

ANTI-TAKEOVER LEGISLATION AFTER *CTS CORP. V. DYNAMICS CORP. OF AMERICA*: THE ACCEPTANCE OF CONTROL SHARE REGULATION

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INTRODUCTION

The use of tender offers¹ by investors to acquire control of corporations increased markedly during the 1960s, becoming the predominant method of corporate takeover.² In 1960, there were eight cash tender offers for \$200 million of listed securities, compared to 107 tender offers for approximately \$1 billion of securities in 1966.³

Because tender offers were largely unregulated in the 1960s, abuses were widespread.⁴ In order to protect the shareholders of the target corporation from a lack of available information and from tender offerors who required quick decisions from investors, Congress passed the Williams Act in 1968.⁵ The Act requires entities seeking to acquire control of a corporation to file a disclosure statement with the Securities and Exchange Commission (SEC) and to send copies of the statement to management and shareholders of the target company and to any competitive bidder.⁶ The Act

1. A tender offer is generally defined as [a] public offer or solicitation by a company, an individual or a group of persons to purchase during a fixed period of time all or a portion of a class or classes of securities of a publicly held corporation at a specified price or upon specified terms for cash and/or securities.

E. ARANOW & H. EINHORN, *TENDER OFFERS FOR CORPORATE CONTROL* 70 (1973).

2. Warren, *Developments in State Takeover Regulation: MITE and its Aftermath*, 40 BUS. LAW. 671, 672 (1985). Prior to this time, proxy solicitations and exchange offers of securities were the most popular methods of corporate takeover. See *Piper v. Chris-Craft Indus.*, 430 U.S. 1, 22 (1976).

3. E. ARANOW & H. EINHORN, *supra* note 1, at 65 n.3. The authors cite several reasons for the rapid increase in the use of tender offers in the United States: (1) increased corporate liquidity and availability of credit; (2) comparatively low price/earnings ratios, book values and cash ratios, making stock acquisitions relatively attractive; (3) more widespread knowledge about the tender offer method of takeover; (4) lack of significant federal or state regulation of tender offers; (5) quicker and more frequently successful takeovers, as compared to the proxy method of takeover; (6) greater flexibility than with other methods of takeover; (7) appeal to shareholders of target companies; (8) lower administrative costs than with takeover by proxy contest; and (9) new respectability of cash tender offers. *Id.* at 65-66.

4. See Warren, *supra* note 2, at 673.

5. The Williams Act added to the Securities Exchange Act of 1934, § 13(d)-(e), codified at 15 U.S.C. § 78m(d)-(e) (1982), and § 14(d)-(f), codified at 15 U.S.C. § 78n(d)-(f) (1982).

6. See 17 C.F.R. § 240.14d-3 (1988).

also enables shareholders to withdraw any shares offered within the first seven days of the offer's effective date⁷ and requires offerors to purchase all offered shares at the same price.⁸

During the time Congress was drafting the Williams Act, individual states began to regulate tender offers for the shares of corporations operating within their borders.⁹ Thirty-seven states passed anti-takeover statutes between 1968, when Virginia passed the first anti-takeover statute, and 1985.¹⁰ These state statutes vary widely; many include provisions which differ dramatically from the requirements of the Williams Act.¹¹

Because some of the state laws severely reduced the feasibility of tender offer takeovers from the point of view of offerors, corporations attempting to acquire by tender offer filed suits challenging the statutes' constitutionality.¹² Challengers argued that the Williams Act pre-empted the state statutes and that the statutes constituted an impermissible burden on interstate commerce.¹³ As a result, during the late 1970s and early 1980s, courts invalidated provisions of several state anti-takeover statutes.¹⁴

The United States Supreme Court broke its silence on the constitutionality of the state statutes when it decided the case of *Edgar v. MITE Corp.*¹⁵ in 1982. In this case, three justices¹⁶ concluded that the Williams Act pre-

7. 15 U.S.C. § 78n(d)(5) (1982).

8. 15 U.S.C. § 78n(d)(7) (1982).

9. See *infra* notes 61-64 and accompanying text. Application of the state statutes depends on the connection between the target corporation and the state. Determining factors include incorporation under the laws of the state; principal place of business in the state; substantial assets located in the state; percentage of the corporation's workforce located in the state; business carried on in the state; registration of the target corporation's securities under federal securities laws; and registration of the securities under state securities laws. E. ARANOW, H. EINHORN & G. BERLSTEIN, DEVELOPMENTS IN TENDER OFFERS FOR CORPORATE CONTROL 208 (1977).

10. Warren, *supra* note 2, at 671.

11. See *infra* notes 41-60 and accompanying text.

12. See, e.g., L.P. Acquisition Co. v. Tyson, 772 F.2d 201 (6th Cir. 1985) (partly upholding and partly striking down the Michigan Take-Over Offers Act); Martin-Marietta Corp. v. Bendix Corp., 690 F.2d 558 (6th Cir. 1982) (granting an injunction against the enforcement of the anti-fraud provisions of the Michigan Take-Over Offers Act); Agency Rent-A-Car, Inc. v. Connolly, 686 F.2d 1029 (1st Cir. 1982) (finding sanctions imposed by the Massachusetts Act Regulating Take-Over Bids in the Acquisition of Corporations not pre-empted by the Williams Act); Kennecott Corp. v. Smith, 637 F.2d 181 (3d Cir. 1980) (granting preliminary injunction against enforcement of the New Jersey Corporation Takeover Bid Disclosure Law); Icahn v. Blunt, 612 F. Supp. 1400 (W.D. Mo. 1985) (overturning the Missouri Control Share Acquisition Act); AMCA Int'l Corp. v. Krouse, 482 F. Supp. 929 (S.D. Ohio 1979) (upholding Ohio statute governing tender offers on both pre-emption and commerce clause grounds).

13. The supremacy clause of the United States Constitution states that federal law is the supreme law of the land. U.S. CONST. art. VI, cl. 2. Any state law conflicting with a federal law, either expressly or impliedly, is pre-empted by the federal law.

14. See, e.g., Mesa Petroleum Co. v. Cities Serv. Co., 715 F.2d 1425 (10th Cir. 1983) (overturning the Oklahoma Take-Over Bid Act on commerce clause grounds); Telvest, Inc. v. Bradshaw, 697 F.2d 576 (4th Cir. 1983) (overturning provision of Virginia's Take-Over Bid Disclosure Act); National City Lines, Inc. v. LLC Corp., 687 F.2d 1122 (8th Cir. 1982) (invalidating the Missouri Take-over Bid Disclosure Act); Great Western United Corp. v. Kidwell, 577 F.2d 1256 (5th Cir. 1978), *rev'd on other grounds sub nom.* Leroy v. Great Western United Corp., 443 U.S. 173 (1979) (striking down Idaho's anti-takeover statute); Sharon Steel Corp. v. Whaland, 124 N.H. 1, 466 A.2d 919 (1983) (finding provisions of the Security Takeover Disclosure Act unconstitutional).

15. 457 U.S. 624 (1982).

16. Only Chief Justice Burger and Justice Blackmun joined in the pre-emption portion of Justice White's opinion. *MITE*, 457 U.S. at 630.

empted the Illinois Business Take-Over Act.¹⁷ A majority of the *MITE* Court held the Illinois Act unconstitutional under the commerce clause.¹⁸ Applying a balancing test developed in *Pike v. Bruce Church, Inc.*,¹⁹ the *MITE* Court ruled that the burdens imposed on interstate commerce were excessive in relation to the local interest the statute sought to protect.²⁰ After this ruling, district courts and courts of appeals overturned several other state statutes on pre-emption and commerce clause grounds.²¹

Five years after the *MITE* decision, the Supreme Court reviewed another state law that regulated tender offers. In *CTS Corp. v. Dynamics Corp. of America*,²² the Court reversed a decision of the Seventh Circuit Court of Appeals²³ and upheld the Indiana Control Shares Acquisition Act.²⁴ The Indiana Act, instead of regulating the acquisition of a corporation's stock, enables shareholders to vote on whether the shares actually acquired will be granted voting rights.²⁵ Since the Supreme Court upheld the Indiana statute, more than twenty states passed similar anti-takeover laws.²⁶

This Note sets forth the principal provisions of the Williams Act and of various state anti-takeover statutes, focusing on control share acquisition acts, which appear to survive constitutional scrutiny. A brief discussion of the application of pre-emption and commerce clause analysis to anti-take-

17. ILL. REV. STAT. ch. 121 1/2, ¶ 137.51 *et seq.* (1979), *repealed by* Act of Sept. 14, 1983, Public Act 83-365 § 1, 1983 Ill. Legis. Serv. 2628 (West). The Court in *Edgar v. MITE Corp.*, 457 U.S. 624, 635-40 (1982), held that three provisions of the Illinois Act conflicted with the Williams Act: the pre-commencement period, the provision for hearing, and the allowance for review of the proposed takeover by the Secretary of State. See *infra* notes 151-57 and accompanying text.

