THE CASE FOR THE CONSTITUTIONALITY OF STATE BUSINESS COMBINATION STATUTES

By John F. Pritchard*

I. Introduction

The recent decision of the United States Supreme Court in *CTS Corp. v. Dynamics Corp. of America*¹ has dramatically altered the landscape upon which battles for corporate control are fought. In upholding the constitutionality of the Control Share Acquisition Chapter of the Indiana Business Corporation Law (Indiana Act),² the Court ruled that Indiana was constitutionally free to enact a statute relating to the corporate governance of its domestic corporations (in this case, the voting rights of shareholders) despite the fact that the statute had a significant effect on the tender offer process and that it might discourage some tender offers.

*CTS* was decided in the midst of increasingly active policy discussions at both state and national levels concerning the economic, political and social effects of hostile tender offers. Proponents of hostile takeovers argue that these takeovers serve important economic goals by enhancing value for individual shareholders of companies and for the economy as a whole by increasing share prices and replacing inefficient management, resulting in the better utilization of assets. On the other side of the debate, opponents of hostile takeovers argue that such takeovers harm the economy by sacrificing long-term economic growth for short-term gains by shareholders of target companies. As evidence, the opponents cite the proliferation of corporate debt, diminution of research and development opportunities, risk-averse behavior of management, and long-term weak-

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ness in the stock price of target companies after a hostile takeover attempt or upon consummation of a takeover.³

Ten states, many in the wake of CTS, have enacted so-called business combination statutes which inhibit second stage transactions such as mergers following the hostile acquisition of the target’s stock:⁴ Arizona, Delaware, Indiana, Kentucky, Minnesota, Missouri, New Jersey, New York, Washington, and Wisconsin.⁵ These statutes have been challenged in court based upon allegations that they are preempted by the provisions of the Williams Act⁶ and that they constitute an impermissible burden on interstate commerce under the commerce clause. To date there have been four decisions on the constitutionality of these statutes.⁷ Several additional challenges to business combination statutes were briefed and argued but, due to developments in the battle for control, did not result in court rulings upon the validity of the statutes.⁸


4. See infra notes 9-27 and accompanying text (describing the nature and effect of business combination statutes).


It is the premise of this article that business combination statutes are constitutional under the principles announced in *CTS* as well as under principles which the Court did not reach in that case.

II. THE PROVISIONS AND PRACTICAL EFFECT OF BUSINESS COMBINATION STATUTES

Although the business combination statutes that have been enacted vary in their provisions, all except Delaware's are similar to and modeled after section 912 of the New York Business Corporation Law (New York statute).\(^9\) By way of illustrating the provisions and practical effect of all such statutes, the focus of this article is on the provisions of the New York statute.

The New York statute is addressed to the corporate governance, and thus to the internal affairs, of those New York corporations which are covered by its terms and which have not elected to opt out of its coverage.\(^10\) The statute concerns the circumstances under which an "interested shareholder," one who acquires more than 20% of a New York corporation's\(^11\) outstanding voting stock,\(^12\) may merge with the corporation. It provides in relevant part that:

no resident domestic corporation shall engage in any business combination with any interested shareholder of such resident domestic corporation for a period of five years following such interested shareholder's stock acquisition date unless such business combination or the purchase of stock made by such interested shareholder on such interested shareholder's stock acquisition date is approved by the board.

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\(^10\) N.Y. Bus. Corp. Law § 912 (McKinney 1986). In fact, the New Jersey statute is almost identical to the New York statute. N.J. Stat. Ann. §§ 14A:10A-1 to -6 (West Supp. 1988). The primary difference is that the New Jersey statute is triggered when the acquiring obtains 10% of a target company's shares rather than the 20% required under the New York statute.


\(^12\) The New York statute does not apply to corporations which adopted amendments to their bylaws opting out of its provisions before March 31, 1986, whose original certificates of incorporation elect not to be governed by its provisions or whose disinterested shareholders by majority vote elect to opt out of its provisions. Id. § 912(d)(3).

\(^{12}\) Id. § 912(a)(10)(A)(i).
of directors of such resident domestic corporation prior to such interested shareholder’s stock acquisition date.\textsuperscript{13}

Accordingly, an interested shareholder who acquires 20\% or more of a corporation’s stock without advance approval of its board of directors must wait five years before proposing any business combination\textsuperscript{14} with the corporation. After the waiting period, the statute provides the interested shareholder with two alternatives for consummating the business combination. The first alternative permits combinations that are “approved by the affirmative vote of the holders of a majority of the outstanding voting stock not beneficially owned by such interested shareholder or any affiliate or associate of such interested shareholder.”\textsuperscript{15} The second alternative is for the interested shareholder to pay a formula fair price to shareholders which, generally speaking, is an amount equal to at least the highest price per share paid by the shareholder during the five year period prior to the date of the proposed business combination.\textsuperscript{16}

The Delaware Business Combination Statute (Delaware statute),\textsuperscript{17} enacted on February 2, 1988, while similar in purpose, varies from the New York statute in its provisions. Bidders for Delaware corporations may avoid the application of the Delaware statute by satisfying either of two exemptions not found in the New York statute.\textsuperscript{18} Three courts have already relied heavily on these exemptions in finding the Delaware statute to be constitutional.\textsuperscript{19}

The Delaware statute provides that a person who acquires 15\% or more of the voting stock of a Delaware corporation may not effect mergers and certain other business combinations with the target for three years, unless the company’s board of directors approves either

\textsuperscript{13} Id. § 912(b). The statute applies only to New York corporations which have their “principal executive offices” and “significant business operations” located within the state and have at least 10\% of their voting stock owned beneficially by New York residents. Id. § 912(a)(13)(A) & (B).

\textsuperscript{14} Id. § 912(b).

\textsuperscript{15} The term “business combination” is defined to include, in addition to mergers, certain other transactions pursuant to which an interested shareholder would obtain an interest in the corporation or its assets. Id. § 912(a)(5)(A)-(F).

\textsuperscript{16} Id. § 912(c)(3).

\textsuperscript{17} Del. Code Ann. tit. 8, § 203 (Supp. 1988).

\textsuperscript{18} Id. § 203(a)(2) & (3). See infra text accompanying note 20.

\textsuperscript{19} Staley, 686 F. Supp. at 482-85; BNS, 683 F. Supp. at 470-72 (discussing exemptions or “escapes” which allow offers beneficial to shareholders to proceed and “save the statute from constitutional infirmity”); City Capital Assocs., Fed. Sec. L. Rep. (CCH) ¶ 94,079, at 91,055-56.
the business combination or the transaction that resulted in the stockholder becoming an interested stockholder by crossing the 15% threshold. However, the interested stockholder may effect a business combination with the target without prior board approval if it acquires ownership of 85% of the company’s outstanding voting stock in the same transaction that took it over the 15% threshold. Excluded in computing the 85% requirement are shares owned by directors who are also officers and shares owned by certain corporate stock plans (ESOPs). Finally, a stockholder who gains control of the board may effect a business combination with the target which is approved by a vote of two-thirds of the remaining shares.20

Equally important in the assessment of the constitutionality of these statutes is what the New York and other business combination statutes do not do. They do not prevent or in any way interfere with the purchase, by tender offer or otherwise, of any of the shares of covered corporations. In New York, an interested shareholder who purchases 20% or more of a corporation’s shares without board approval may, through his voting power, replace the board of directors of the corporation, replace its management, change its operating policies, declare dividends in which it would share pro rata with other shareholders and otherwise impose its own policies upon the corporation. The only thing such a shareholder cannot use its voting power to accomplish is a business combination between the corporation and the interested shareholder or its affiliates.21

The New York statute represents Governor Cuomo’s own approach to state takeover legislation. In his memorandum22 in support of the bill, the Governor made it clear that the legislation is not intended to block hostile takeovers for New York corporations. In fact, he recognized that such takeovers can “move the assets of the targets into the hands of more efficient management” and thus be “economically desirable” when they are “soundly financed . . . by operating companies that are seeking to expand.”23

The purpose of the New York statute, according to the Governor’s Memorandum, is to inhibit “highly leveraged takeovers by offerors who either are not interested in operating the target com-

22. See Governor’s Program Bill, 1985 Extraordinary Session Assembly Bill 2, ch. 915 [hereinafter Memorandum].
23. Id. at 7.
panies and seek the opportunity for profit through liquidation of the target, or are compelled by the pressures of the financing of the takeover to effect a total or partial liquidation."\(^{24}\) In short, the legislation is designed to prevent a bidder, without the prior approval of the target's board of directors, from purchasing the corporation with its own assets. The statute accomplishes this objective by preventing the bidder from merging with the corporation for five years, thus depriving it of unfettered access to its assets.

