchase. If it appears that the state securities commission will not allow the tender to commence, or even if the commission may significantly delay the tender, arbitrageurs may be less interested in participating in the tender.

When state takeover laws were initially enacted, commentators predicted that tender offers would no longer be effective vehicles for acquiring control of companies.149 Although these predictions were less than prescient, the data discussed above suggest that the probability that the initial bidder in a contested tender offer will gain control of the target company has decreased in the last few years. This could be attributed to the opportunity to utilize defensive tactics now provided target management as a result of the enactment of takeover laws by many states or the more frequent appearance of a “white knight” third party bidder, or both.

In addition to decreasing the probability that initial bidders will be successful in a contested tender offer, state takeover laws probably have a “chilling effect” upon tenders. A number of effects of state takeover laws probably discourage tenders. First, it is probably less likely that the initial bidder will be successful. In addition, because of the delayed and prolonged tender it is less likely that it will be possible to purchase the shares for a bargain price.150 The bidder’s expenses are also increased. It does not appear, however, that state takeover laws have significantly reduced the number of tenders made.151

147. See note 143 supra. If a third party bidder friendly to existing target management prevails, target management may be retained or even receive a long-term employment contract in connection with the transaction. In any event, even if a third party friendly bidder prevails in the tender offer, target shareholders are able to sell their shares at the tender premium. Based on the results of Professor Austin’s studies, it appears that target shareholders are able to sell their shares at the tender premium in about the same percentage of contested tender offers as they were able to prior to the extensive enactment of state takeover laws. Of course, Professor Austin’s comparative figures do not reflect the numbers of tender offers discouraged by state takeover laws.


151. Ruth Appleton, Esq., Chief of the Office of Tender Offers and Acquisitions of the Securities and Exchange Commission, has provided the following information
During the period from 1970 through 1974, a relatively small number of tender offers were made. During this period, only a handful of state takeover laws were in effect. During 1975 through 1979, the annual number of tender offers had generally increased. During the period from 1975 through 1977, tender offer laws became effective in 27 additional states. Although it is impossible to tell how many tender offers were discouraged by these laws, it does not appear that the enactment of such laws during 1975-1977 by almost all the commercial states (California, according to form, being the lone rebel) has dramatically affected the number of tender offers made.

3. Local Benefits

A. Pseudo-Foreign Corporation Laws

It was set forth above that the internal affairs doctrine permits corporations to avoid regulation by the law of the state of commercial domicile by incorporating or reincorporating elsewhere. Pursuant to pseudo-foreign corporation laws, states can retain regulatory control regarding the number of tender offers made during the period from 1969 through 1979. Note that the information set forth below refers to the SEC fiscal year, which runs from October 1 through September 30.

<table>
<thead>
<tr>
<th>Year</th>
<th>No. of Tender Offer Filings</th>
</tr>
</thead>
<tbody>
<tr>
<td>1969 (Oct. '68-Sept. '69)</td>
<td>70</td>
</tr>
<tr>
<td>1970</td>
<td>34</td>
</tr>
<tr>
<td>1971</td>
<td>43</td>
</tr>
<tr>
<td>1972</td>
<td>50</td>
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<td>1973</td>
<td>75</td>
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<td>1974</td>
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<td>113</td>
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<td>1976</td>
<td>134</td>
</tr>
<tr>
<td>1977</td>
<td>134</td>
</tr>
<tr>
<td>1978</td>
<td>179</td>
</tr>
<tr>
<td>1979</td>
<td>147</td>
</tr>
</tbody>
</table>

Most of the principal commercial states adopted tender offer laws during 1975 and thereafter. During this period the number of tender offers made has significantly increased. See generally Miskin & Nathan, Tender Offers Continue to Surge, N.Y.L.J., Dec. 19, 1977, at 30, col. 1.

Professor Douglas Austin of the University of Toledo is preparing information regarding tender offers made during 1978 and 1979. He is compiling this information during the winter of 1979, and it will be published in 1980. (Correspondence on file with author.)

152. See id. Professor Austin has stated that from 1970 through 1975 an aggregate of 269 tender offers were made. See Trends in Tactics, supra note 143, at 25, col. 5. This difference between his figures and the figures supplied by the Securities and Exchange Commission (see note 151 supra) could result from the fact that the SEC figures are compiled on the basis of its fiscal year (from October 1 through September 30), while Professor Austin's information is presumably compiled on a calendar year basis.

153. See Trends in Tactics, supra note 143, at 25, col. 5. See also information supplied by Ruth Appleton, Esq., set forth in note 151 supra.

154. During this period takeover laws became effective in Indiana, Delaware, Connecticut, New York, Massachusetts, Pennsylvania, Michigan, Illinois, Texas and New Jersey, among others.

155. See notes 7-11 and accompanying text, supra.
control over corporations commercially domiciled there, if the state so desires. This is not an insignificant benefit. The state of commercial domicile obviously has an interest in the financial stability of corporations domiciled there, both to protect resident shareholders of the corporation as well as creditors of the corporation. In addition, such a state would have an interest in promulgating the standard of care which must be exercised by directors and officers of corporations commercially domiciled in the state, as well as standards for indemnification of officers and directors of such corporations.

Perhaps most important, states have an interest in protecting resident shareholders from arguably fraudulent or unfair practices. For example, the recent drop in stock prices has made more companies consider the advisability of attempting to "go private." Different states have taken different approaches to regulating procedures for going private. Many states have done nothing (generally relying upon the fiduciary duties of controlling shareholders and management to other shareholders), while other states, such as California, have adopted more restrictive protective legislation. States obviously have an interest in protecting shareholder rights in connection with any corporate reorganization, if a large percentage of its shareholders reside in the state.