18. Chief Justice Burger alone joined Justice White's entire opinion, while Justices Powell, Stevens, and O'Connor joined only in the section of the opinion which held that the Illinois Business Take-Over Act violated the commerce clause. *MITE*, 457 U.S. at 640.

19. 397 U.S. 137 (1970). Although this frequently cited test is usually attributed to the *Pike* decision, some commentators maintain that Justice Stewart did not in fact apply an open-ended balancing in that case. See, e.g., Regan, *The Supreme Court and State Protectionism: Making Sense of the Dormant Commerce Clause*, 84 MICH. L. REV. 1091, 1220 (1986) (asserting that Stewart instead adopted a *per se* rule against acts which have a protectionist effect).

20. *MITE*, 457 U.S. at 643-46.

21. See *infra* notes 73-112 and accompanying text.

22. 107 S. Ct. 1637 (1987).

23. *Dynamics Corp. of America v. CTS Corp.*, 794 F.2d 250 (7th Cir. 1986).

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

25. This type of law is known as a control share acquisition act because it applies only when a tender offeror contemplates buying a certain percentage of corporate stock which will result in a degree of control over the corporation, usually 20-50%. See, e.g., ARIZ. REV. STAT. ANN. § 10-1212(A)(5) (Supp. 1987); IND. CODE ANN. § 23-1-42-1 (Burns Supp. 1988).

26. See FORTUNE, Nov. 9, 1987, at 179.

The Arizona legislature, in a special session held during the summer of 1987, passed a statute governing corporate takeovers. Arizona House Bill 2002, amending § 10-028, ARIZ. REV. STAT., and amending Title 10, ARIZ. REV. STAT., by adding Chapter 6. The Arizona statute applies to target corporations with at least fifty shareholders, which control assets within Arizona valued at at least one million dollars and have more than five hundred employees living in the state. Additionally, target corporations are governed by the Arizona statute only if they are incorporated in Arizona or have their principal place of business or their principal executive office in the state. Substantively, the statute is very similar to the Indiana anti-takeover statute upheld in *CTS Corp. v. Dynamics Corp. of America*, 107 S. Ct. 1637 (1987).

The Delaware General Assembly recently approved a strict anti-takeover law that can prohibit hostile acquirors from merging their operations with target corporations for three years after an offer is made. The law is particularly controversial and significant because of its far-reaching effect. Fifty-six percent of the Fortune 500 and forty-five percent of the companies listed on the New York Stock Exchange are incorporated in Delaware. See Wall St. J., Jan. 29, 1988, at 18, col. 4.

over statutes follows. Finally, this Note discusses the *CTS* decision, analyzes the Court's pre-emption and commerce clause holdings, and compares the Court's reasoning to that of the Seventh Circuit Court of Appeals in the same case.²⁷

THE WILLIAMS ACT—THE FEDERAL APPROACH

An examination of the legislative history of the Williams Act is important in analyzing whether a particular state statute may peacefully coexist with the federal act. Enacted in 1968, the Williams Act regulates the tender offer method of corporate acquisition. The Act, which amended the Securities Exchange Act of 1934, requires the disclosure of specific information by both those seeking to acquire a corporation and the management of the corporation to be acquired.

The Act applies to any person or corporation that seeks to acquire more than five percent of the outstanding shares of a publicly traded corporation by tender offer.²⁸ Upon commencement of the offer, the offeror must file the required information with the SEC, and send it to the principal office of the target corporation and to each exchange on which the corporation's stock is traded.²⁹ The information statement must contain the background and identity of the purchasers; the source and amount of funds used to make the purchase; the purpose of the acquisition, including any plans to liquidate the company or make major changes in its corporate structure or lines of business; and the number of shares currently held by the purchaser.³⁰ In addition to imposing disclosure requirements on purchasers, the Williams Act also requires target corporation management to publish a statement containing its recommendation with respect to the tender offer within ten business days of the offer.³¹

Tender offers are governed not only by the specific provisions of the Williams Act, but also by regulations promulgated by the SEC under the Act.³² SEC regulations currently in effect protect the target corporation's shareholders in several important ways. First, they enable shareholders to withdraw their shares during the first seven days of a tender offer or within sixty days of commencement of the offer, if the acquiring corporation has not yet purchased their shares.³³ Second, the SEC imposes pro rata purchases on the offeror when the total number of shares tendered exceeds the number sought by the acquiring corporation.³⁴ Third, the SEC estab-

27. 794 F.2d 250 (7th Cir. 1986).

28. 15 U.S.C. § 78n(d)(1) (1982).

29. 15 U.S.C. § 78n(d)(1) (1982); 17 C.F.R. § 240.14d-3 (1988).

30. 15 U.S.C. § 78m(d)(1) (1982); 17 C.F.R. § 240.14d-6(e) (1988).

31. 15 U.S.C. § 78n(d)(4) (1982); 17 C.F.R. § 240.14e-2 (1988).

32. 17 C.F.R. §§ 240.14d-1 to .14d-100 (1988).

The Williams Act requirement that both tender offerors and target company management disclose information is characterized as a "market approach," because both groups present their arguments in full to the shareholders and the shareholders determine on their own the merits of a takeover. See *Great Western United Corp. v. Kidwell*, 577 F.2d 1256, 1276 (5th Cir. 1978), *rev'd on other grounds, sub nom. Leroy v. Great Western United Corp.*, 443 U.S. 173 (1979); see also Warren, *supra* note 2, at 674 n.18.

33. 15 U.S.C. § 78n(d)(5) (1982); 17 C.F.R. § 240.14d-7(a) (1988).

34. 15 U.S.C. § 78n(d)(6) (1982); 17 C.F.R. § 240.14d-8 (1988). For example, if two million

lishes minimum time periods during which the offer is to remain open.³⁵ Fourth, every stockholder who tenders shares must receive the same price for his shares, even if the offer price is increased during the course of the offer.³⁶ Finally, the SEC explicitly prohibits fraud or other deceptive practices.³⁷

The detailed disclosure requirements of the Williams Act and the shareholder protections contained in the regulations promulgated under the Act enable investors of the target corporation to make carefully considered, well-informed decisions.³⁸ In response to criticism that the Act not only protects investors but also helps incumbent management ward off unwanted takeovers, Congress stressed its intention to maintain a neutral posture.³⁹ Thus, the primary congressional purpose behind the Act was to shield investors from the conflicting forces that might try to influence an unsuspecting shareholder, at the same time striking a balance between the tender offeror and target company management.

STATE STATUTES—GENERAL CHARACTERISTICS

Because specific provisions of the numerous state statutes governing corporate takeovers vary dramatically, this Note does not discuss each statute in detail. Rather, the Note describes typical provisions common to many statutes, discuss the scope of state legislation, and point out potential state purposes served by the legislation.⁴⁰

A. *Disclosure Requirements*

Most state statutes require a tender offeror to file a disclosure statement with the state securities commissioner and to send a copy of the statement to the target corporation.⁴¹ In addition to the five major disclosure requirements of the Williams Act,⁴² many states also require disclosure of the following information: the offeror's organizational structure, operations, and

shares are tendered and the offeror wishes to acquire only one million shares, the offeror must acquire 50% of the stock tendered by each shareholder.

35. 17 C.F.R. § 240.14e-1(a) (1988).