Governor Cuomo identified the harmful characteristics of such "bust-up" takeovers as follows:

These takeovers are often not for the purpose of diversification, expansion or growth, but are financial transactions driven by substantial, immediate returns for the takeover offerors. These transactions primarily rearrange ownership interests by substituting lenders for shareholders and shift the risk from equity owners to creditors. They adversely affect employees and communities. They restrict the ability of the affected businesses to grow, to invest for long-term return and to provide increased productivity and employment. And they encourage defensive tactics on the part of the actual or potential takeover target that are aimed at making the target less attractive but which also have the effect of impairing the long-term potential of New York resident domestic corporations. As a major industrial state, New York is intimately concerned about avoiding the adverse effects on the State and its citizens of these types of takeovers.\(^{25}\)

The Governor went on in the memorandum to make a case on social and economic grounds concerning the undesirability of the "abusive" takeovers that are the target of the statute. However, he emphasized that under the statute a "potential acquirer [sic] would be free to purchase as much stock of the target as it wished and to

\(^{24}\) Id. at 6. As the Supreme Court observed in CTS Corp. v. Dynamics Corp. of Am., 107 S. Ct. 1637 (1987), some 20 years after enactment of the Williams Act, "It is appropriate to note when discussing the merits and demerits of tender offers that generalizations usually require qualification.... The divergent views in the literature—and even now being debated in the Congress—reflect the reality that the type and utility of tender offers vary widely." CTS, 107 S. Ct. at 1651 n.13.

\(^{25}\) Memorandum, supra note 22, at 6.
vote that stock in the election of directors who in turn elect management . . . ."26 He noted, moreover, that "a board of directors that improperly rejects an acquisition proposal would be subject to removal by means of the proxy mechanism."27

III. THE CONSTITUTIONAL ISSUES

Several actions have been commenced attacking business combination statutes on constitutional grounds.28 The principal basis for attack under the supremacy clause is that these statutes place a powerful new weapon in the hands of incumbent management with which they can thwart most hostile tender offers. This, so the argument goes, is inconsistent with the policy of neutrality which underlies the Williams Act29 because it upsets the delicate balance between offeror and target that Congress sought to maintain.29 Accordingly, business combination statutes are preempted by the federal tender offer legislation. The attack under the commerce clause is based upon the assertion that, although business combination statutes do not discriminate against interstate commerce in preventing hostile tender offers, they do burden interstate commerce in corporate control. This burden, it is argued, is excessive in relation to the meager "local benefits" of the legislation and thus the statutes do not pass muster under the balancing test set out by the Supreme Court in *Pike v. Bruce Church.*31

Inherently, the ability to determine whether a statute is constitutional involves a prediction of how the Supreme Court would decide the issue. Most followers of the Supreme Court were surprised

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26. Id. at 8.
27. Id. at 9.
30. See infra notes 68-72 and accompanying text.
31. 397 U.S. 137, 142 (1970). If the "burden imposed on such commerce is clearly excessive in relation to the putative local benefits," then the statute is an impermissible burden on interstate commerce. Id.
that the Court in CTS upheld the constitutionality of the Indiana Act. The fate of the “first generation” statutes, highlighted by the Supreme Court’s ruling in Edgar v. MITE Corp., had given proponents of the Indiana Act little reason for optimism.

To date, the business combination statutes have been considered only by lower courts. A ruling by the Supreme Court on one of these statutes could result in another surprise.

A. The Supreme Court’s Decision in CTS

The Indiana Act attacked in CTS governs the voting power of “control shares” of Indiana corporations. A person who acquires control shares may not vote them until the shares are granted voting rights by a majority of the corporation’s disinterested shareholders in a special election held to consider the issue. The corporation has fifty days after the acquiror requests the election to hold the shareholder meeting.

As the Supreme Court recognized, “[t]he practical effect of this requirement [of the Indiana Act] is to condition acquisition of control of a corporation on approval of a majority of the pre-existing disinterested shareholders.” While the Indiana Act regulates only the voting rights of shareholders, it has a direct impact upon the tender offer process. A bidder seeking to gain control of an Indiana corporation by means of a tender offer must simultaneously conduct a proxy fight to obtain the necessary shareholder approval of his right to vote the shares acquired—a proxy fight that takes up to fifty days.

The Court first addressed the question of whether the Williams Act preempts the Indiana Act, stating that the issue was whether the state law “frustrates the purposes of the federal law.” It found

32. 457 U.S. 624 (1982). In MITE, the Supreme Court held that the Illinois Business Takeover Act was unconstitutional under the commerce clause. A plurality of Justices also found that the Illinois Act violated the supremacy clause. The MITE ruling led many lower courts to strike down other first generation statutes on constitutional grounds. Subsequently, many of these same states, and others, enacted a “second generation” of takeover statutes that sought to avoid the constitutional infirmities of the Illinois Act enunciated in MITE. The Indiana Act was the first of these statutes to be ruled upon by the Supreme Court.

33. Control shares are acquired voting shares which, when aggregated with all other shares owned by the acquiror, pass one of three thresholds of voting power—20%, 33.3% or 50%. The Indiana Act applies only to domestic corporations which have other substantial contacts with the state. CTS, 107 S. Ct. at 1641.
35. CTS, 107 S. Ct. at 1641.
36. Id. at 1644.
that the "regulatory conditions that the [Indiana] Act places on tender offers are consistent with the text and purposes of the Williams Act." 37 Accordingly, it did not rule on the threshold issue of the preemptive effect of the Williams Act.

However, the Court stressed that the Williams Act, which "Congress passed . . . in 1968 in response to the increasing number of hostile tender offers," imposes requirements in only two basic areas—disclosure by the tender offeror of information concerning the offer and procedural rules governing tender offers. 38 Thus, the Williams Act is limited to the regulation of tender offers that have been commenced. It contains no provisions relating to corporate governance matters and does not purport to assure that the legal climate will remain favorable to the institution of tender offers.

Neither the Williams Act nor its legislative history contains any suggestion that the Act might operate to preempt state corporate laws concerning the internal affairs of their domestic corporations. Indeed, in a statement concerning shareholder voting rights that is equally relevant to mergers regulated by business combination statutes, the Court in CTS observed that "[t]he longstanding prevalence of state regulation in this area suggests that, if Congress had intended to pre-empt all state laws that delay the acquisition of voting control following a tender offer, it would have said so explicitly." 39

Although the Court did not address the preemptive effect of the Williams Act, the United States government did. Noting that the "United States has an interest in both the free flow of commerce among the states and proper consideration of the prerogatives of the states," the Solicitor General, Charles Fried, filed a brief with the Supreme Court in the CTS case on behalf of the Securities and Exchange Commission (SEC) and the United States as amici curiae. 40 In it, he stated the position of the United States that the Williams Act does not preempt state laws (even those directly regulating tender offers) that favor one side or the other in tender offer contests so long as they do not conflict with the provisions of the Williams Act:

The United States believes that the Indiana Chapter is not pre-empted by the Williams Act . . . . [T]here is no