The benefit derived from pseudo-foreign corporation laws therefore is that the state of commercial domicile will regulate the internal affairs of corporations domiciled there, to the extent, if any, that the state desires to do so to protect shareholders and creditors residing there.

B. Benefits Derived from State Takeover Laws

It was noted above that the primary effect of state takeover laws is to delay the commencement of a tender offer to prolong the tender offer once it has commenced. One result of this delay has been that the bidder rarely acquires the target company shares for the price originally bid. Frequently a third party enters the fray and competes with the original bidder for the shares of the target company. A

156. California Corporations Code § 1101 provides that in connection with any merger other than a short-form merger, the common shares of a disappearing corporation may be converted only into common shares of the surviving corporation unless all shareholders of the disappearing corporation approve another plan. CAL. CORP. CODE § 1101 (West Supp. 1980). Similarly, in connection with a sale of assets transaction, if the buyer controls the seller, the terms of the sale must be approved by at least 90% of the seller's outstanding shares, unless the shareholders of the seller receive common shares of the buyer in connection with the sale. See CAL. CORP. CODE § 1001(d) (West Supp. 1980).

157. See, e.g., Flom, supra note 150.

158. See Steinbrink, supra note 143, at 894 n.42; Trends in Tactics, supra note 143, at 25, col. 3; see, e.g., Auerbach, Pertec Suitors Agree to Settle Takeover
number of commentators have therefore concluded that one effect of state takeover laws has been that bidders are not able to get the bargain they had been able to obtain pursuant to the quicker "Saturday night special" tender offer permitted under the Williams Act.159 (Alternatively, it could be argued that bidders now bid a lower initial price in anticipation of the competition to follow.)

Another related local benefit stemming from state takeover laws is the additional time given shareholders to decide whether to tender their shares. This results both from the waiting period (during which a tender has been announced but has not commenced) and from the longer hold-open period required, coupled with the increased withdrawal rights and pro rata takeup protection given target company shareholders. Since the recent SEC proposals regarding tender offer regulation would lengthen the required hold-open period and would extend withdrawal rights and pro rata takeup protection beyond that currently provided in the Williams Act, this suggests that this is now seen as a more desirable regulatory scheme.160


An example of such a bidding war pursuant to which target shareholders received a large premium for their shares was the contest between United Technologies and J. Ray McDermott for control of Babcock and Wilcox Company. At the time the tender was announced, the market price of the shares was $33. United Technologies originally bid $42 for the shares. McDermott was eventually successful with an offer of $65 per share. See Metz, Babcock and Wilcox: A Battle That Shook Wall St., Notions, N.Y. Times, Sept., 1977, at 57, col. 1.


Professor Austin's studies suggest that tender offer premiums are now not significantly higher than premiums received by target shareholders a decade ago. He notes that during the period from 1968 through 1972, a "majority" of the premiums contained in tender offers amounted to less than 50% of the market price of the shares two weeks prior to the tender offer. See Trends in Tactics, supra note 143, at 25, col. 3. Although the premiums received by shareholders during 1972 through 1975 increased somewhat, during the 1976-1977 period 71.6% of the tender offers studied offered target shareholders premiums of less than 50% of the market price of the shares. These figures do not distinguish between contested and uncontested tender offers, however. It could be true that premiums currently received by shareholders in uncontested tender offers are not significantly higher than those received a decade ago, but that shareholders now receive greater premiums in a contested offer and/or when two bidders are fighting for control of a target company. See generally Ehrbar, Corporate Takeovers Are Here to Stay, Fortune, May 8, 1978, at 91.

Another writer disputes the findings of Professor Austin. This article, written in 1978, contends that tender offer premiums were then averaging more than 60% over market price, and in contested tender offers the premiums were greater. See generally Ehrbar, Corporate Takeovers Are Here to Stay, Fortune, May 8, 1978, at 91. This article notes that the premium target shareholders have historically received in tender offers is approximate 25%.

4. Less Restrictive Alternatives

A. Pseudo-foreign Corporation Laws

It does not appear that there is an alternative to pseudo-foreign corporation laws which would less impede interstate commerce while still affirming a state's right to regulate corporations commercially domiciled there. It could be argued that the foreign corporation should be required to have perhaps 70 or 90 percent of its contacts with the state before the pseudo-foreign corporation law should apply. Such a change would result in pseudo-foreign laws applying to fewer corporations and to corporations with generally fewer national contacts. While such a result would place a lesser burden on interstate commerce, it would also substantially erode a state's ability to regulate corporations commercially domiciled in the state.

B. State Takeover Laws

It has been suggested that the primary benefit accruing from state takeover laws is the prolongation of tender offers that has resulted from the required waiting period, expanded withdrawal rights, pro rata takeover provisions and the extended mandatory hold-open period. One significant burden upon commerce which results from this legislative scheme is that tender offers now must be announced in advance of the tender rather than concurrently with the commencement of the tender, as is permitted under the Williams Act. The waiting period provisions both permit target management to engage in defensive tactics and also give third parties additional notice of the tender, giving them time to consider whether they wish also to bid for the target shares.

It appears that whatever benefit is derived from the waiting period is outweighed by the burden upon commerce which results. The benefits of the waiting period could essentially be retained by prolonging the hold-open period and lengthening pro rata purchase rights and withdrawal rights. Pursuant to such an alternative regulatory scheme, shareholders would still have a significant period of time to consider whether they wish to tender their shares, while management would not have an opportunity to engage in defensive tactics prior to the commencement of a tender. For these reasons it would appear that state law waiting period provisions should be deemed an impermissible burden upon interstate commerce.