36. 15 U.S.C. § 78n(d)(7) (1982).

37. 15 U.S.C. § 78n(e) (1982); 17 C.F.R. § 240.14e-1 (1988).

38. See *Piper v. Chris-Craft Indus.*, 430 U.S. 1, 26-31 (1977) (discussing the legislative history of the Act. Testifying before the Senate Subcommittee on Securities, Manuel Cohen, then SEC chairman stated, "the general approach . . . of this bill is to provide the investor, the person who is required to make a decision, an opportunity to examine and to assess the relevant facts. . . ."); *Rondeau v. Mosinee Paper Corp.*, 422 U.S. 49, 60 (1975) (noting that "the principal object of the Williams Act is to solve the dilemma of shareholders desiring to respond to a cash tender offer").

Senator Harrison Williams, the sponsor of the Act, stated, "This legislation will close a significant gap in investor protection under the Federal securities laws by requiring the disclosure of pertinent information to stockholders when persons seek to obtain control of a corporation by a cash tender offer. . . ." 133 CONG. REC. 854 (1967).

39. Senator Williams remarked, "[we] have taken extreme care to avoid tipping the scales either in favor of management or in favor of the person making the takeover bids. [Senate Bill 510] is designed solely to require full and fair disclosure for the benefit of investors." 113 CONG. REC. 24664 (1967).

40. Because many state statutes were repealed after the *MITE* decision, the discussion necessarily includes some laws which have been overturned.

41. E. ARANOW, *supra* note 9, at 212-13.

42. See *supra* note 30 and accompanying text.

capital structure; pending legal or administrative proceedings; material changes to the offeror's business; financial statements; and a list of corporate officers and directors, along with biographical information.⁴³

B. *Substantive Provisions*

1. *Pre-MITE statutes*

Substantive provisions of pre-*MITE* state tender offer statutes differ substantially.⁴⁴ Many states stipulate a length of time for which the offer must remain open, thus enabling shareholders to fully consider its terms. Stipulated lengths of time vary from ten to sixty days.⁴⁵ The Williams Act does not specify a minimum length of time during which an offer must remain open, but the SEC regulations require offerors to leave the offer open for at least twenty business days.⁴⁶ Although longer "hold open" periods ostensibly protect shareholders from making hurried decisions, they also tend to favor incumbent management. The officers of the target corporation are given more time to organize to fight a takeover, while the offerors are required to delay consummating their plans.

Several states adopt the withdrawal rights granted to shareholders under the Williams Act, allowing shareholders to withdraw tendered shares during the first seven days of the offer and after the offer has been open for sixty days, if the tender offeror has not yet accepted the shares.⁴⁷ Others substantially lengthen the period of time during which investors may withdraw previously tendered shares.⁴⁸ Longer withdrawal periods, like extended "hold open" periods, protect shareholders, but at the same time enable target management to formulate a takeover defense strategy.

Most state statutes contain pro rata purchase requirements similar to those of the Williams Act.⁴⁹ The Williams Act imposes a pro rata purchase requirement on all shares tendered during the first ten days of the offer.⁵⁰ Some states extend the requirement to all shares tendered during the first twenty days of the offer or to all shares tendered, regardless of time elapsed.⁵¹ Pro rata provisions are truly neutral, providing neither offerors nor incumbent management an advantage.

Additionally, several states specifically allow tender offerors to obtain a

43. See E. ARANOW, *supra* note 9, at 212-13. See, e.g., ARIZ. REV. STAT. ANN. § 10-1212(A)(1) (Supp. 1987); HAW. REV. STAT. § 417E-2(f) (1985); IND. CODE ANN. § 23-1-42-6 (Burns Supp. 1988); OHIO REV. CODE ANN. § 1707.041(A)(1) (Anderson 1985); TENN. CODE ANN. § 48-5-104(6) (Supp. 1987); UTAH CODE ANN. § 61-5-3-(2)(c) (1986).

44. E. ARANOW, *supra* note 9, at 213-17.

45. See, e.g., ARK. STAT. ANN. § 23-43-112(b)(2) (1987) (10 days); IND. CODE ANN. § 23-2-3.1-8 (Burns 1984) (20 days); MICH. STAT. ANN. § 21.293(5)(2) (Callaghan 1983) (60 days, and up to 90 days if the terms of the offer change); see also E. ARANOW, *supra* note 9, at 213-14.

46. 17 C.F.R. § 240.14e-1(a) (1988).

47. See, e.g., ARK. STAT. ANN. § 23-43-112(b)(1) (1987); HAW. REV. STAT. § 417E-5(b) (1985); MINN. STAT. ANN. § 80B.06(2) (West 1986); TENN. CODE ANN. § 48-5-103(c) (Supp. 1987); UTAH CODE ANN. § 61-5-6-(2) (1986).

48. For example, Indiana enables shareholders to withdraw any shares not purchased within twenty days of their tender. See IND. CODE ANN. § 23-2-3.1-8 (Burns 1984).

49. See E. ARANOW, *supra* note 9, at 215.

50. 15 U.S.C. § 78n(d)(6) (1982).

51. Ind. Code Ann. § 23-2-3.1-6.5 (Burns 1984); MICH. STAT. ANN. § 21.293(5)(2) (Callaghan 1983). See E. ARANOW, *supra* note 9, at 215.

list of the target corporation's shareholders so that the offerors can communicate directly with the shareholders concerning the terms of the offer. In these states, a target corporation's refusal to provide its shareholder list constitutes a fraudulent act.⁵² This is the only provision in the state statutes that favors tender offerors, since it gives them access to target shareholders, which they might previously have been denied.

Many states have procedures to delay tender offers that fail to meet state statutory requirements.⁵³ The procedure most often consists of an administrative hearing held at the request of the state securities commissioner, the target corporation, or the shareholders.⁵⁴ The Williams Act contains no comparable provision. Such delay procedures, particularly those that can be invoked by target corporation management, greatly handicap tender offerors.

2. *Post-MITE statutes*

After the United States Supreme Court overturned the Illinois Business Take-Over Act in *Edgar v. MITE Corp.*,⁵⁵ states began to look for acceptable methods of regulating takeovers of local corporations. Many of the post-*MITE* statutes are "second-generation" statutes. Second-generation takeover statutes do not directly regulate tender offers; instead, they affect the structure and operations of target corporations after the tender offer is completed.⁵⁶

One type of second-generation takeover statute adopted increasingly by state legislatures is the "control share" acquisition act.⁵⁷ This act enables shareholders of the target corporation to determine whether the block of shares acquired by the offeror will obtain voting rights.⁵⁸ Other second-generation statutes require approval by a supermajority of all shareholders and from disinterested shareholders to effectuate a tender offer.⁵⁹ Legislatures enacted second-generation statutes principally to avoid congressional scrutiny. However, these statutes intrude as much on congressional authority as did the first-generation statutes.⁶⁰

52. HAW. REV. STAT. § 417E-4(3) (1985); MINN. STAT. ANN. § 80B.05(3) (West 1986); TENN. CODE ANN. § 48-5-106(3) (1984); UTAH CODE ANN. § 61-5-5(1)(c) (1986).

53. See, e.g., MICH. STAT. ANN. § 21.293(5)(4) (Callaghan 1983); UTAH CODE ANN. §§ 61-5-3(4) to -3(5) (1986).

54. See E. ARANOW, *supra* note 9, at 216.

55. 457 U.S. 624 (1982).

56. See Sargent, *Do the Second-Generation State Takeover Statutes Violate the Commerce Clause?*, 8 CORP. L. REV. 3, 5 (1985).

57. Both Arizona and Indiana, the state where *CTS* arose, have adopted control share acquisition acts. See ARIZ. REV. STAT. ANN. §§ 10-1201 to 10-1223 (Supp. 1987); IND. CODE §§ 23-1-42-1 to 23-1-42-11 (Burns Supp. 1987). "Control share" acquisition is usually defined in terms of a controlling percentage of ownership, ranging from 20-50%. See *infra* note 127 for the Indiana definition.