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37. Id. at 1648 (emphasis added).
38. Id. at 1644.
39. Id. at 1648 (emphasis added).
conflict between any provision of the Williams Act and any provision of the Indiana Chapter that makes it impossible to comply with both statutes . . . . [T]here is no preemptive federal statutory policy that the Indiana Chapter violates: the Williams Act was designed to favor neither the takeover bidder nor target management, . . . but it does not prohibit states from adopting laws that operate to favor one side or the other, unless those laws conflict with the Williams Act or the Commission’s regulations under that Act. 41

The Court also held that the Indiana Act does not violate the commerce clause. In so doing, the Court flatly ruled that states have the right to regulate the internal affairs of their domestic corporations even though such regulations may “decrease the number of successful tender offers.” 42

The Indiana Act is a corporate governance statute which regulates the distribution of power among the various constituencies of the corporation. The Court in CTS indicated that such statutes stand on a different footing than the generation of state statutes directly regulating the tender offer process that were struck down in MITE. 43 Moreover, as discussed below, the main and concurring opinions in CTS, which represent the views of six Justices, raise the question whether Justice White's preemption analysis in MITE is shared by a majority of the Court, even in the context of a state statute directly regulating the tender offer process. 44

41. Id. (citations omitted). Subsequently, the SEC filed amicus briefs in three other state takeover statute cases: RP Acquisition Corp. v. Staley Continental, Inc., 686 F. Supp. 476 (D. Del. 1988); CRTF Corp. v. Federated Dep't Stores, Inc., 683 F. Supp. 422 (S.D.N.Y. 1988); and Salant Acquisition Corp. v. Manhattan Indus., Inc., 682 F. Supp. 199 (S.D.N.Y. 1988). In the Salant and Staley briefs, the SEC took the position that the state takeover statutes were preempted by the Williams Act. Moreover, in the Staley brief, the SEC stated that the position on the supremacy clause expressed in CTS was only that of the United States. See Staley amicus brief, supra, at 12 n.9. The brief filed by the SEC in CRTF does not address constitutional issues.

42. CTS, 107 S. Ct. at 1652.

43. Id. at 1646.

44. See MITE, 457 U.S. at 631-39 (preemption analysis of three provisions in the Illinois Act seen as upsetting the balance established by the Williams Act: (1) the precommitment disclosure requirement, (2) the hearing provisions, and (3) the provision permitting the Secretary of State “to pass on the substantive fairness of a tender offer”).
B. The Supremacy Clause

The preemption of a state takeover statute by the Williams Act depends upon whether "the state[s] law stands as an obstacle to the accomplishment and execution of the full purposes or objectives of Congress." In practice, courts have rarely held state statutes to be preempted under this test in the absence of an "actual conflict" between the state and federal statutes or an "unambiguous congressional mandate" requiring preemption of the statute.

Following these principles, preemption rulings have generally been limited to state laws which regulate the same subject matter regulated by federal statutes; state laws that merely touch upon the same area as the federal law are not preempted unless a specific, direct conflict is found.

The ordinary presumption of constitutionality given to state laws is strongest in the preemption context. To preserve the states' law-making authority, "[c]onsideration under the Supremacy Clause starts with the basic assumption that Congress did not intend to displace state law." A state law will not be found to be preempted "in the absence of persuasive reasons—either that the nature of the

45. CTS, 107 S. Ct. at 1644 (quoting Hines v. Davidowitz, 312 U.S. 52, 67 (1941)). State statutes may run afoul of the supremacy clause under one of several preemption tests fashioned by the courts: (1) that Congress has explicitly displaced state law, e.g., Shaw v. Delta Air Lines, Inc., 463 U.S. 85, 95-96 (1983); (2) that Congress has so pervasively regulated a field, that it is entirely occupied, precluding state regulation, e.g., Rice v. Santa Fe Elevator Corp., 331 U.S. 218, 230 (1947); (3) that the state law "actually conflicts" with federal law either because compliance with both is a "physical impossibility," Florida Lime & Avocado Growers, Inc. v. Paul, 373 U.S. 132, 142-43 (1963); or (4) because it falls within the Hines test. See generally Fidelity Fed. Sav. & Loan Ass'n v. De La Cuesta, 458 U.S. 141, 152-53 (1982).


47. E.g., Florida Lime & Avocado Growers, Inc., 373 U.S. at 146-47.

48. See Huron Portland Cement Co. v. Detroit, 362 U.S. 440, 446 (1960) (where the Court concluded that there was "no overlap between the scope of the federal ship inspection laws and that of the municipal ordinance" regulating exhaust emitted from ships). Accord Rice, 331 U.S. at 237 (no preemption where state and federal laws raised only speculative conflicts).

regulated subject matter permits no other conclusion, or that the Congress has unmistakably so ordained.”

This is particularly true when a court reviews legislation in an area traditionally governed by state law. “Where . . . the field which Congress is said to have pre-empted has been traditionally occupied by the States, . . . ‘we start with the assumption that the historic police powers of the States were not to be superseded by the Federal Act unless that was the clear and manifest purpose of Congress.’”

Few fields have been so consistently and completely occupied by the states as the regulation of the internal affairs of their domestic corporations. As the Supreme Court stated in CTS after reviewing numerous state laws affecting corporate governance matters: “It is thus an accepted part of the business landscape in this country for states to create corporations, to prescribe their powers, and to define the rights that are acquired by purchasing their shares.” Thus, only an “unambiguous congressional mandate” would justify a finding of federal preemption of a state statute regulating business combinations between its domestic corporations and their dominant shareholders.

1. The Difference Between the Business Combination Statutes and the Williams Act

Business combination statutes regulate only the circumstances under which a covered corporation may engage in a business combination with an interested shareholder. The statutes apply regardless of the method by which the interested shareholder has acquired more than the threshold amount of the corporation’s stock. Bidders remain free to acquire any or all of the stock of covered domestic corporations and to exercise all of the powers of a major shareholder except, in

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51. Jones v. Rath Packing Co., 430 U.S. 519, 525 (1977) (holding that a state statute which did not allow for variation in weight loss on packaged meat labels conflicted with a similar federal statute and was therefore preempted) (quoting Rice, 331 U.S. at 230).
52. CTS, 107 S. Ct. at 1650.
53. Cf. Florida Lime & Avocado Growers, Inc., 373 U.S. at 146-47 (“[W]e are not to conclude that Congress legislated the ouster of this . . . statute . . . in the absence of an unambiguous Congressional mandate to that effect.”).
54. Tender offers—the only subject matter of the Williams Act—are, of course, only one of the ways of acquiring such a block of stock. See, e.g., Hanson Trust PLC v. SCM Corp., 774 F.2d 47, 56 (2d Cir. 1985).
the absence of prior approval by the corporation’s board of directors, the right to propose a business combination (as defined in the statutes) with the corporation within five years. The Supreme Court’s observation concerning the Indiana Act is even more true of business combination statutes. "[T]his Act does not prohibit any entity . . . from offering to purchase, or from purchasing, shares in Indiana corporations, or from attempting thereby to gain control."55

In sharp contrast, the Williams Act, 56 which was adopted in 1968 as an integral part of the Securities and Exchange Act of 1934 (1934 Act), 57 does not purport to govern the internal affairs of state-chartered corporations, such as mergers or other business combinations. Rather, the Williams Act requires that, upon commencement of a tender offer, the offeror provide shareholders of the target company with specified information about the offer.58 It also establishes specified procedural rules governing tender offers. For example, it requires that the offer remain open for not less than twenty business days59 and provides that shareholders who tender their shares may withdraw them at any time prior to the expiration of the offer.60 All shares tendered must be purchased for the same price and on a pro rata basis if the offer is oversubscribed.61

This side-by-side comparison of the Williams Act and business combination statutes demonstrates that these statutes regulate subjects which are mutually distinct. The state statutes do not restrain the ability of a bidder to purchase shares pursuant to a tender offer. Further, there is no evidence that Congress even considered state statutory regulation of business combinations when enacting the Williams Act.