It would appear that a similar conclusion should be reached regarding the provisions of state laws which provide for hearings by the state securities commission. Such hearings probably do benefit shareholders in that they may insure full and accurate disclosure to the shareholders. Target management utilizes these hearing requirements, however, as a significant defensive tool. Many state statutes provide that such hearings must be held upon request by target management. Since the tender may not commence until all such hearings have been completed, target management almost always requests such hearings, frequently in a number of states. Pursuant to such hearings, the commencement of tender offers could be delayed for months, thereby substantially increasing the costs to the bidder and making it more likely that a third party bidder will enter upon the scene. Because these hearing procedures substantially delay the commencement of a tender offer after its announcement, and because the essential benefits of the state laws would continue without such provisions, they should be deemed impermissible burdens upon interstate commerce. The primary benefit of state takeover laws—the prolongation of the period during which shareholders may decide whether to tender their shares—may be retained without providing for hearings by the state securities commissions.

161. For example, United Technologies Corporation initially announced on April 5, 1977 its intention to tender for the shares of Babcock & Wilcox at a price of $42 a share, with the tender to commence as soon as all state law requirements had been satisfied. Babcock & Wilcox then requested hearings under the takeover laws of four different states. Because of these maneuvers by target management, United Technologies was not able to have the tender commence until August 4, 1977; the initial tender price was then $48. A third party bidder appeared on the scene and was successful. See generally Brown, supra note 159, at 844-45.

Another example of the burdens imposed by the state law hearing requirements can be seen in the attempted tender offer by Thrall Car Manufacturing Company for the shares of Youngstown Steel Door Company. On May 24, 1976 Thrall Car announced its intention to tender for Youngstown Steel shares at a price of $14 a share. The management of Youngstown Steel requested a hearing pursuant to the state takeover law. These hearings were held from June 25 through July 16, 1976. The commission issued its order on August 2, 1976. When one reads this order, it appears that the Ohio Securities Commission was attempting to insure that state takeover laws would be deemed unconstitutional. The Division of Securities found the disclosure document inadequate in many ways. Among other things, the Division wanted Thrall Car to disclose a great amount of information regarding the business of Youngstown Steel. This information seemingly could only have been obtained from Youngstown Steel management, who did not appear amenable to such cooperation, to say the least. More importantly, the Division found both the price offered target shareholders too low and the hold-open period of the offer too short. As if this was not enough to frustrate Thrall Car, the Division announced that any amended offer and the accompanying disclosure document would first be forwarded to Youngstown Steel management for their comments, and then the offer and disclosure document would be again reviewed by the commission. A third party bidder that was supported by Youngstown Steel management appeared on the scene; this third party bidder was able to avail itself of the "friendly offer" exemption of the Ohio takeover law. The bidder was therefore able to tender successfully for the shares of Youngstown Steel while Thrall Car could not make a tender offer, since it had not complied with the state statute. See Tender Offers for Corporate Control, supra note 38, at 223-25.
5. Balancing the Benefits and Burdens

A. Pseudo-Foreign Corporation Laws

It was argued above that pseudo-foreign corporation laws could advance significant state policies, while their enforcement could also result in substantial burdens upon interstate commerce. The commerce clause balance in some circumstances will not be an easy one.

It was noted above that the burdens upon interstate commerce resulting from pseudo-foreign corporation laws hopefully will ebb as the pseudo-foreign corporation exception to the internal affairs doctrine becomes more established (which should occur if a number of states adopt pseudo-foreign corporation laws). Most civil law countries apply the law of the country in which the corporation's "social seat" is located to questions regarding its internal affairs; no significant burden on commerce appears to result.162 It would therefore appear that the burdens upon interstate commerce imposed by such laws would largely be a transitory phenomenon.

It has been said that state regulations which are aimed at restraining fraudulent or unfair trade practices are more likely to survive commerce clause review than those oriented toward increasing the profitability of local business.163 Pseudo-foreign corporation laws seem clearly to be the former type.

Because the burden upon commerce imposed by such laws hope-
fully will gradually diminish, and because they do not represent an attempt by a state to favor local business vis-à-vis out-of-state enter-
prises these laws should be allowed to survive commerce clause chal-
lenge. During the period in which such laws become accepted it may be necessary to deem such laws unconstitutional as applied in certain situations, if the burden in question is substantial.164

B. State Takeover Laws

It was suggested above that both the waiting period provisions of state takeover laws as well as the provisions allowing hearings by state securities commissions are impermissible burdens upon inter-
state commerce, since the benefits of state takeover laws could be retained while these significant burdens could be eliminated. The

162. See note 98 supra.
164. For example, in the Arden-Mayfair litigation, the California Superior Court Judge found that the statute as applied to Arden-Mayfair regarding the election of its directors was unconstitutional. See Louart Corp. v. Arden-Mayfair, Inc., No. C 192091 (L.A. Super. Ct. Aug. 5, 1977) (Minute Order). See generally Comment, 16 San Diego L. Rev. 1943 (1979).
question remains whether state takeover laws without these provisions should be deemed impermissible burdens upon interstate commerce.

A number of judges and commentators have emphasized the fact that state takeover laws were essentially special interest legislation designed to protect management of local target companies.\textsuperscript{165} Despite management’s significant role in the enactment of a number of state takeover laws, this should not be considered determinative. Although the Supreme Court has sometimes focused upon an improper legislative purpose or motive in connection with the enactment of legislation as a justification for deeming the statute unconstitutional, in most instances the Court does not deem legislative purpose significant.\textsuperscript{166} The commerce clause determination should be based upon the effect of these laws and not on a attempt to generalize the motivations of the legislatures of more than two-thirds of the states.

The extent of the burden imposed upon interstate commerce by state takeover laws would depend upon whether, as argued below, state takeover laws would be deemed analogous to “internal affairs” questions and thereby be governed by only the law of one state.\textsuperscript{167} If this view is accepted, only one state takeover law will apply to any takeover. If it is not accepted, it will be quite possible that two or more state takeover laws could regulate a tender. Additional burdens upon interstate commerce would result from the conflicting requirements of the different laws. The analysis set forth below assumes that the tender offer would be deemed an “internal affairs” question.