58. See, e.g., ARIZ. REV. STAT. ANN. § 10-1215 (Supp. 1987) (However, control shares are automatically accorded voting rights with respect to electing directors or managers.); IND. CODE ANN. §§ 23-1-42-7 to -9 (Burns Supp. 1988).

59. See, e.g., MD. CORPS. & ASS'NS CODE ANN. §§ 3-601 to 3-603, 8-301(14) (1985).

60. See discussion *infra* at text accompanying notes 173-75.

C. *Who the State Statutes Affect*

The reach of state statutes depends on both the ownership interest sought by the acquiring entity and the relationship of the target company to the state. All state statutes apply to persons or corporations seeking to acquire at least five percent of the target company's outstanding stock.⁶¹ Thus, no state statute applies to a broader group of investors than does the Williams Act.⁶²

The requisite relationship of a target company to the regulating state differs markedly from state to state. State statutes typically apply to corporations incorporated within the state, those with substantial assets or their principal place of business in the state, or those with a certain number of shareholders or percentage of ownership within the state.⁶³ Depending on the specific provisions, the statute may apply to only a small number of target corporations with a significant presence in the state or, alternatively, to any corporation with merely a few shareholders residing in the state. Because most publicly traded corporations have shareholders in many states, it is conceivable that an investor, in acquiring stock in a particular corporation, could be simultaneously subject to several different and possibly conflicting state statutes.⁶⁴ Under such an inconsistent scheme of legislation, the tender offer would necessarily violate one of the state statutes, thus preventing the takeover from occurring.

D. *What States Are Attempting To Accomplish*

The state statutes have a variety of stated and implied purposes. These purposes are significant in determining whether the statutes either comport with the federal scheme of regulation and serve a legitimate state need, or instead violate the supremacy or commerce clause of the constitution.

Most statutes, like the Williams Act, attempt to protect the current shareholders of the target corporation by requiring disclosure of any information pertinent to deciding whether to offer shares and by allowing shareholders to withdraw tendered shares within a certain period of the offer.⁶⁵ Although the state statutes aim to further the objectives of the Williams Act, their extraterritorial reach raises constitutional questions. The statutes govern takeovers of local corporations, determined chiefly by the state of incor-

61. See E. ARANOW, *supra* note 9, at 208.

62. *Id.* at 207-08.

63. Several state statutes apply to a narrower class of investors than does the Williams Act. See, e.g. HAW. REV. STAT. § 417E-1 (1985) (applies to investors seeking a 10% interest); IND. CODE ANN. § 23-2-3.1-1 (Burns 1984) (10%); OHIO REV. CODE ANN. § 1707.041(A)(1) (Anderson 1985) (10%); TENN. CODE ANN. § 48-5-102(10)(A) (Supp. 1987) (10%); UTAH CODE ANN. § 61-5-2(11) (1986) (applies to investors seeking to acquire at least 20% of a corporation's stock).

64. A target corporation incorporated under the laws of one state with its principal place of business in a second state and substantial assets in a third state could be regulated concurrently by the laws of all three states. See E. Aranow, *supra* note 9, at 208 & n.8.

65. The Indiana Takeover Offers Act expressly acknowledges the importance of providing shareholders with sufficient information to make a rational decision. "By enacting this chapter, it is the intent and purpose of the general assembly to provide for full and fair disclosure . . . to shareholders of Indiana corporations, so that the opportunity of each shareholder to make an informed and well-reasoned investment decision may be secured." IND. CODE ANN. § 23-2-3.1-0.5(b) (Burns 1984).

poration. Because they apply equally to resident and nonresident shareholders, the statutes, by their very structure, reach across state borders. Thus, shareholder protection alone is not a purely local objective.

A second, less obvious objective of state legislatures is to protect individual shareholders from the fluctuation in stock prices inherent in tender offer acquisitions.⁶⁶ This also does not appear to be a legitimate local purpose, since shareholders within the state and those outside the state are equally affected by fluctuating stock prices. Additionally, since most state tender offer statutes enable management of target corporations to unilaterally exempt themselves from state regulation by approving the offer or by opting out of the statute's protections, the sole objective must not be to protect individual shareholders.⁶⁷

A third, more "protective" purpose embraced by many statutes is to shield local corporations from the disruptive effects of a takeover or merger.⁶⁸ Because of a fear that state residents might lose their jobs when out-of-state management takes over a corporation, the state's actual purpose, however, may be to protect the local economy. Since protecting local jobs necessarily affects interstate commerce, a power expressly reserved to Congress, it is not a valid exercise of state power.⁶⁹

A fourth objective sought by state legislatures in adopting anti-takeover statutes is to exercise their valid regulatory power over the internal affairs of corporations operating within their state.⁷⁰ Tender offers are not inherently internal corporate matters of a particular state, however. Although tender offers entail some internal policy-making by management in determining whether to resist a takeover, they primarily involve communications between many parties who may reside in many different states. Because of its far-reaching effect, regulation of tender offers for corporations organized under the laws of the state is not a purely local objective.

First-generation takeover statutes, which directly regulate the tender offer process, rather than corporate rights and relationships, are difficult to justify as valid state legislation under the internal affairs doctrine.⁷¹ The newer, second-generation statutes, on the other hand, may be justified on this basis. Since second-generation statutes regulate only the target corpora-

66. See E. ARANOW, *supra* note 9, at 229-30.

67. *Id.*

68. The Utah legislature explicitly recognizes in its takeover laws the negative effects of takeovers on local businesses. The perceived dangers of takeovers include the tendency of business to focus on short-term results to the detriment of long-term concerns, inconsistency with shareholder interests, the threat to jobs of Utah residents, plant closings, and disruption of relationships with customers and suppliers. UTAH CODE ANN. § 61-5-1 (1986).

69. *Pike v. Bruce Church Inc.*, 397 U.S. 137, 142 (1970).

70. As the Supreme Court stated:

It thus is an accepted part of the business landscape in this country for States to create corporations, to prescribe their powers, and to define the rights that are acquired by purchasing their shares. A State has an interest in promoting stable relationships among parties involved in the corporations it charters, as well as in ensuring that investors in such corporations have an effective voice in corporate affairs.

CTS Corp. v. Dynamics Corp. of America, 107 S. Ct. 1637, 1650-51 (1987).

71. The internal affairs doctrine is a conflict of laws principle designed to ensure that the laws of only one state govern the affairs of a corporation. *Dynamics Corp. of America v. CTS Corp.*, 794 F.2d 250, 264 (7th Cir. 1986).

tion's post-tender offer decision-making, they arguably represent a valid exercise of state power over the affairs of corporations incorporated within the state.⁷²

CONSTITUTIONAL SCRUTINY: DO STATE ANTI-TAKEOVER STATUTES WITHSTAND COMMERCE AND SUPREMACY CLAUSE ANALYSIS?

The two constitutional grounds on which state statutes regulating tender offers are most frequently overturned are pre-emption by the Williams Act under the supremacy clause⁷³ and violation of the commerce clause.⁷⁴ Although these two grounds overlap considerably and are not always readily distinguished, they will be discussed individually.

A. *Pre-emption Analysis*

The supremacy clause of the United States Constitution provides that the Constitution and other federal laws shall take precedence over state laws.⁷⁵ Thus, state laws that conflict with federal laws are invalid.

1. *Four judicial tests for pre-emption*

Courts apply four tests for determining whether the supremacy clause should pre-empt a state statute. First, if Congress specifically prohibits state regulation of the aspect of commerce in question pursuant to its powers under Article 1, section 8 of the United States Constitution, then the state statute is pre-empted.⁷⁶ Second, even if Congress does not specifically prohibit concurrent state legislation, intent to pre-empt state legislation in a particular area may be inferred from the language and structure of the federal law.⁷⁷ If the scheme of federal regulation is so pervasive so as not to allow room for states to legislate concurrently, the federal statute pre-empts the state law.⁷⁸

In addition to situations in which congressional legislation explicitly or impliedly demonstrates its intent to regulate exclusively in a particular area, state statutes are pre-empted in two other situations. First, when it is physically impossible for the subject of the regulation to comply with certain provisions of both the federal and state statutes, the federal statute pre-empts

72. See Sargent, *supra* note 56, at 5.

73. U.S. CONST. art. VI, cl. 2.

74. U.S. CONST. art. I, § 8, cl. 3.

75. "This Constitution and the laws of the United States which shall be made in pursuance thereof . . . shall be the supreme law of the land. . . ." U.S. CONST. art. VI, cl. 2.