55. See CTS, 107 S. Ct. at 1652.
58. Id. § 78n(d)(1); 17 C.F.R. § 240.14d-3 (1986). Under the Williams Act, the offeror is required to disclose at least the information specified in 15 U.S.C. § 78m(d): namely, the offeror must include, among other things, the background of the purchaser, financing arrangements, changes the offeror proposes for the target's structure, the number of shares beneficially owned and any contracts between the offeror and another person or entity with respect to the securities of the issuer.
Clearly, there is no conflict between the provisions of business combination statutes and the provisions of the Williams Act. Section 28(a) of the 1934 Act addresses preemption in the context of a conflict of ‘provisions’ and does not address issues of conflicting ‘purpose.’ As Justice Scalia stated in his concurring opinion in CTS:

I also agree with the Court that the Indiana control shares Act is not pre-empted by the Williams Act, but I reach that conclusion without entering into the debate over the purposes of the two statutes. The Williams Act is governed by the antipre-emption provision of the Securities Exchange Act of 1934, 15 U.S.C. § 78bb(a) [§ 28(a)], which provides that nothing it contains ‘shall affect the jurisdiction of the securities commission (or any agency or officer performing like functions) of any State over any security or any person insofar as it does not conflict with the provisions of this chapter or the rules and regulations thereunder’ (emphasis added). Unless it serves no function, that language forecloses pre-emption on the basis of conflicting ‘purpose’ as opposed to conflicting ‘provision.’ Even if it does not have literal application to the present case (because, perhaps, the Indiana agency responsible for securities matters has no enforcement responsibility with regard to this legislation), it nonetheless refutes the proposition that Congress meant the Williams Act to displace all state laws with conflicting purpose.

As the Supreme Court has recognized, section 28(a) ‘was plainly intended to protect, rather than to limit, state authority.’

The Supreme Court has frequently held that the plain meaning of a statute must be given effect and that the legislative history of

62. As set forth in its amicus curiae brief filed with the Supreme Court in CTS, the position of the United States government is that the Williams Act does not preempt state laws unless they conflict with the provisions of the federal statute. See Brief for SEC and United States, supra note 40, at 15.

63. CTS, 107 S. Ct. at 1653 (Scalia, J., concurring).

an unambiguous statute is almost always irrelevant. The plain meaning of the only statutory expression of intent in the 1934 Act requires a finding that Congress did not intend that any policy reflected in the Act become the basis for preempting state laws not inconsistent with its actual provisions.

2. The Intent of Congress in Enacting the Williams Act

The Supreme Court has reminded us in the context of the Williams Act itself that "[r]eliance on legislative history in divining the intent of Congress is . . . a step to be taken cautiously" and that courts "must be wary against interpolating [their] notions of policy in the interstices of legislative provisions." The argument that the Williams Act preempts business combination statutes is based, in the first instance, upon an implicit policy of "neutrality" between contending factions in contested tender offers which supposedly underlies the federal legislation. This policy, so the argument goes, preempts state statutes which do not actually conflict with the federal statutory provisions but, nonetheless, favor one side or the other in the tender offer. In applying the preemption argument to business combination statutes, however, its proponents must stretch the scope of the Williams Act, since a necessary second premise is that this policy of neutrality extends well beyond the tender offer process, the subject matter of the Williams Act. Even if the Williams Act's legislative history were a sufficient basis for preempting state laws which directly regulate the tender offer process (such as the Illinois Act struck down in MITE) there is no basis for concluding that it preempts state corporate governance laws simply because they

65. See Garcia v. United States, 469 U.S. 70, 75 (1984) ("[T]urning to the legislative history as an additional tool of analysis, we do so with the recognition that only the most extraordinary showing of contrary intentions from those data would justify a limitation on the 'plain meaning' of the statutory language.").


may make the states’ domestic corporations unattractive to some potential bidders.

Proponents of the preemption thesis rely heavily upon the plurality opinion in MITE. There, Justice White contended that a policy of neutrality embodied in the Williams Act imposes a balance between bidders and incumbent management in tender offers that the states may not upset. The Illinois Act attacked in MITE regulated tender offers by providing for a twenty-day precommencement notice period and for a state hearing on the fairness of the offer. As the Court observed in CTS, the MITE plurality found that these provisions regulating tender offers "contrasted dramatically" with the Williams Act.

In CTS, however, the Supreme Court emphasized that the "plurality opinion in MITE did not represent the views of a majority of the Court" on the issue of the preemptive effect of the Williams Act. In fact, Justice White's opinion on this issue in MITE was joined only by Chief Justice Burger and Justice Blackmun. Justice Powell and Justice Stevens refused to support the supremacy clause portion of Justice White's opinion. Justice Powell stated that "the Williams Act's neutrality policy does not necessarily imply a congressional intent to prohibit state legislation designed to assure—at least in some circumstances—greater protection to interests that include but often are broader than those of incumbent management.'

Similarly, Justice Stevens wrote: "I am not persuaded, however, that Congress' decision to follow a policy of neutrality in its own legislation is tantamount to a federal prohibition against state legislation designed to provide special protection for incumbent management." Justices O'Connor, Marshall, Brennan, and Rehnquist did not reach the supremacy clause issue, although Justice O'Connor joined in the commerce clause portion of Justice White's opinion.

In any event, the Supreme Court has made it abundantly clear that the congressional policy upon which the MITE plurality relied is limited to the context of actual tender offers and is "but one

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68. MITE, 457 U.S. at 627.
69. CTS, 107 S. Ct. at 1645.
70. Id. at 1645 n.6. Chief Justice Burger and Justices White and Blackmun contended that the Williams Act preempted the Illinois Act and, therefore, violated the supremacy clause. Chief Justice Burger and Justices White, Powell, Stevens, and O'Connor agreed that the Illinois Act placed an indirect burden on interstate commerce and thereby violated the commerce clause.
71. MITE, 457 U.S. at 646-47 (Powell, J., concurring in part).
72. Id. at 655.
73. Id.
characteristic of legislation directed toward a different purpose—the protection of investors.” In *Piper v. Chris-Craft Industries, Inc.*, the Court examined in detail the origins and context of this policy of neutrality, concluding that “[t]he legislative history thus shows that the sole purpose of the Williams Act was the protection of investors who are confronted with a tender offer.” In reaching this conclusion, the Court pointed to a statement by the Williams Act’s Senate sponsor, Senator Williams:

> Today, the public shareholder in deciding whether to accept or reject a tender offer possesses limited information. No matter what he does, he acts without adequate knowledge to enable him to decide rationally what is the best course of action. This is precisely the dilemma which our securities laws are designed to prevent.

It seems clear from the legislative history of the Williams Act that Congress did not intend to promote the use of tender offers. Any policy of neutrality that may underlie the Williams Act was evidently limited to the desire not to enact procedural rules which would favor incumbent management or the takeover bidder in those offers that are commenced. This is plain from the fact that the Supreme

75. Id. at 35 (emphasis added). Reiterating its statement in *Rondeau v. Mosinee Paper Corp.*, 422 U.S. 49, 58 (1975), the Court said: “The purpose of the Williams Act is to insure that public shareholders who are confronted by a cash tender offer for their stock will not be required to respond without adequate information . . . .” *Chris-Craft Indus.*, 430 U.S. at 35 (emphasis added). Or, as the Court recently phrased it in *Schreiber v. Burlington N.*, Inc., 472 U.S. 1, 9 (1985), “[t]he expressed legislative intent was to preserve a neutral setting [in tender offers] in which the contenders could fully present their arguments.”
76. *Schreiber*, 472 U.S. at 8-9 (quoting 113 *Cong. Rec.* 24,664 (1967)).
77. In *BNS Inc. v. Koppers*, Inc., 683 F. Supp. 458 (D. Del. 1988), Chief Judge Schwartz followed the plurality opinion in *MITE* by extending the relatively narrow principle of neutrality set forth in the Williams Act to his analysis of the Delaware statute. Applying the four-part preemption test utilized (but not endorsed) by Justice Powell in *CTS*, Judge Schwartz concluded that the Delaware statute has a “pro-management slant.” *Id.* at 470. But that alone was not enough for pre-emption. Judge Schwartz said that “*CTS* suggests that incidentally pro-management measures undertaken to benefit shareholders do not offend the Williams Act policies.” *Id.* The key question was whether the pro-management slant would result in more than an incidental effect on tender offers for Delaware corporations. Based on his reading of *MITE* and *CTS*, Judge Schwartz concluded that the Delaware statute would be “in all likelihood constitutional and not preempted.” *Id.* at 472. This conclusion was based in large part on the existence of the three major exemptions
Court found that the purpose of the Williams Act was to protect those investors "who are confronted with a tender offer." 78