Certain commentators who do not consider tender offers an internal affairs question argue that tender offers should be regulated in the same manner that securities transactions are generally regulated by blue sky laws.\textsuperscript{168} Pursuant to this analysis, state takeover laws should not be extraterritorial and should only govern offers made to resident shareholders. Such an approach would be an improvement upon the current extraterritorial laws which base jurisdiction upon any sub-


\textsuperscript{167} See notes 251-57 and accompanying text, infra.

\textsuperscript{168} See generally Securities Law and the Constitution, supra note 38.
stantial (sometimes even a minimal) contact with the state. It is submitted that such an analysis, however, fails to consider the difference between a tender offer and a normal offering of securities. In a normal public offering, securities are being offered by the company to the general public. If for some reason a state blue sky law is deemed too restrictive or the offer would not qualify in that state, no significant problem results; offers are merely made only in the states where the applicable blue sky laws are satisfied. The only burden upon interstate commerce which results is that potential offerees in the state having the restrictive law cannot purchase the shares.

In contrast, a tender offer is made to a specific group of people—existing shareholders. In addition, it is a complex transaction with a number of important substantive terms and rights (such as the hold-open period, withdrawal rights and pro rata repurchase rights) provided the target shareholder. The regulation of a tender offer by all states in which target shareholders reside would obviously result in shareholders being treated differently. In addition, the tender would remain open in some states longer than in others. Most importantly, if a state enacted a restrictive takeover law, or if only a few shareholders resided in the state, a bidder might choose to ignore such states and merely bid for shares in states where a larger number of shareholders reside or which have less restrictive takeover laws.  

The obviously undesirable result would be that certain shareholders would not be able to take advantage of the full premium offered in the tender offer. Because of these factors, it would appear more desirable to have one extraterritorial tender offer law govern a tender offer rather than several different state takeover laws.

It has been noted that regulating tender offers made to shareholders residing outside the state does not result in any "local" benefit to the regulating state. This is true, but in no way differs from the "extraterritoriality" of state regulation of corporate internal affairs matters. Such regulation almost always has some extraterritorial effects, but has never been considered impermissible for that reason. It will be argued below that a tender offer should be considered

169. It was noted above that Arkansas purports to regulate all tender offers made to target companies with more than thirty-five Arkansas shareholders. See Ark. Stat. Ann. § 67-1264(5)(c) (Supp. 1979). Offerors have attempted to avoid compliance with the Arkansas statute by excluding Arkansas residents from the offer. See generally M. Lipton & E. Steinberger, Takeovers and Freeze-Outs 244-45 (1978). Such a tactic would appear to violate the terms of the New York Stock Exchange Company Manual. See id. at 225.

170. Unless trading of the shares of the target company would be suspended, shareholders would be able to sell shares on the open market. The market price in such instances, however, frequently is significantly less than the tender price.
an internal affairs matters, thereby justifying the extraterritoriality of the tender offer laws.

If the state law waiting period provisions as well as the provisions permitting hearings by state securities commissions would be deleted from state takeover laws, the burden upon interstate commerce resulting from such laws would diminish. The remaining significant burdens would be disclosure requirements exceeding those of federal law as well as different hold-open periods and pro rata repurchase and withdrawal rights.

Disclosure requirements differing from that required by federal law would not appear to create a constitutional problem.\textsuperscript{171} State blue sky laws frequently impose disclosure requirements in addition to those required by the SEC, and it is accepted that state blue sky laws are constitutional. No disclosures required by state law are prohibited by federal law.

The longer hold-open period (coupled with prolonged withdrawal rights) provided by state statutes would burden interstate commerce. These provisions give target shareholders more time to decide whether to tender their shares, and thereby give a third party bidder additional time to decide whether to compete for the shares. Although it was set forth above that the number of tender offers has not been significantly reduced while such laws have been in effect, they clearly could have a "chilling effect" upon tender offers.

It appears that the SEC has concluded that it would be wise to lengthen the hold-open period and expand withdrawal rights prescribed under the Williams Act.\textsuperscript{172} These proposals would extend withdrawal rights until the expiration of 15 business days from the commencement of the offer (proposed rule 14d-7) and they would require a tender offer to remain open at least 30 business days from the commencement of an offer (proposed rule 14e-1). This suggests that the SEC has concluded that the benefits accruing to target shareholders from such extensions would exceed any burdens upon commerce which would result. It is submitted that the hold-open periods and withdrawal rights set forth in state laws which are longer than


those prescribed under the Williams Act should be deemed constitutional, unless the period set forth is clearly excessive.

Expanded pro rata repurchase rights also place a burden upon the tender offer. In order to satisfy the pro rata repurchase rights of the Williams Act as well as the repurchase rights set forth in the applicable state law, the bidder would have to buy more shares than required. However, in light of the benefits which accrue to shareholders from giving them a significant period of time to decide whether to tender their shares, such prolonged pro rata repurchase rights should be deemed constitutional, unless the period is clearly excessive.

State regulation of securities transactions and corporate internal affairs has generally not been considered an impermissible burden upon commerce. It is submitted that the state takeover laws (without a waiting period and without provisions for an administrative hearing) should satisfy a commerce clause review.\(^{173}\) State takeover laws in that form should not be deemed to place an impermissible burden upon commerce unless and until it is clearly established that such laws place an excessive burden upon commerce.

\(^{173}\) Quite another question is presented by a city and not a state enacting a takeover law. Such a law was enacted by Urbana, New York. See TENDER OFFERS FOR CORPORATE CONTROL, supra note 38, at 254 n.103. It is extremely doubtful that such a statute would be constitutional.