76. See *Jones v. Rath Packing Co.*, 430 U.S. 519, 525 (1977) (holding that states may not enact food labeling requirements that do not allow "reasonable variation," when the federal law does allow such variations, because of a need for uniformity); *Campbell v. Hussey*, 368 U.S. 297 (1961), *reh'g denied*, 368 U.S. 1005 (1962) (striking down a Georgia law that superseded federal labeling of tobacco).

77. *City of Burbank v. Lockheed Air Terminal, Inc.*, 411 U.S. 624 (1973) (holding that a city could not regulate aviation inconsistently with the federal scheme of regulation).

78. *Id.* at 633.

the state statute.⁷⁹ Second, a state statute is pre-empted when it hinders the accomplishment and execution of congressional objectives.⁸⁰ In determining whether state legislation frustrates congressional objectives, courts must not only consider the written words of the federal and local schemes of regulation, but also must examine the intent of Congress in enacting a particular statute to determine whether the state statute frustrates the congressional purpose.⁸¹ Accordingly, courts frequently adopt a practical approach, determining whether the behavior that the state statute is likely to induce comports with the result Congress hoped to achieve.⁸²

2. Pre-emption of state statutes

In promulgating the Williams Act, Congress did not expressly or impliedly prevent states from regulating tender offers.⁸³ Instead, the Williams Act specifically protects the ability of states to regulate tender offers for corporations domiciled within their borders.⁸⁴ Thus, Congress clearly intended to allow states to enact concurrent legislation in the area of corporate tender offers. Because states may regulate tender offers, pre-emption analysis of a particular state statute depends on the specific provisions of the statute. The Williams Act pre-empts statutes that contain provisions which contradict those in the Act so that it is physically impossible to comply with both provisions, and statutes that frustrate the purposes of the federal legislation.

The Michigan Take-Over Offers Act⁸⁵ and the Missouri Control Share Acquisition Statute⁸⁶ are two examples of statutes pre-empted by the Williams Act. Both statutes contained provisions that frustrated the congressional purpose of maintaining a balance between the target company and the offeror. The Michigan statute provided for pre-commencement notification of the state department of commerce, the target company, and the general public; a hearing by the administrator of the state commerce department which could delay the effective date of the offer indefinitely; and a sixty day hold-open period.⁸⁷ The court in *L.P. Acquisition Co. v. Tyson*⁸⁸ held that these three provisions impermissibly delayed the offer, giving incumbent

79. *Florida Lime & Avocado Growers, Inc. v. Paul*, 373 U.S. 132, 142-43, *reh'g denied*, 373 U.S. 858 (1963).

80. *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941) (ruling that the state of Pennsylvania could not regulate in the area of immigration, because of pervasive federal law).

81. *See generally* *Great Western United Corp. v. Kidwell*, 577 F.2d 1256, 1274-81 (5th Cir. 1978), *rev'd on other grounds sub nom. Leroy v. Great Western United Corp.*, 443 U.S. 173 (1979).

82. *See, e.g., Dynamics Corp. of America v. CTS Corp.*, 794 F.2d 250, 264 (7th Cir. 1986).

83. As the Eighth Circuit observed, "Congress has not chosen to expressly or impliedly bar states from regulating tender offers." *National City Lines, Inc. v. LLC Corp.*, 687 F.2d 1122, 1129 (8th Cir. 1982).

84. "Nothing in this chapter shall affect the jurisdiction of the securities commission . . . 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." 15 U.S.C. § 78bb(a) (1952). This section appeared in the original Securities Exchange Act of 1934; Congress did not amend section 78bb(a) when passing the Williams Act.

85. MICH. COMP. LAWS ANN. §§ 451.901 to 451.917 (West 1984), portions of which were overturned in *L.P. Acquisition Co. v. Tyson*, 772 F.2d 201 (6th Cir. 1985).

86. MO. ANN. STAT. § 351.407 (Vernon Supp. 1988), invalidated in *Icahn v. Blunt*, 612 F. Supp. 1400 (W.D. Mo. 1985).

87. *See L.P. Acquisition Co. v. Tyson*, 772 F.2d 201 (6th Cir. 1985).

88. *Id.* at 209.

management an opportunity to fight a take-over, and thereby frustrated the purpose of the Williams Act.

The Missouri law allowed an offeror to commence a tender offer only after the shareholders voted their approval.⁸⁹ Because it was virtually impossible for offerors to wait for shareholder approval and commence the purchase within five days of filing the disclosure statement, as required under the Williams Act,⁹⁰ the state statute conflicted directly with the Williams Act and was therefore pre-empted.⁹¹ Additionally, the provisions of the Missouri statute enabled target company directors to unilaterally exempt the tender offer transaction from the state statute. This loophole favored incumbent management over tender offerors and thus frustrated the purpose of the Williams Act.⁹²

Therefore, the Williams Act pre-empted both the Michigan and Missouri statutes. The Michigan statute was found unconstitutional because it gave the state the ability to indefinitely delay an offer, thereby handicapping the tender offeror and upsetting the delicate balance the Williams Act sought to preserve. On the other hand, the Missouri law represented a statute which was plainly inconsistent with the explicit provisions of the Williams Act. Because an offeror could not physically comply with the terms of both the federal and the state legislation, the Williams Act pre-empted the Missouri law.

B. Commerce Clause Analysis

1. Effect on interstate commerce

The commerce clause of the United States Constitution gives Congress the power to regulate commerce "among the several States."⁹³ Direct state regulation of interstate commerce and legislation which has a direct effect on interstate commerce⁹⁴ is prohibited. Additionally, statutes that protect local business by discriminating against interstate commerce are invalid.⁹⁵ Recently, courts have also invalidated statutes under the commerce clause when activities may be subject to inconsistent regulation.⁹⁶ When state laws merely indirectly affect interstate commerce, courts usually apply the balancing test set forth in *Pike v. Bruce Church, Inc.*⁹⁷

Under the *Pike* test, courts balance the burdens imposed on interstate commerce against the local interests served by the statute. Statutes that un-

89. See *Icahn v. Blunt*, 612 F. Supp. 1400 (W.D. Mo. 1985).

90. 17 C.F.R. 240.14d-2 (1988).

91. *Icahn*, 612 F. Supp. at 1419-20.

92. *Id.* at 1420.

93. U.S. CONST. art. I, § 8, cl. 3.

94. *Shafer v. Farmers' Grain Co. of Embden*, 268 U.S. 189, 199 (1925). "[A] state statute which by its necessary operation directly interferes with or burdens [interstate] commerce is a prohibited regulation and invalid, regardless of the purpose with which it was enacted." *Id.*

95. See *Lewis v. BT Inv. Managers, Inc.*, 447 U.S. 27, 36-37 (1980).

96. See, e.g., *Brown-Forman Distillers Corp. v. New York State Liquor Auth.*, 476 U.S. 573, 583 (1986).

97. 397 U.S. 137 (1970). If the statute "regulates evenhandedly to effectuate a legitimate local public interest" and its effect is only incidental, the statute is upheld "unless the burden imposed on [interstate] commerce is clearly excessive in relation to the putative local benefits." *Id.* at 142 (quoting *Huron Cement Co. v. Detroit*, 362 U.S. 440, 443 (1960)).

duly burden interstate commerce are invalid under the commerce clause.⁹⁸ Moreover, statutes that are found to "regulate evenhandedly to effectuate a legitimate local interest" are overturned if they impose a substantial, rather than an incidental, burden on interstate commerce.⁹⁹

2. *Scrutiny of state statutes under the commerce clause*

Because most tender offers involve transactions between buyers and shareholders living in a number of different states,¹⁰⁰ first-generation state anti-takeover statutes necessarily affect interstate commerce. Although some courts invalidate first-generation legislation as direct regulation of interstate commerce,¹⁰¹ most courts use the *Pike* test to analyze both first and second-generation statutes.¹⁰²