Equally compelling, however, is the fact that nothing in the legislative history of the Williams Act suggests that tender offers should be discouraged; that states should repeal those business corporation laws making tender offers less attractive; or that they should refrain from enacting any such laws in the future. Quite the contrary, the Supreme Court stated in Chris-Craft Industries that "[t]he legislative history shows that Congress was intent on regulating takeover bidders, theretofore operating covertly, in order to protect the shareholders

or "outs" of subsection (a) of the Delaware statute. Del. Code Ann. tit. 8, § 203(a)(1), (2) & (3) (Supp. 1988). Judge Schwartz also minimized the significance of the three-year delay for second-step mergers lacking board approval. He recognized that even without the Delaware statute a bidder would be unable to obtain control of a Delaware target company with a staggered board for at least two years. *BNS*, 683 F. Supp. at 470. The New York statute would not fare as well under Judge Schwartz's reasoning since the New York statute lacks two of the three exemptions found in the Delaware statute. It also prohibits second-step mergers absent board approval for five years, not three years. Compare N.Y. Bus. Corp. Law § 912(b) (McKinney 1986) with Del. Code Ann. tit. 8, § 203(a) (Supp. 1988).

A judge applying Judge Schwartz's reasoning would likely hold the New York statute to be preempted by the Williams Act.

Just over a month after the *BNS* opinion was handed down, Judge Roth in RP Acquisition Corp. v. Staley Continental, Inc., 686 F. Supp. 476 (D. Del. 1988), also analyzed § 203 in light of the policy of neutrality underlying the Williams Act, concluding that "we once again find that the facts adduced are insufficient to support a determination that Section 203 is most likely unconstitutional." *Id.* at 477.

Judge Farnan in City Capital Assocs., Ltd. Partnership v. Interco Inc., Fed. Sec. L. Rep. (CCH) ¶ 94,079 (D. Del. Sept. 23, 1988), relied on the analysis and "rationale" applied in *BNS* and *Staley* in refusing to hold § 203 unconstitutional. Judge Farnan stated: "The limited opportunity which *BNS* left for future constitutional challenges of § 203 required a much greater evidentiary showing than that which has been presented here." *Id.* at 91,056.

In a hastily prepared opinion, Judge Evans in RTE Corp. v. Mark IV Indus., Inc., No. 88-C-378 (E.D. Wis. May 6, 1988), vacated, [1987-1988 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,789 (E.D. Wis. June 22, 1988), held the Wisconsin Business Combination Statute unconstitutional under the supremacy clause. The Wisconsin statute is similar to that of New York except the "freeze-out" period is three years instead of five years. Wis. Stat. Ann. § 180.726 (2) (West Supp. 1988). As in *BNS*, the court followed the MITE plurality's view by extending the principle of neutrality embodied in the Williams Act to the Wisconsin statute. Judge Evans concluded incorrectly that the Wisconsin law vests management with absolute veto power over the outcome of a tender offer contest and that it therefore conflicts with the Williams Act. Again, a judge applying Judge Evans's reasoning would probably find the New York statute unconstitutional under the supremacy clause.

78. Chris-Craft Indus., 430 U.S. at 35 (emphasis added).
of target companies.”

The Court noted that Senator Kuchel, a co-sponsor of the Williams Act, described takeover bidders as “corporate raiders” and “takeover pirates.” In fact, the Court quoted extensively from Senator Kuchel’s remarks which were addressed to the very ills that business combination statutes seek to cure:

Today there are those individuals in our financial community who seek to reduce our proudest businesses into nothing but corporate shells. They seize control of the corporation with unknown sources, sell or trade away the best assets, and later split up the remains among themselves. The tragedy of such collusion is that the corporation can be financially raped without management or shareholders having any knowledge of the [stock] acquisitions . . . . The corporate raider may thus act under a cloak of secrecy while obtaining the shares needed to put him on the road to a successful capture of the company.50

As first introduced, the Williams Act was aimed at providing incumbent corporate management with protection from cash tender offers. In response to the argument that the takeover process could be a healthy mechanism, the sponsors of the Williams Act “made it clear that the legislation was designed solely to get needed information to the investor.”51

Understood in their proper context, these remarks on neutrality in the legislative history in no way support the conclusion that the states are implicitly prevented from regulating the tender offer process in ways which do not conflict with the provisions of the Williams Act. As the Supreme Court in CTS quoted Judge Posner, “It is a big leap from saying that the Williams Act does not itself exhibit much hostility to tender offers to saying that it implicitly forbids states to adopt more hostile regulations.”52

79. Chris-Craft Indus., 430 U.S. at 28 (emphasis added).
80. Id. at 28 (quoting 113 Cong. Rec. 857-58 (1967)) (emphasis added).
81. Id. at 30-31 (quoting 113 Cong. Rec. 24,664 (1967) (remarks of Sen. Williams)).
82. CTS, 107 S. Ct. at 1643 (quoting Dynamics Corp. v. CTS, 794 F.2d 250, 262 (7th Cir. 1986)). Indeed, as Judge Posner also pointed out in the decision of the Seventh Circuit Court of Appeals in CTS, the legislative history of the Williams Act states only that “if the bill avoids tipping the balance of regulation either in favor of management or in favor of the person making the takeover bid.” Dynamics Corp. of Am., 794 F.2d at 262 (quoting H.R. Rep. No. 1711, 90th Cong., 2d Sess. 4 (1968), reprinted in 1968 U.S. CODE CONG. & ADMIN. NEWS 2811) (emphasis added).
No inference should be drawn from the statements on the subject of neutrality in the Williams Act's legislative history that Congress intended to preempt state laws governing the internal affairs of their domestic corporations simply because they may dissuade some potential bidders from commencing some tender offers. The references to neutrality fall far short of demonstrating the "clear and manifest purpose of Congress" necessary to preempt state legislation in a "field which the States have traditionally occupied." The circumstances under which a corporation may or may not engage in specified business combinations are among the corporate governance issues that fall most clearly within the scope of the internal affairs doctrine.

The principal argument against business combination statutes is that they inhibit the financing necessary to consummate most hostile takeovers. Opponents of these statutes point out that financing is often provided with the expectation that a bidder who successfully completes a tender offer will be able to effect a second-step merger and thereby obtain control of the assets of the target corporation. Business combination statutes thus purportedly provide incumbent management with a decided advantage over potential bidders in need of financing. It is said that this resulting lack of neutrality, in turn, harms a target corporation's shareholders by depriving them of the chance to decide one of the most important issues of corporate control.

Yet this argument cannot provide the basis for invoking the supremacy clause to strike down business combination statutes as it ignores the standards for preemption set forth by the Supreme Court and the application of the internal affairs doctrine to matters of corporate governance. A panoply of state business corporation laws would become subject to attack if the Williams Act were held to

83. Rice, 331 U.S. at 230.
84. See, e.g., CTS, 107 S. Ct. at 1650 (state laws regulating mergers are a "typical example" of laws regulating corporate governance); Restatement (Second) of Conflicts of Laws § 304 (1971). The Supreme Court has explained the underpinnings of the internal affairs doctrine in Rogers v. Guaranty Trust Co., 288 U.S. 123, 130 (1933), a case involving the issuance, allotment, and sale of stock.