Certain state takeover laws have unusual provisions which appear to impermissibly burden interstate commerce. For example, Hawaii's law requires that a bidder offer to purchase 100\% of the target shares [see Haw. Rev. Stat. § 417E-2(3) (1976)]; a bidder may not specify that it will only bid for a certain lower percentage of the shares. This significantly burdens interstate commerce, since tender offers frequently are made for less than 100\% of the shares; the cost of buying all or nearly all of the outstanding shares may be prohibitive. The benefit which results from this law is that all shareholders wishing to tender may obtain the premium for all shares tendered, rather than the pro rata take-up which would occur pursuant to all other statutes. It would appear that the burden on interstate commerce resulting from such a provision clearly exceeds its benefits.

Kansas has enacted a provision which provides that if a person acquires 2\% of the stock of a company without disclosing an intention to "influence control of the target company" or without making the appropriate filing with the state securities commission, a tender offer may not be made for one year. See Kan. Stat. §17-1277(b) (Supp. 1973). For similar statutes, see Ga. Code § 22-1904 (1977); Ohio Rev. Code Ann. § 1707.041(b)(2) (Page 1977). It is unclear what local benefit is derived from this provision, other than making sure that target management is notified at an early date of an intended tender offer. The burdens imposed by the provision are significant; if a person has purchased shares at some point when it did not have an intention to make a tender offer or for whatever other reason the provision was not satisfied, a tender offer apparently cannot be made until the expiration of the one-year period. (In one instance, the Ohio Securities Commissioner concluded that the Ohio provision only applied if the purchaser had an intention to seek control of the target company at the time the purchaser bought the shares. See M. Lipson & E. Sternberger, supra note 169, at 251.) In addition, the provision represents an additional means pursuant to which target management can be notified of an intended tender offer and engage in defensive maneuvers. Since the benefits of this provision are minimal and the burden significant, such a provision should not withstand a commerce clause review. (It should be noted that the SEC's proposed Rule 14e-2 contains a somewhat similar requirement regarding disclosure of an intention to make a tender offer.)
D. Preemption

A state statute normally is preempted if the federal law (or the legislative history of that law) clearly reflects the intention of Congress that state regulation of the subject matter should be preempted. Even if the federal law does not expressly preempt state regulation, an intention to preempt may be inferred if (i) the federal regulation of the subject matter is so pervasive that it leaves no room for state supplementation, (ii) the federal interest in the subject matter is so dominant that the states must be precluded from enacting laws on that subject, or (iii) if the need for uniform national regulation is so great that state regulation cannot be tolerated.

If an intent to preempt state regulation regarding the subject matter is not expressly evident and cannot be inferred, a state law can be deemed preempted if it directly conflicts with the substantive requirements of the federal law and it is impossible to comply with both laws, or if the state law undermines the purposes and objectives of the federal law.

The three types of preemption outlined above have been referred to as express preemption, implicit (or inferred) preemption, and operational preemption.

1. Express Preemption

The Williams Act contains no language from which one could conclude that Congress intended to preempt the field of regulation of

174. The doctrine of preemption is derived from the supremacy clause, U.S. Const. art. VI, cl. 2, which provides:

This constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.


tender offers. Indeed, it has been noted that the Williams Act was codified in the Securities Act of 1934, and the Securities Act of 1934 contains a savings clause which provides that states should be able to enact laws regarding the subject matter if they do not conflict with federal law.\(^{181}\)

2. Implicit Preemption

There has been some debate regarding whether the Williams Act constitutes a sufficiently comprehensive or pervasive federal scheme such that an intent to preempt should be inferred. Some commentators have argued that it is such a scheme,\(^{182}\) while others contend it is not.\(^{183}\)

An important consideration in connection with this question of implied preemption of state takeover laws by the Williams Act is the fact that the state and federal governments traditionally have regulated securities transactions concurrently.\(^{184}\) In addition, Virginia had already adopted its takeover law when Congress enacted the Williams Act, and the continuing effectiveness of this state law after the effective date of the Williams Act was not addressed in the Williams Act. Since that time a number of other states have adopted state takeover laws. The Williams Act has been amended during this period and no mention has been made of an intention to preempt. Similarly, the proposed new federal securities law expressly permits state regulation of tenders if the corporation has a certain level of contacts with the state.\(^{185}\)

It is submitted that it is unclear whether Congress impliedly intended to preempt state takeover legislation with the enactment of the Williams Act. Because of this, and because states historically have been permitted to regulate securities transactions concurrently with the federal government, state takeover legislation should not be deemed impliedly preempted by the Williams Act because the federal regulation is so pervasive that it leaves no room for state supplementation.

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181. See 15 U.S.C. §78bb(a) (1976). This savings clause should not be given a great deal of weight, however, since it was enacted decades before the enactment of the Williams Act or state takeover laws.

182. See Commerce Clause Limitations, supra note 116, at 1164.

183. See, e.g., A Response to Great Western, supra note 99; Security Law and the Constitution, supra note 38, at 519.

184. For example, it has been said that "under the securities laws state regulation may co-exist with that offered under the federal securities law." SEC v. Nat'l. Sec., Inc, 393 U.S. 453, 461 (1969).

185. Under the proposed new federal securities law, states could regulate tenders if 50% of the corporation's shareholders lived in the state and the corporation's principal place of business was there. See generally Bartell, Federal-State Regulations Under the Federal Securities Code, 32 Vand. L. Rev. 457 (1979).
The Supreme Court cases in which the federal interest in the subject matter has been deemed so dominant that the states have been barred from enforcing laws in the same field have generally been limited to foreign affairs and national security questions. Also, the right of states to regulate securities transactions and the internal affairs of corporations has historically been sanctioned. For these reasons it does not appear that the federal interest in regulating tender offers is so dominant that state regulation of the field must be precluded.