The Idaho Takeover Statute,¹⁰³ the Illinois Business Take-over Act,¹⁰⁴ and the Minnesota Corporate Take-overs Act¹⁰⁵ are three examples of anti-takeover statutes analyzed recently under the *Pike* test. Because of the factual differences between the statutes and the varied predispositions of the courts, only the Minnesota statute survived constitutional scrutiny.¹⁰⁶

Analyzing the validity of the state purposes promoted by the Idaho law, the court in *Great Western United Corp. v. Kidwell*¹⁰⁷ found that protection of local corporations was not a legitimate local purpose.¹⁰⁸ Moreover, because only two percent of the target corporation's shareholders lived in Idaho, the court did not accord much weight to the state's interest in protecting local shareholders.¹⁰⁹ Furthermore, the court decided that the first-generation statute's pre-effective date filing requirements, provision for a mandatory hearing at the request of incumbent management, and a potentially unlimited delay of an offer's effective date¹¹⁰ imposed a substantial burden on interstate commerce.¹¹¹ The *Kidwell* court weighed the "uncertain" and "incidental" legitimate benefits conferred by the Idaho statute against its substantial extraterritorial impact and concluded that the burdens were dis-

98. Like any balancing test, the *Pike v. Bruce Church* test is difficult to apply with precision and consistency. It appears, however, to favor state regulation since the burdens must be *clearly excessive* in relation to local benefits. See generally Regan, *supra* note 19, at 1105-07.

99. *Pike*, 397 U.S. at 142.

100. E. ARANOW, *supra* note 9, at 229.

101. See, e.g., Edgar v. MITE Corp., 457 U.S. at 640-42 (plurality opinion); Icahn v. Blunt, 612 F. Supp. 1400, 1415 (W.D. Mo. 1985).

102. See, e.g., Edgar v. MITE Corp., 457 U.S. at 643-46; L.P. Acquisition Co. v. Tyson, 772 F.2d 201, 206-07 (6th Cir. 1985); Cardiff Acquisitions, Inc. v. Hatch, 751 F.2d 906, 909-12 (8th Cir. 1984); Icahn v. Blunt, 612 F. Supp. 1400, 1416-18 (W.D. Mo. 1985). Second-generation statutes are not considered direct regulation of interstate commerce since they affect only the voting rights to be accorded shares, generally thought of as the "internal affairs" of a corporation. See *infra* notes 174-75 and accompanying text.

103. IDAHO CODE §§ 30-1501 to 30-1513 (Cum. Supp. 1977).

104. ILL. REV. STAT. ch. 121 1/2, para. 137.51 *et seq.* (1979), repealed by Act of Sept. 14, 1983, Public Act 83-365 § 1, 1983 Ill. Legis. Serv. 2628 (West).

105. MINN. STAT. ANN. § 80B.01 (West 1984).

106. *Hatch*, 751 F.2d at 909-12.

107. 577 F.2d 1256 (5th Cir. 1978), *rev'd on other grounds sub nom.* Leroy v. Great Western United Corp., 443 U.S. 173 (1979).

108. *Kidwell*, 557 F.2d at 1282.

109. *Id.* at 1283, 1285.

110. *Id.* at 1263.

111. *Id.* at 1285.

proportionate to the legitimate benefits.¹¹² Thus, the court invalidated the Idaho law under the commerce clause.

Similarly, in *Edgar v. MITE Corp.*,¹¹³ a majority of the Supreme Court held that the Illinois Business Takeover Act¹¹⁴ was unconstitutional under the *Pike* commerce clause analysis.¹¹⁵ The Court found that the act's extra-territorial reach and its substantive provisions substantially hindered interstate commerce. Moreover, the asserted state interests in protecting shareholders and in regulating the internal affairs of local corporations, although legitimate on their face, were illusory. The state could not justify its legislation as shareholder protection when a significant percentage of shareholders were nonresidents; similarly, regulating a corporation's internal affairs was not a valid state purpose of a statute that applied to target corporations not incorporated in Illinois.¹¹⁶

In a case decided after *MITE*, the Eighth Circuit Court of Appeals applied the *Pike* test to uphold the Minnesota Corporate Take-overs Act, a second-generation statute, under the commerce clause.¹¹⁷ The court distinguished the Minnesota statute from the overturned Illinois statute on several grounds. First, several troublesome provisions of the Illinois Act¹¹⁸ were not included in the Minnesota Act,¹¹⁹ and thus the Minnesota Act was not as burdensome on interstate commerce. Second, the Minnesota legislature tailored its Act to minimize the extraterritorial effect. By narrowing the scope of the statute to apply only to target corporations with at least twenty percent of their shareholders and substantial assets within the state, the state ensured that the statute's benefits would be enjoyed by corporations with a significant relationship to Minnesota.¹²⁰ Because the Minnesota statute imposed a lower burden on interstate commerce and established a closer nexus between the state and those affected by the law, the statute was upheld.¹²¹

The above analysis of circuit court scrutiny of state anti-takeover statutes and the Supreme Court's fractured plurality decision in *MITE* set the stage for the Court's surprising decision in *CTS Corp. v. Dynamics Corp. of America*¹²² Although the different outcomes of the cases may be justified strictly on factual distinctions between the statutes, the disparate rulings among the circuits demonstrated the need for a definitive Supreme Court decision on the statutes' constitutionality.

112. *Id.* at 1286.

113. 457 U.S. 624 (1982).

114. ILL. REV. STAT. ch. 121 1/2, para. 137.51 *et seq.* (1979), *repealed by* Act of Sept. 14, 1983, Public Act 83-365 § 1, 1983 Ill. Legis. Serv. 2628 (West).

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

116. *Id.* at 643-46.

117. *Hatch*, 751 F.2d 906.

118. *See infra* notes 151-157 and accompanying text.

119. *Hatch*, 751 F.2d at 909-11.

120. *Id.* at 911.

121. *Id.* at 912.

122. 107 S. Ct. 1637 (1987).

CTS CORP. V. DYNAMICS CORP. OF AMERICA¹²³A. *The Indiana Control Shares Acquisition Act*¹²⁴1. *Application*

In *CTS Corp. v. Dynamics Corp. of America*,¹²⁵ the United States Supreme Court upheld the Indiana Control Shares Acquisition Act,¹²⁶ a second-generation statute that regulates tender offers. The statute's application is limited in two ways—to acquisitions of a certain percentage of ownership, known as “control shares,”¹²⁷ and to target corporations with a threshold presence within the state, known as “issuing public corporations.”¹²⁸ Additionally, corporations may elect to exclude themselves from the scope of the Act.¹²⁹

Like most statutes regulating tender offers, the Indiana Control Shares Acquisition Act imposes disclosure requirements on the tender offeror. Under the Act, any person who proposes to make or has made a control share acquisition may at the person's election deliver an “acquiring person statement” to the issuing public corporation.¹³⁰ The principal substantive provision of the Act enables shareholders of the target corporation to determine the voting rights accorded control shares.¹³¹ After the offeror files a

123. *Id.*

124. IND. CODE ANN. § 23-1-42-1 (Burns Supp. 1988).

125. 107 S. Ct. 1637 (1987).

126. IND. CODE ANN. § 23-1-42-1 (Burns 1987).

127. “Control shares” are defined in section 23-1-42-1 of the Indiana Code as: shares that, except for this chapter, would have voting power with respect to shares of an issuing public corporation that, when added to all other shares of the issuing public corporation owned by a person . . . would entitle that person, immediately after acquisition of the shares . . . to exercise or direct the exercise of the voting power of the issuing public corporation in the election of directors within any of the following ranges of voting power:

- (1) One-fifth (1/5) or more but less than one-third (1/3) of all voting power.
- (2) One-third (1/3) or more but less than a majority of all voting power.
- (3) A majority or more of all voting power.