When, by acquisition of his stock, plaintiff became a member of the corporation, he, like every other shareholder, implicitly agreed that in respect of its internal affairs the company was to be governed by the laws of the State in which it was organized. His rights, whatever the tribunal chosen for their vindication, are to be determined upon the ascertainment and proper application of [that State's] law.

See also First Nat'l City Bank v. Banco para El Comercio Exterior de Cuba, 462 U.S. 611, 621 (1983) ("[T]he law of the state of incorporation normally determines issues relating to the internal affairs of a corporation.").
preempt state takeover statutes on the ground that they are not neutral in the battle for corporate control. The Supreme Court in CTS was obviously concerned about this inevitable consequence, noting that "the Williams Act would pre-empt a variety of state corporate laws of hitherto unquestioned validity if it were construed to pre-empt any state statute that may limit or delay the free exercise of power after a successful tender offer."\(^5\)

In regulating mergers, business combination statutes constitute but one aspect of a myriad of other, more common corporate governance provisions in state business corporation laws. These provisions affect the relative ease of asserting influence or control over corporations once a substantial block of shares has been acquired.\(^6\)

To strike down business combination statutes as unconstitutional would be to federalize a significant portion of the law relating to internal corporate affairs. This would be in contravention of the policies the Supreme Court established in such cases as *Cort v. Ash*,\(^7\) and resoundingly affirmed in CTS. As the Court stated in *Cort v. Ash*:

> Corporations are creatures of state law, and investors commit their funds to corporate directors on the understanding that, except where federal law expressly requires certain responsibilities of directors with respect to stockholders, state

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6. For example, states commonly require a majority or greater vote (up to two-thirds in some cases) of outstanding shares to approve corporate changes such as mergers, sales of substantially all corporate assets or dissolution of the corporation. Because these types of changes are often used by acquirors to squeeze out minority shareholders, the need for shareholder approval has the effect of making takeovers more expensive (since a larger number of shares must be bought) and therefore less attractive. *See* Hochman & Folger, *Deflecting Takeovers: Charter and By-Law Techniques*, 34 Bus. Law. 537, 547-48 (1979).

7. Provisions for the cumulative voting of shares are also common, and the Supreme Court in CTS recognized them as a valid form of state regulation of internal corporate affairs. *See* CTS, 107 S. Ct. at 1647-48. As several commentators have pointed out, cumulative voting rights can nonetheless constitute a significant deterrent to hostile tender offers. Hochman & Folger, *supra*, at 538-39. When coupled with a staggered or classified board of directors, cumulative voting can force the holder of a majority block of shares to wait more than two years before gaining control of the board, thus frustrating the purpose of some tender offerors who must obtain immediate and "unfettered" access to the target's assets. *Id.* at 539.

law will govern the internal affairs of the corporation.  

The Williams Act is a narrow statute intended to fill a small gap in federal securities regulation. In filling that gap, Congress may have intended to respect the balance that existed between tender offerors and incumbent management under each state’s corporate laws. It gave no indication, however, that it intended the Williams Act to be the final and comprehensive word on takeovers by creating a federal law of corporations.

Business combination statutes reflect state policy that directors of domestic corporations should have a strong voice in so fundamental a corporate event as a merger between the corporation and an interested shareholder. By preventing an interested shareholder from effecting a merger with the corporation without prior board approval, the statutes place this decision in the hands of those charged by state law with deciding such issues based upon the best interests of the corporation’s shareholders. Thus, the statutes regulate the relative decision-making authority of the various groups given power within the corporation.

Under corporation law in New York and other states, shareholders elect directors who in turn owe them fiduciary duties. Accordingly, the board must make the decision of whether to approve a proposed merger by a bidder who intends to acquire more than the threshold amount of the corporation’s stock within the confines of the business judgment rule. This is the kind of decision that a

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88. Id. at 84 (emphasis added). See also Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 479 (1977) (“Absent a clear indication of congressional intent, we are reluctant to federalize the substantial portion of the law of corporations that deals with transactions in securities, particularly where established state policies of corporate regulation would be overridden.”).

89. In a recent law review article, Professor Langevoort pointed out: Although enacted in 1968, and amended in 1970, the Williams Act . . . seems outdated. Its drafters could not have anticipated the variety and occasionally destructive character of the takeover techniques and defensive maneuvers that have become commonplace, the impact that a takeover culture in American business has had on the investment of human capital, or the extent of leverage and risk that takeovers and defensive restructuring have introduced into corporate financial structures. A natural inclination for courts is to allow states to supplement aging federal responses to these problems, subject to later federal revision.

board, with assistance from its professional advisers, is well equipped to make.\textsuperscript{90}

The purpose and practical effect of these statutes is to restrict hostile bust-up stock purchase transactions (whether by tender offer or otherwise) which require financing predicated on the sale of the target’s assets. Since there is a continuing debate over the economic and sociopolitical impact of such hostile takeovers, the decision to inhibit such transactions, by subjecting them to the approval of the target’s board of directors, is a policy judgment which the state is entitled to make.\textsuperscript{91}

Thus, the authority which the state statutes give the boards of covered corporations will not prevent hostile tender offers, except those in which the offeror must be able to sell the assets of the target in order to obtain financing. Nothing in the statutory scheme of the Williams Act prevents states from protecting shareholders, employees, and communities from the detrimental effects of such bust-up offers.

In any event, disappointed shareholders have the option of ousting the board in a proxy contest—one that might be led by a rejected bidder with just under 10\% of the corporation’s stock. Such

\textsuperscript{90} E.g., Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 179 (Del. 1986) (holding that business judgment rule protects decision of board of directors whether to approve a proposed merger); Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 954 (Del. 1985) (same).

\textsuperscript{91} The most current literature increasingly debunks the notion that hostile takeovers benefit shareholders and the economy. This lends support to state action which may make the economic climate less favorable to hostile takeovers.


Empirical evidence does not support the proposition that hostile takeovers improve efficiency. See Coffee, Regulating the Market for Corporate Control: A Critical Assessment of the Tender Offer’s Role in Corporate Governance, 84 Colum. L. Rev. 1145 (1984); Lowenstein, Pruning Deadwood in Hostile Takeovers: A Proposal for Legislation, 83 Colum. L. Rev. 249 (1983). Many of the merger participants in the last decade were well-managed concerns which acquired financially healthy and well-managed companies enjoying strong market positions. The acquired companies, in most cases, ranked first or second within their industries. Indeed, postmerger financial performance of companies which engaged in hostile takeover activity is negative compared to premerger performance. See Herman & Lowenstein, The Efficiency Effects of Hostile Takeovers, reprinted in Knights, Raiders and Targets, supra, at 211.
a bidder could propose a new slate of directors pledged to approve his second-step merger, thus removing any impediment to consummation of his offer.

C. The Commerce Clause

Short of a decision by Congress to federalize corporation law—a step it has consistently refused to take—the states are the only source in our federal system of the rules of corporate governance, including the rules governing the approvals required for mergers. Whatever academic views the courts may have on whether the decision to engage in a given proposed business combination should be subject to the control of the corporation’s board of directors (as opposed to a vote of its shareholders), the commerce clause does not impose any ideal form of corporation law on the states.

In fact, nothing in the commerce clause prevents states from completely forbidding corporations from engaging in mergers or other business combinations. While business combination statutes may change one aspect of the market for corporate control, the Supreme Court stated unequivocally in CTS that “[w]e have rejected the notion that the Commerce Clause protects the particular structure or methods of operation in a . . . market.”

Thus, the commerce clause does not require a state to define in any particular way the collection of rights of shares of its domestic corporations that will be put into commerce. It reflects a theory of political and economic union under which the states are not required to further any particular economic theory, but are prohibited only from discriminating against sister states and their residents, and from burdening interstate commerce with conflicting and overlapping state regulations.