It could be argued that uniform national regulation of the securities area is required, and that states should not be permitted to regulate securities transactions. This argument has not been well received in the United States, however; state regulation of securities transactions has generally been deemed constitutional.

A related point to be argued below is that tender offer regulation should be treated as an "internal affairs" matter and not as an "issuance of securities." State regulation of corporate internal affairs has generally been constitutionally sanctioned.

There is a more basic reason for not deeming the regulation of tender offers a matter which so requires uniform national regulation that state regulation should be preempted. A great deal of valuable information has been learned from the state regulation of tender offers. It has been learned that prolonging the tender offer period (while giving target shareholders certain prophylactic rights during that period) benefits target shareholders and does not appear to put a significant burden upon interstate commerce. Because much has been and presumably will continue to be learned from state tender offer regulation, it is submitted that such regulation should be deemed preempted only to the extent that it conflicts with or undermines the purposes and objectives of the federal law.

3. Operational Preemption

A state law is obviously preempted if its requirements conflict with those contained in the federal law and it is impossible to comply


with both.\textsuperscript{190} State takeover laws frequently set forth substantive provisions that are different from those set forth in the Williams Act.\textsuperscript{191} For example, the pro rata repurchase rights, withdrawal rights, hold-open periods, disclosure requirements and waiting periods set forth in the takeover laws of the various states frequently vary from those set forth in the Williams Act.\textsuperscript{192} It is possible, however, to comply with both the state and federal provisions.\textsuperscript{193} For example, if more shares are tendered than desired, the pro rata repurchase requirements of the Williams Act can be satisfied as to target company shareholders who tender within the first ten days, and then another computation could be made under the applicable state law as to shares tendered after the tenth day but within the period during which target company shareholders are given prorata repurchase rights under state law. The bidder would have to buy more target shares than desired, but both state and federal requirements would be satisfied.\textsuperscript{194}

Similarly, if a state law granted shareholders withdrawal rights for a longer period than that set forth in the Williams Act, the bidder would merely have to honor the longer withdrawal right period set forth in state law to satisfy both the state and federal law require-

\textsuperscript{190} See, e.g., Goldstein v. Cal., 412 U.S. 546, 554-55 (1973) ; Free v. Bland, 369 U.S. 663 (1962). In addition to those situations where there is an actual and unresolvable conflict, the Supreme Court has sometimes suggested that the possibility of states enacting legislation conflicting with federal legislation is sufficient to deem state law preempted. See generally Ray v. Atlantic Richfield Co., 435 U.S. 151 (1978) ; City of Burbank v. Lockheed Air Terminal, Inc., 411 U.S. 624, 639 (1973) ; but cf. Huron Portland Cement Co. v. City of Detroit, 362 U.S. 440 (1960) (licensing and inspection of ships by federal government did not preempt the state's right to control pollution). The holdings of the Atlantic Richfield and Burbank cases, however, were principally based upon the fact that a pervasive federal scheme was in effect and preemption was required thereby.

Even if a state statute has conflicted with the federal statute and the conflict was not resolvable, the Supreme Court has held that the state law will only be deemed preempted if a conflicting state law undermines the purposes of the federal law. See Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Ware, 414 U.S. 117, 134-40 (1973).

\textsuperscript{191} For a general discussion of the state takeover laws and the Williams Act, see notes 225-50 & accompanying text infra.

\textsuperscript{192} See id.

\textsuperscript{193} It should be noted, however, that certain rules proposed by the Securities and Exchange Commission, if enacted, could result in an irreconcilable conflict between state and federal rules. Proposed rule 14c-1 [44 Fed. Reg. 9956 (1979)] provides, among other things, that tender offers must remain open for at least thirty \textit{business} days. See Securities Exchange Act of 1934 Release No. 15,548 (Feb. 5, 1979), [1979 Transfer Binder] Fed. Sec. L. REP. (CCH) ¶ 81,935. If this proposed rule becomes effective, it could be impossible to satisfy this requirement as well as the requirements of some state takeover laws that tender offers remain open no longer than 35 days.

Some commentators argue that state law deviations from federally mandated pro rata repurchase obligations and withdrawal rights should be preempted. See Tender Offers for Corporate Control, supra note 38, at 226-29.

\textsuperscript{194} But see Tender Offers for Corporate Control, supra note 38, at 226-29.
ments. It has been contended that this undermines the federally created right of the bidder that tenders become irrevocable on the eighth day after the tender commences.\(^\text{195}\) A convincing argument could be made that the longer withdrawal rights provided by state law are intended to give unsophisticated shareholders additional time to decide whether to tender shares. A provision such as this which is intended to protect target shareholders supports rather than undermines the purpose of the Williams Act. Since the state withdrawal right provisions advance the general purpose of the Williams Act (protecting target shareholders), and since it is possible to comply with both federal and state withdrawal right provisions, the state provisions should not be deemed preempted.

In the securities area the Supreme Court has been solicitous of the state interest in regulating securities transactions. For example, in *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Ware*,\(^\text{196}\) the Court upheld a state statute which conflicted with the requirements of the New York Stock Exchange Rules (which were promulgated pursuant to the 1934 Securities Exchange Act).\(^\text{197}\) The Court held that it was unnecessary to find the state law preempted in order to advance the policy of the 1934 Act.\(^\text{198}\) Because there is no actual irreconcilable conflict between state and federal takeover laws at the present time, and because states historically have been given the right to regulate securities transactions concurrently with the federal securities laws, it is submitted that state takeover laws should not be deemed preempted because they directly conflict with the federal law.