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

128. “Issuing public corporation” is defined in section 23-1-42-4 of the Control Shares Acquisition Act as a corporation with:

- (1) One hundred (100) or more shareholders;
- (2) Its principal place of business, its principal office, or substantial assets within Indiana; and
- (3) Either:
 - (A) More than ten percent (10%) of its shareholders resident in Indiana;
 - (B) More than ten percent (10%) of its shares owned by Indiana residents; or
 - (C) Ten thousand (10,000) shareholders resident in Indiana.

IND. CODE ANN. § 23-1-42-4 (Burns Supp. 1988).

129. Section 23-1-42-5 of the Indiana Code provides in part:

Unless the corporation's articles of incorporation or bylaws provide that this chapter does not apply to control share acquisitions of shares of the corporation before the control share acquisition. . . .

IND. CODE ANN. § 23-1-42-5 (Burns Supp. 1988).

130. IND. CODE ANN. § 23-1-42-6 (Burns Supp. 1988). The acquiring person statement must include: (1) identity of the acquirer; (2) statement that acquisition is taking place pursuant to the Act; (3) number of shares of issuing public corporation already owned by the acquiring person; (4) range of voting power sought; and (5) if Control Shares acquisition has not yet occurred: (a) detailed description of proposal; and (b) representations that acquisition is not contrary to law and that acquirer has the financial resources necessary to complete the transaction, along with facts on which the representations are based.

131. IND. CODE ANN. § 23-1-42-9 (Burns Supp. 1988).

disclosure statement, the shareholders of the target corporation must decide the voting rights of the shares within fifty days.¹³² If the offeror fails to file a disclosure statement, the shareholders must determine the voting rights at their next regularly scheduled meeting.¹³³

B. *Striking down the Indiana Control Shares Acquisition Act*

Dynamics Corporation of America filed suit in federal district court on the same day it announced its tender offer for 17.9 percent of CTS Corporation stock, bringing its potential ownership above the twenty percent trigger of the Act.¹³⁴ Dynamics requested declaratory and injunctive relief, claiming violations of the supremacy and commerce clauses of the federal Constitution. The district court held that the Act constituted an impermissible burden on interstate commerce and granted the preliminary injunction;¹³⁵ CTS appealed.

The Seventh Circuit considered the constitutionality of the Indiana Control Shares Acquisition Act on both pre-emption and commerce clause grounds. The court, following the reasoning of the Supreme Court plurality decision in *Edgar v. MITE Corp.*,¹³⁶ declared that the Williams Act forbids states to adopt legislation that makes a takeover more difficult to accomplish than it is under the Williams Act.¹³⁷ Noting that Congress intended to strike a delicate balance between target company management and the bidder in the takeover attempt, the court reasoned that the Williams Act pre-empts, under the supremacy clause, any state statute that upsets this balance in any way.¹³⁸

By granting Indiana corporations the right to delay a shareholder meeting to determine the voting rights of acquired shares for fifty days, the Control Shares Acquisition Act, in effect, forces bidders to keep their offers open for fifty days.¹³⁹ This far exceeds the twenty business days required under the Williams Act.¹⁴⁰ Additionally, a majority of "disinterested"¹⁴¹ share-

132. IND. CODE ANN. § 23-1-42-7(b)(Burns Supp. 1988).

133. IND. CODE ANN. § 23-1-42-7(c) (Burns Supp. 1988).

134. *See* Dynamics Corp. of America v. CTS Corp., 637 F. Supp. 389, 390 (N.D. Ill. 1986). Had the tender offer been successful, Dynamics Corp. would have owned 27.5% of CTS stock.

135. *Id.*

136. 457 U.S. 624 (1982).

137. Dynamics Corp. of America v. CTS Corp., 794 F.2d 250, 262 (7th Cir. 1986).

138. *Id.*

139. The effect of the Indiana statute is both to impose a 50-day delay on tender offers at the option of the target firm and to make it far more difficult for tender offers to succeed even if delay is not an impediment. The offeror dare not accept the tendered shares till the stockholders' meeting is held, since if he loses the vote on voting rights he will end up with nonvoting shares and will not be able to control the corporation. . . .

Id. at 261.

140. 17 C.F.R. § 240.14e-1(a) (1988).

141. "Interested shares" are defined in the Act as:

the shares of an issuing public corporation in respect of which any of the following persons may exercise or direct the exercise of the voting power of the corporation in the election of directors:

- (1) An acquiring person or member of a group with respect to a control share acquisition.
- (2) Any officer of the issuing public corporation.

holders can vote not to accord voting rights to the control shares.¹⁴² Disinterested shareholders also can determine the price for which the offeror may resell any shares tendered and purchased. Because of the considerable power vested in disinterested shareholders to thwart any takeover attempt, the court ruled that the Williams Act pre-empts the statute.¹⁴³

Assuming that the Williams Act did not intend to prevent the states from regulating tender offers, the Seventh Circuit Court of Appeals considered the validity of the Control Shares Acquisition Act under the commerce clause. Applying the *Pike v. Bruce Church, Inc.*¹⁴⁴ balancing test, the court determined that the Indiana statute heavily burdened nonresident offerors and shareholders and that the burden far outweighed any benefits to local interests.¹⁴⁵ Since most shareholders of both CTS and Dynamics were probably not Indiana residents,¹⁴⁶ the statute directly impeded commercial transactions between residents of other states.¹⁴⁷

C. *The Supreme Court Speaks—State Regulation Is Permissible*

A majority of the Supreme Court upheld the Indiana statute on both pre-emption and commerce clause grounds, reversing the Seventh Circuit Court of Appeals.¹⁴⁸ With this decision, the Court obliterated the uncertainty surrounding the very fact-specific lower court rulings.

1. *Pre-emption analysis*

The Supreme Court concluded that it is possible for entities to comply both with the terms of the Williams Act and with the Indiana statute.¹⁴⁹ Thus, pre-emption analysis requires an examination of whether the state statute frustrates the purpose of the federal law. Although the Court was not bound to follow the reasoning of the plurality in *Edgar v. MITE Corp.*,¹⁵⁰ which concluded that the Illinois statute frustrated the objectives of the Williams Act, the CTS majority decided that the Indiana statute passed constitutional muster even following the reasoning of the MITE plurality. The substantive provisions of the Indiana Control Shares Acquisition Act were distinguished from those of the Illinois statute, and were held not to frustrate the objectives of the federal legislation.

In *Edgar v. MITE Corp.*,¹⁵¹ the Supreme Court noted three provisions

(3) Any employee of the issuing public corporation who is also a director of the corporation.

IND. CODE ANN. § 23-1-42-3 (Burns Supp. 1988).

"Disinterested" persons are persons other than those listed in (1)-(3) above.

142. See IND. CODE ANN. § 23-1-42-9 (Burns Supp. 1988).

143. *Dynamics Corp.*, 794 F.2d at 263.

144. 397 U.S. 137 (1970).

145. *Dynamics Corp.*, 794 F.2d at 263.

146. "We have not been told the geographical distribution of Dynamics' and CTS's shareholders but . . . we can assume that the vast majority of both . . . are nonresidents." *Id.*

147. "For the sake of trivial or even negative benefits to its residents Indiana is depriving nonresidents of the valued opportunity to accept tender offers from other non-residents." *Id.* at 264.

148. *CTS Corp. v. Dynamics Corp. of America*, 107 S. Ct. 1637 (1987).

149. *Id.* at 1644.

150. 457 U.S. 624 (1982).