States exercise their powers to develop business corporation laws by creating corporations and by determining the rights and obligations of their various constituencies. As Chief Justice Marshall said in Trustees of Dartmouth College v. Woodward:

A corporation is an artificial being, invisible, intangible, and existing only in contemplation of law. Being the mere

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92. CTS, 107 S. Ct. at 1652 (citing Exxon Corp. v. Governor of Md., 437 U.S. 117, 127 (1978)).
creature of law, it possesses only those properties which the charter of its creation confers upon it, either expressly, or as incidental to its very existence. These are such as are supposed best calculated to effect the object for which it was created.\textsuperscript{94}

Under the internal affairs doctrine, issues of the corporate governance of state-chartered corporations are determined exclusively by state law. As the Court stated in \textit{CTS}, "No principle of corporation law and practice is more firmly established than a State's authority to regulate domestic corporations . . . ."\textsuperscript{95} For this reason, no state has the right or the power to make laws concerning business combinations involving corporations organized under another state's laws.\textsuperscript{96} Moreover, as a corollary to the internal affairs doctrine, in purchasing stock of a corporation, the acquiror "impliedly agree[s] that in respect of its internal affairs the company [is] to be governed by the laws of [its state of incorporation]."\textsuperscript{97}

The Supreme Court has respected the autonomy of the state in regulating all aspects of corporate organization and government, which are matters traditionally of local concern.\textsuperscript{93} As the Supreme Court stated in reversing the decision of the Seventh Circuit in \textit{CTS}, "We think the Court of Appeals failed to appreciate the significance for Commerce Clause analysis of the fact that state regulation of corporate governance is regulation of entities whose very existence and attributes are a product of state law."\textsuperscript{99}

Because states have the right to create and define the rights and attributes of the shares of their domestic corporations which are for sale in interstate commerce, business combination statutes are not subject to attack on commerce clause grounds. Indeed, the very

\textsuperscript{94} 17 U.S. (4 Wheat.) 518, 636 (1819) (quoted with approval in \textit{CTS}, 107 S. Ct. at 1649-50).

\textsuperscript{95} \textit{CTS}, 107 S. Ct. at 1649.

\textsuperscript{96} Prompted by the obvious need for uniform resolution of internal affairs questions affecting such matters as voting rights of shareholders, validity of stock issuances, relative rights of shareholders, election of directors, ability to effect mergers and other organic changes and the duties of officers, directors, and controlling shareholders to the corporation and its shareholders, courts almost invariably decide these questions by applying the incorporating state's law, regardless of where the operative facts occurred. See, e.g., \textit{Restatement (Second) of Conflict of Laws} § 302, comment b, at 307-08, & § 304 (1971).

\textsuperscript{97} \textit{Rogers}, 289 U.S. at 130.

\textsuperscript{98} \textit{Santa Fe Indus.}, 430 U.S. at 479.

\textsuperscript{99} \textit{CTS}, 107 S. Ct. at 1649.
existence of the market for corporate control depends upon state laws defining shareholders' property rights, ownership interests and powers.\textsuperscript{100}

The Supreme Court in \textit{CTS} recognized that "[b]y prohibiting certain transactions, and regulating others, [state laws regulating corporate governance] necessarily affect certain aspects of interstate commerce."\textsuperscript{101} The Court, nonetheless, concluded that any incidental effect that such laws have on commerce was wholly justified:

Large corporations that are listed on national exchanges, or even regional exchanges, will have shareholders in many States and shares that are traded frequently. The markets that facilitate this national and international participation in ownership of corporations are essential for providing capital not only for new enterprises but also for established companies that need to expand their businesses. \textit{This beneficial free market system depends at its core upon the fact that a corporation—except in the rarest situations—is organized under, and governed by, the law of a single jurisdiction, traditionally the corporate law of the State of its incorporation.}\textsuperscript{102}

In fact, the Court explicitly recognized in the same context that state corporate laws are valid despite the fact that in many instances they make it difficult for corporations to merge.\textsuperscript{103}

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\textsuperscript{100} See Louisville & Nashville R.R. v. Kentucky, 161 U.S. 677 (1896). In this case the Supreme Court upheld, against a commerce clause challenge, a state's prohibition of a state-chartered railroad's purchase of competing railroads. As the power to purchase, then, is derivable from the State, \textit{the State may accompany it with such limitations as it may choose to impose.} Its [sic] results, then, from the argument of the appellant that, if there be any interference with interstate commerce it \textit{is in imposing limitations upon the exercise of a right which did not previously exist}, and hence, if the State permits such purchase or consolidation, it is bound to extend the authority to every possible case, or expose itself to the charge of interfering with commerce. \textit{This proposition is obviously untenable.}

\textit{Id.} at 702-03 (emphasis added). See also \textit{Trustees of Dartmouth College}, 17 U.S. at 636.

\textsuperscript{101} \textit{CTS}, 107 S. Ct. at 1650.

\textsuperscript{102} \textit{Id.} (emphasis added).

\textsuperscript{103} \textit{Id.}

These regulatory laws may affect directly a variety of corporate transactions. Mergers are a typical example. In view of the substantial effect that a merger may have on the shareholders' interests in a corporation, many States require supermajority votes to approve mergers. \textit{See, e.g., MBCA} § 73 (1979) (requiring approval of a merger by a majority of all shares, rather than simply a majority of votes cast); \textit{RMBCA} § 11.03
The possibility (or even the certainty) that business combination statutes will cause a significant reduction in the number of tender offers for covered corporations does not change the constitutional analysis. In CTS, the Supreme Court rejected the argument that state corporate laws that may decrease the number of tender offers violate the commerce clause:

The very commodity that is traded in the securities market is one whose characteristics are defined by state law. Similarly, the very commodity that is traded in the "market for corporate control"—the corporation—is one that owes its existence and attributes to state law. Indiana need not define these commodities as other States do; it need only provide that residents and nonresidents have equal access to them. This Indiana has done. Accordingly, even if the Act should decrease the number of successful offers for Indiana corporations, this would not offend the Commerce Clause. ¹⁰⁴

Likewise, business combination statutes do not offend the commerce clause.

The traditional test to be applied in ruling on "dormant" commerce clause issues is that set out in Pike v. Bruce Church, Inc.: ¹⁰⁵ "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." ¹⁰⁶ Significantly, the Court in CTS analyzed the Indiana Act without using the Pike test. Instead, the Court applied a three-part test that has subsequently been followed by courts ruling on business combination statutes. The Court reviewed the Indiana Act to see if: (1) the effects of the statute were discriminatory; (2) the statute created an impermissible risk of inconsistent regulation; and (3) the statute promoted stable corporate relationships and protected shareholders. ¹⁰⁷

(1984) (same). By requiring a greater vote for mergers than is required for other transactions, these laws make it more difficult for corporations to merge.

Id.