The most difficult preemption question is whether the state laws are preempted by the federal law because they frustrate the purposes and objectives of the Williams Act. A factor which complicates this analysis is that the purposes of the Williams Act are less than clear. One purpose of the Williams Act clearly is to protect shareholders of the target company.\(^\text{199}\) A question that is less clear is whether another

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195. *See id. at 227.*


197. *Id. at 139-40.*


purpose of the Williams Act is to balance the equities between target management and the tender offeror. Certain statements can be found in the legislative history which suggest that such a balance was attempted. On the basis of this legislative history, the circuit court in Great Western held that a purpose of the Williams Act was to establish such a balance between target management and the tender offeror, and that the state laws undermine this balance and therefore should be deemed preempted.

Other commentators have argued that no such balance was struck in the Williams Act between the interests of target management and the tender offeror. Proponents of this view note that the “Williams bill” as initially introduced by Senator Williams was decidedly pro-target management, and gradually was amended to the form in which it was enacted as the Williams Act; it is also emphasized that a number of people who testified regarding the bill stated that its sole purpose was to protect investors in target companies. Similarly, the Supreme Court has found that the Williams Act reflects a “policy of neutrality in contests for control,” but this policy “does not go . . . to the purpose of the legislation . . . . Neutrality is, rather, but one characteristic of legislation directed toward a different purpose—the protection of investors.”

It is therefore not clear whether a purpose of the Williams Act was to balance the interests of target management and tender offerors. This should not affect the determination as to whether state takeover laws are operationally preempted by the Williams Act, however. It was set forth above that state waiting period provisions and provisions permitting administrative hearings should be deemed impermis-

200. Senator Williams noted, regarding the Williams Act, that “we have taken extreme care to avoid tipping the scales either in favor of management or in favor of the person making the takeover bid.” 113 Cong. Rec. 24,664 (1967). In addition, a Senate report on the bill stated:

The committee has taken extreme care to avoid tipping the balance of regulation either in favor of management or in favor of the person making the takeover bid. The bill is designed to require full and fair disclosure for the benefit of investors while at the same time providing the offeror and management equal opportunity to fairly present their case.

SENATE COMM. ON BANKING AND CURRENCY, FULL DISCLOSURE OF CORPORATE EQUITY OWNERSHIP AND IN CORPORATE TAKEOVER BIDS, S. REP. NO. 550, 90th CONG., 1st Sess. 3 (1967).

201. 577 F.2d at 1279-80. See also 439 F. Supp. at 437; Langevoort, supra note 116, at 249; Commerce Clause Limitations, supra note 116, at 1168.


sible burdens on commerce. If these provisions would be stricken from state takeover laws, such laws would not significantly undermine any balance struck by the Williams Act between the interests of target management and tender offerors. No notice of a tender offer would be required prior to its commencement. Target management would no longer be able to engage in defensive tactics prior to the commencement of a tender offer. In order to satisfy any applicable state law it may be necessary to disclose more information in addition to that required under federal law, hold the offer open longer than required under the Williams Act or to give somewhat different withdrawal rights and pro rata repurchase protection than provided under the Williams Act. It is submitted that such variances do not significantly erode any objectives of the Williams Act. For this reason, if the provisions of state law requiring a waiting period and permitting state administrative hearings are deleted from state take-
other laws, such laws would not undermine the purposes of the Williams Act and therefore should not be deemed preempted by federal law.

It has also been argued that the state takeover laws should be operationally preempted by the Williams Act since such laws take a "fiduciary approach" to tender offers while the Williams Act reflects a "market approach." The essence of this argument seems to be that state law gives target management power to block a tender offer, while federal law leaves the decision with the shareholders. The belief that state takeover laws give target management the power to block a tender offer stems from the fact that many state laws exempt tender offers approved by target management. Such tender offers may proceed without satisfying state requirements. Absent such approval by target management, state takeover requirements must be followed in most cases.

It appears that the proponents of the view that state takeover laws reflect a "fiduciary approach" over-estimate the club given target management under these laws. It was set forth above that target management is successful in retaining control in less than a majority of contested tender offers. Admittedly target management is given some power under state takeover laws. If the waiting period pro-

204. The Great Western circuit court found that the degree of disclosure required under Idaho law undermined the utility of federally mandated disclosure and was thereby preempted. See 577 F.2d at 1281.
205. See 577 F.2d at 1276-80; M. Lipton & E. Steinberger, supra note 169, at 233-34.
206. See notes 143-47 and accompanying text supra.
207. The probability of success of an uncontested tender offer appears to be much higher than that of a contested one. Of the contested tender offers studied
visions and provisions allowing administrative hearings are deemed impermissible burdens upon commerce, however, it would appear that the burden upon commerce imposed by these statutes would be reduced and the power of target management would also be commensurately reduced, thereby reducing the significance of the “friendly offer” exemption.

In a contested tender offer (which cannot avail itself of the “friendly offer” exemption), target company shareholders still have the opportunity to tender their shares. Because of this opportunity and because the power of target management would be reduced if the waiting period and administrative hearing provisions are deleted from state takeover laws, it is submitted that the state takeover laws in that form would not significantly undermine any objective of or any “market approach” reflected in the Williams Act and should not be deemed operationally preempted by federal law.

It has been noted that, if there is no irreconcilable conflict between state and federal law, the question of preemption is a policy decision. As a result of state takeover laws, it has been discovered that longer hold-open periods (with longer accompanying pro rata repurchase and withdrawal rights) benefit target shareholders and probably do not substantially impede takeovers. Because so many valuable lessons can be learned from the experimentation which results in the course of state takeover regulation, it is submitted that such experimentation should be allowed to continue.

IV. Federal Corporation Law

Although Congress has enacted securities laws which regulate the issuance and trading of securities and the dissemination of information by corporations, the internal affairs of American corporations are generally regulated by state corporate law. It has been suggested that, regarding large truly national corporations, it seems somewhat absurd from a policy standpoint that such corporations would be governed by the corporate law of the state where the charter

by Professor Austin during the period from 1972 through 1977, approximately 93% of these offers were either partially or completely successful. During the same period, only approximately 70% of contested tender offers were partially or completely successful. See Austin, Trends in Tactics, supra note 143, at 25. Professor Austin does not note what percentage of the “unsuccessful” contested tender offers represent instances in which a third party gained control of the company.

208. See Hirsch, supra note 178, at 542-79.
209. Accord, Shipman, supra note 202, at 760.
210. See, e.g., Santa Fe Indus., Inc. v. Green, 430 U.S. 462 (1977). Certain stock exchanges also regulate certain internal affairs matters of listed companies,
documents are filed rather than a federal corporation law.211 Such an argument is persuasive from a policy standpoint. There are competing considerations, however.

State corporate law has a rich body of precedent and most statutory sections of the corporate law of commercial states (such as Delaware, New York and California) have been construed in numerous court decisions; the meaning of such statutes in most situations is now relatively clear. A new federal corporation law would obviously be a composite of state corporate law. The statutory sections probably would not be enacted by Congress in a form identical to a state code section; it is likely that Congress would revise the section in some manner or combine two or more sections. The result would be, at least in the short run, that the meaning of such sections would be unclear. The obvious counter-argument to this view is that in a short period of time (after such sections had been construed by courts) they would then be clear in their meaning.

A more fundamental reason exists for not enacting a federal corporation law. It is submitted that there is no necessity for federal pre-emption of corporate law applicable to national corporations. Concern relating to state corporate law abuse generally focuses upon relatively few statutory sections.212 Such concerns could be addressed pursuant to a federal act which would address only these primary concerns. State corporate law not in conflict with these sections could continue to apply to such national corporations. National corporations could continue to avail themselves of the relative certainty now existing in state corporate law and federal policy could be furthered by the enactment of any statutes deemed to reflect an important federal policy.213


212. For example, reform proposals generally suggest that corporate management (i) should be required to satisfy a higher standard of care and (ii) should be permitted to be indemnified by the corporation of its insurance company in a fewer number of instances. Other proposed reforms pertain to requiring more disclosure by large corporations and permitting a "public representative" to sit on the board of directors of large corporations. Methods of increasing the independence of the company's auditors and board of directors from company management have also been suggested. See generally Oldham, Book Review, supra note 10.

Another practical concern militates against any proposal for a federal corporation law. As the drafters of California’s new general corporation law recently discovered drafting a corporations code is a terribly difficult and complex task. Rather than require Congressmen and their staffs to become mired in the technicalities of corporate law drafting, it would seem preferable to focus their attention and energy upon the relatively small number of issues which are cause for public concern.

Approximately a decade ago there was a significant amount of interest in the idea of a federal corporation law.\textsuperscript{214} Until recently, this interest has been steadily waning. Certain members of Congress have shown a renewed interest in the idea of federal chartering, or at least a more active federal role in regulating the internal affairs of large corporations.\textsuperscript{214a} In any event, it is still unclear whether there is significant support on Capitol Hill for either of these ideas. Because of this, and because the Supreme Court has recently narrowly construed the federal securities law,\textsuperscript{216} it appears clear that in the near


214. For example, the 1972 Democratic Party platform proposed the establishment of a commission to study federal chartering of large corporations. See \textit{Text of Platform Adopted by Democrats at Miami Beach}, 30 Cong. Q. Weekly Rep. 1726, 1728 (1972). Although federal chartering has been proposed sporadically during this century (see, e.g., Brabner & Smith, supra note 93; Snapp, supra note 93), the idea received a great deal of attention in the early 1970’s. See generally R. Nader, M. Green & J. Seligman, supra note 6; Henning, supra note 4; Jennings, supra note 6; Schwartz, supra note 9; Schwartz supra note 6; Note, \textit{Federal Chartering of Corporations: A Proposal}, 61 Geo. L.J. 89 (1972).

214a. A “Corporate Democracy Act”, House of Representatives Bill 7010, introduced by Representative Benjamin Rosenthal, would regulate a large number of corporate internal affairs. This proposal would affect all corporations with more than $250,000,000 in assets or sales, or more than 5,000 employees. Senator Howard Metzenbaum is sponsoring Senate Bill No. 2567. This bill would apply to the one thousand largest corporations in the United States. This bill is somewhat less expansive than the proposed Corporate Democracy Act, but would require a majority of a corporation’s board to be comprised of independent directors, would require the corporation’s board to have audit and nominating committees comprised entirely of independent directors, would require cumulative voting, and would increase the ability of shareholders to nominate candidates for the board of directors. A bill sponsored by Representative Paul Simon, H.R. 4154, would prohibit any person from simultaneously holding office as a director or officer of more than one governed corporation. See generally BNA’s Washington Memorandum, No. 81 (May 6, 1980) at 1.

215. See, e.g., Santa Fe Indus., Inc. v. Green, 430 U.S. 462 (1977) (a breach of fiduciary duty, absent any deception, misrepresentation or nondisclosure, does not establish a cause of action under §10(b) of the Federal Securities Act of 1934; Ernst & Ernst v. Hockfelder, 425 U.S. 185 (1976) (an action for damages under §10(b) of the Federal Securities Act of 1934 must establish “scienter”—an intent to deceive, manipulate or defraud—on the part of the defendant); Blue Chip Stamps v. Manor Drug Stores, 422 U.S. 723 (1975) (a plaintiff in a private damages action pursuant to §10(b) of the Federal Securities Act of 1934 must have “purchased” or “sold” a security).