104. CTS, 107 S. Ct. at 1652 (emphasis added).
105. Pike, 397 U.S. at 142.
106. Id. See also Huron Portland Cement Co., 362 U.S. at 444.
107. CTS, 107 S. Ct. at 1648-52. Even Justice White in his dissent does not
The Supreme Court in *CTS* noted that “[t]he principal objects of dormant Commerce Clause scrutiny are statutes that discriminate against interstate commerce.”108 Business combination statutes easily pass muster under this fundamental test. Because the provisions of these statutes affect only business combinations involving a state’s domestic corporations and apply equally to resident and nonresident interested shareholders, they regulate evenhandedly, and do not have even the incidental effect of discriminating against interstate commerce.109 While opponents of the Indiana Act in *CTS* argued that its effects would fall disproportionately upon out-of-state offerors, the Court ruled that “[b]ecause nothing in the Indiana Act imposes a greater burden on out-of-state offerors than it does on similarly situated Indiana offerors, we reject the contention that the Act discriminates against interstate commerce.”110 As the Court indicated in *Kassel v. Consolidated Freightways Corp.*,111 state laws which do not discriminate against interstate commerce are entitled to “special deference.”112

The Supreme Court observed in *CTS* that state regulations have also been invalidated under the commerce clause on the grounds that they “adversely may affect interstate commerce by subjecting activities to inconsistent regulations.”113 However, the Supreme Court found that the Indiana Act “poses no such problems,” stating that “[s]o long as each State regulates voting rights only in the corporations it has created, each corporation will be subject to the law of only one State.”114

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110. *Id.*
112. *Id.* at 675. *See also Exxon Corp.*, 437 U.S. at 125-26; *Huron Portland Cement Co.*, 362 U.S. at 448.
Business combination statutes are also designed to prevent the possibility of inconsistent or overlapping regulations. They apply only to corporations organized under the laws of the enacting state, and many are also limited to corporations which have their executive offices and significant business operations in the state.115 The statutes do not purport to regulate foreign corporations doing business in the state, and under the internal affairs doctrine there is no risk of overlap with the laws of other states. Thus, these statutes do not have the "sweeping extraterritorial effect" which led the plurality in MITE to conclude that the Illinois Act violated the commerce clause.116 For these reasons, as in the case of the Indiana Act upheld in CTS, business combination statutes do "not create an impermissible risk of inconsistent regulation by different States."117

The Supreme Court, in reviewing a law challenged on commerce clause grounds, stated in Kassel that "[t]he extent of permissible state regulation is not always easy to measure. It may be said with confidence, however, that a State's power to regulate commerce is never greater than in matters traditionally of local concern."118 Like laws and regulations adopted under a state's police power addressed to health and safety concerns, laws governing the internal affairs of a state's domestic corporations are clearly addressed to "matters traditionally of local concern" within the meaning of Kassel.119 As the Court observed in CTS, "Every State in this country has enacted laws regulating corporate governance."120

Business combination statutes do not prohibit or regulate interstate commerce in shares of covered corporations. Nor do they affect the right of any bidder to acquire and vote the shares of these corporations. Indeed, an interested shareholder may use its voting power to seek the election of a new board of directors and, if

116. MITE, 457 U.S. at 642.
117. CTS, 107 S. Ct. at 1649.
118. Kassel, 450 U.S. at 670 (emphasis added).
119. See, e.g., Cort v. Ash, 422 U.S. 66 (1975). The suggestion has been made that a business combination statute which does not require that a corporation covered by the statute have shareholders who are residents of the state in question may be constitutionally infirm for that reason. However, as the Court stated in CTS as to domestic corporations: "We agree that Indiana has no interest in protecting nonresident shareholders of nonresident corporations. But this Act applies only to corporations incorporated in Indiana. We reject the contention that Indiana has no interest in providing for the shareholders of its corporations the voting autonomy granted by the Act." CTS, 107 S. Ct. at 1651.
120. CTS, 107 S. Ct. at 1650.
successful, may change management and impose its own policies on the corporation. Thus, under business combination statutes, while an interested shareholder may not enter into a business combination with the target, it is entitled to all other economic and voting benefits of the shares purchased.

Opponents of such statutes contend that they impede commerce in corporate control by discouraging tender offers. There is no evidence to date, however, that business combination statutes will deter substantial numbers of tender offers for shares of covered corporations, reduce the prices offered for shares in such transactions, or otherwise burden or inhibit interstate commerce in such shares. Indeed, a number of successful hostile tender offers have been commenced and successfully completed for corporations covered by such statutes. 121

Business combination statutes are designed to curb takeover abuses which result from highly leveraged, bust-up transactions, 122 while permitting those hostile takeovers likely to result in benefits for shareholders and the economy. The statutes will not affect negotiated transactions, nor will they affect the financing of hostile takeovers in the host of circumstances where the bidder either has the necessary cash or securities to effect the offer, or does not need to sell off the target’s assets to finance the debt incurred. 123

There is a lively debate over whether and to what extent business combination statutes will achieve their intended purpose of protecting shareholders, employees and communities from the harmful effects of bust-up tender offers. The competing views reflect that there are two distinct positions in academic, business and government circles on the larger question of which this is but a part—whether hostile tender offers help or harm these same interest groups. As the Supreme Court recognized in CTS:


122. The postmerger financial results achieved by these transactions are well documented. Lowenstein and Herman gathered financial data for 56 hostile tender offers that were conducted in 1975-1983. To buy the targets, which were generally profitable concerns, the bidders incurred heavy levels of debt and interest charges. As a result, the bidders suffered an immediate and sharp decline in postmerger profitability. Herman & Lowenstein, The Efficiency Effects of Hostile Takeovers, presented at the Columbia University Conference on Takeovers (Nov. 1985).

123. See supra text accompanying and following note 91.
It is appropriate to note when discussing the merits and demerits of tender offers that generalizations usually require qualification. No one doubts that some successful tender offers will provide more effective management or other benefits such as needed diversification. But there is no reason to assume that the type of conglomerate corporation that may result from repetitive takeovers necessarily will result is [sic] more effective management or otherwise be beneficial to shareholders. The divergent views in the literature—and even now being debated in the Congress—reflect the reality that the type and utility of tender offers vary widely. Of course, in many situations the offer to shareholders is simply a cash price substantially higher than the market price prior to the offer.

The literature on this subject is in fact daunting, and the question is obviously far better suited to legislative than judicial resolution. For this reason, courts should not attempt to second-guess whether business combination statutes will or will not achieve the benefits which the state legislatures intended.

IV. Conclusion

The constitutionality of business combination statutes depends largely upon whether federal courts (and ultimately the Supreme Court) will continue, in the wake of CTS, to accord a broad preemptive effect to the Williams Act. The four cases which have

125. The U.S. Congress has joined the debate over the ultimate effects of hostile takeovers. Recent congressional action on the subject of hostile takeovers indicates that Congress believes that state legislatures should be left to weigh the wealth of scholarship themselves. The Senate Banking Committee is now considering legislation to amend the Williams Act to enhance disclosure to shareholders, prohibit certain management defenses, restrict street sweeps and otherwise further regulate the tender offer process. Section 15 of the legislation, S. 1323, as approved by the Banking Committee on September 30, 1987, orders the General Accounting Office to study the role of state laws in the tender offer process for two years and to then report to Congress. S. 1323, 100th Cong., 1st Sess. § 15 (1987). This provision was adopted after the Senate Banking Committee had considered and rejected, by significant margins, numerous amendments, the terms of which would have specifically preempted, or limited the ability of states to enact what are commonly labeled "antitakeover" statutes. The SEC has also proposed a rule which would require street sweeps to be governed under the same rules regulating tender offers. SEC Release No. 34-24976, 19 Sec. Reg. L. Rep. (BNA) 1545 (Oct. 9, 1987).
considered the issue, BNS,126 Staley,127 City Capital Associates,128 and RTE Corp.,129 employed the traditional analysis, extending the principle of neutrality to require states to refrain from enacting corporate governance statutes which upset the balance between bidder and target. The Delaware statute passed muster in the eyes of the courts in BNS, Staley, and City Capital Associates because, considering the continuing role for shareholders in deciding the fate of a tender offer, the statute protected shareholders, not just incumbent management. The Wisconsin statute was struck down in RTE because the court believed that it gave management a virtual veto power over hostile tender offers which it could not square with Congress' intent in enacting the Williams Act.

As this article demonstrates, the courts have gone too far in permitting Congress' intent in enacting its own relatively narrow remedial legislation to intrude upon the states' prerogatives to regulate the internal affairs of their domestic corporations. State business combination statutes are outside the ambit of any legitimate policy underlying the Williams Act.

Congress, of course, has the power to enact legislation preventing the states from passing laws which have the effect of inhibiting tender offers or of placing too much power in the hands of management to thwart them. It has not done so, and until then the courts should restrict the preemptive effect of the Williams Act to its proper scope.

126. See supra note 77 (summary of holding).
127. Id.
128. Id.
129. Id.