151. *Id.*

of the Illinois statute that conflicted with the Williams Act.¹⁵² The first was an imposed "pre-commencement" period, which enabled target company management to communicate with shareholders but prohibited offerors from doing so during the same period. Because Congress expressly deleted a precommencement hearing provision from the Williams Act and because of the obvious tip in the balance toward management of target companies, the provision frustrated the objectives of the Williams Act.¹⁵³

The second offensive feature of the Illinois Act was the provision for a hearing on a tender offer that failed to stipulate time parameters for the hearing. As a result, incumbent management could postpone tender offers indefinitely. Congress recognized the detrimental effects that delay could have on carrying out a tender offer, since a prolonged offer could give target company management unlimited time to defend their company from take-over.¹⁵⁴ Since Congress intended for tender offers to go forward without serious delay,¹⁵⁵ the Court concluded that the second provision conflicted with the Williams Act.¹⁵⁶

The third troublesome provision of the Illinois Act was its requirement that the Illinois Secretary of State rule on the fairness of each tender offer. Because this provision added another layer of review to the process, enabling someone other than the shareholders to pass judgment on the terms of the takeover, it too conflicted with the Williams Act.¹⁵⁷

The *CTS* Court noted that the Illinois Business Take-over Act, overturned in *MITE*, favored local management over tender offerors, contrary to the evenhanded approach propounded by Congress in the Williams Act.¹⁵⁸ The Court found that the Indiana statute, on the other hand, serves the basic purposes of the Williams Act.¹⁵⁹ The Indiana statute protects the shareholder equally from offeror and corporate management, by allowing shareholders as a group to consider the tender offer.¹⁶⁰

Furthermore, the Indiana Act does not give either target management or the offeror an advantage in communicating with shareholders as did the Illinois Act with its twenty day precommencement period. This further ensures that the balance between contending parties is not upset.¹⁶¹

The Court then addressed the potential fifty day delay in conferring voting rights which would in effect delay consummation of the tender offer for that length of time. The Supreme Court, unlike the Seventh Circuit Court of Appeals, did not consider the practical effect of a fifty day delay to conflict with provisions of the Williams Act that establish a twenty day mini-

152. *Id.* at 635-40; see also *CTS*, 107 S. Ct. at 1645.

153. Senator Williams' bill would have required a tender offeror to notify the target corporation of the offer at least 20 days before commencement of that offer. The SEC stated that "the requirement of a 20-day advance notice to the issuer and the Commission is unnecessary for the protection of security holders. . . ." 112 CONG. REC. 19005 (1966).

154. *MITE*, 457 U.S. at 637.

155. *Id.* at 639.

156. *Id.* at 637.

157. *Id.* at 639-40.

158. *CTS*, 107 S. Ct. at 1645.

159. *Id.* at 1646.

160. *Id.* at 1645.

161. *Id.*

num period during which offers must remain open. The Court noted that offerors did not need to delay their offers pending the result of the voting rights election; instead, offerors could condition their offers on receipt of voting rights within a certain length of time.

The Court decided that even if the practical effect of the Indiana Act was to delay offers for fifty days, a fifty day delay does not necessarily conflict with the Williams Act.¹⁶² The Court then distinguished the fifty day delay possible under Indiana law from the potentially unlimited period which was found unconstitutional by the *MITE* plurality. The Williams Act pre-empts only those provisions that unreasonably prolong tender offers. Because the Williams Act establishes a sixty day maximum period for tender offers, the Court did not consider a potential fifty day open period unreasonable.¹⁶³

2. Commerce clause analysis

The Court first analyzed the Indiana statute by determining whether it discriminates against out-of-state corporations. Because the statute operates without regard to whether an offeror is a local or out-of-state resident, the Court determined that the statute is not discriminatory.¹⁶⁴ Furthermore, the Court concluded that the fact that the statute will more often than not apply to out-of-state entities does not lead to a finding of discrimination.¹⁶⁵ Thus, the Court rejected the argument that the Act discriminated against interstate commerce.

The Court next considered whether the Indiana Act violated the commerce clause by subjecting activities to inconsistent regulations.¹⁶⁶ Looking only to the Act's impact on target corporations, the Court concluded that since the statute affected voting rights only of corporations formed under Indiana law, there was no risk of inconsistent regulation.¹⁶⁷ The Court did not, however, consider the detriment of the state statute on tender offerors, who could be simultaneously subject to conflicting state statutes, if the target corporation has substantial assets in more than one state.

Addressing the Court of Appeals' argument that the Indiana Act hindered tender offers, thus obstructing interstate commerce, the Court stressed the states' interest in regulating state corporate entities.¹⁶⁸ The Court recognized that a state has a valid interest in regulating business relationships in the corporations it charters. Although state regulation will necessarily affect investors from out-of-state, particularly when a large corporation is involved, it is a necessary by-product of states exercising their rights to regulate the activities of state-chartered corporations.¹⁶⁹ Moreover, the Supreme

162. *Id.* at 1647.

163. *Id.*

164. *Id.* at 1648-49.

165. *Id.* at 1649; see *Exxon Corp. v. Governor of Maryland*, 437 U.S. 117 (1978).

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

167. *Id.*

168. See *supra* note 70.

169. *CTS*, 107 S. Ct. at 1650.

Court found the Indiana tender offer legislation regulated evenhandedly,¹⁷⁰ comparing regulation of takeovers of state-chartered corporations to state regulation of mergers and stock voting rights,¹⁷¹ areas in which state regulation is justified by the internal affairs doctrine.¹⁷² The Court concluded, therefore, that the Act's purpose to protect shareholders of Indiana corporations as a group from potentially coercive tender offers is legitimate and justified.

EROSION OF THE WILLIAMS ACT'S CAREFULLY-CRAFTED BALANCE

The Court of Appeals and Supreme Court decisions in *CTS* do not squarely address the same issues. The Court of Appeals analyzed the practical effect of the Indiana Act and found that the effect conflicted with the evenhanded spirit of the Williams Act. Looking at the overall effect on the feasibility of tender offers, the Court of Appeals held that the "balanced" Williams Act pre-empts the Indiana Act because the Indiana Act is more hostile to corporate takeovers. On the other hand, the United States Supreme Court focused narrowly on the specific provisions of the Indiana Act, comparing them to what is allowed by the Williams Act, and determined that none conflicted with the specific provisions of the Williams Act.

Similarly, the two courts' approaches differed in their commerce clause analyses. The Seventh Circuit Court of Appeals, applying the *Pike v. Bruce Church, Inc.*¹⁷³ test, determined that the Indiana legislature in effect regulated transactions between corporations and shareholders who were not Indiana residents. The court asserted that the local interest in regulating such transactions was negligible in relation to the impact on interstate commerce.

On the other hand, the United States Supreme Court weighed more heavily the interest of the state in regulating corporate transactions within its borders, under an internal affairs doctrine justification. The state's interest in regulating the rights accorded to shares of corporate stock, however, is illusory. Because a corporation is an artificial being, a creation of state law, and may not have any significant contact with the state under whose laws it is incorporated,¹⁷⁴ it is deceptive to maintain that a state has a legitimate interest in overseeing the activities of those corporations.

Although second-generation statutes like the Control Shares Acquisitions Act do not directly regulate the actual tender offer, they significantly affect the feasibility of tender offers by making acquired shares potentially less attractive to offerors. These statutes therefore meet the threshold burden of *Pike*, since their burden on interstate commerce is more than "merely incidental."

In concluding that the Indiana Control Shares Acquisition Act did not impermissibly influence interstate commerce, the Supreme Court perpetuated the argument that states may regulate all aspects of rights conferred on

170. *Id.* This term appears to require an equal, nondiscriminatory impact on out-of-state corporations in comparison with in-state corporations, thus avoiding complaints of protectionism.

171. *Id.*

172. *Id.* at 1649-50.

173. 397 U.S. 137 (1970).

174. See, e.g., *MITE*, 457 U.S. at 645.

stock of corporations chartered within their borders. This internal affairs argument, however, is inconsistent with historical interpretations of the supremacy and commerce clauses of the Constitution.¹⁷⁵ The internal affairs approach is flawed because it considers only the corporate shareholders who are purportedly protected by both the Williams Act and by the state legislation. To the extent that courts overlook the practical effects of such laws on prospective tender offerors, courts will fail to see that the delicate balance which the Williams Act seeks to maintain is subtly being destroyed.

CONCLUSION

Since the Supreme Court plurality decision in *Edgar v. MITE Corp.*,¹⁷⁶ which overturned a state law directly regulating tender offers, states are attempting to develop new takeover laws that will survive constitutional scrutiny. Recent second-generation takeover legislation has been adopted as part of states' corporation law instead of their securities regulation in an effort to avoid conflict with federal securities law.

In *CTS Corp. v. Dynamics Corp. of America*,¹⁷⁷ the Supreme Court upheld Indiana's second-generation statute, stressing the state's legitimate interest in regulating the internal affairs of its corporations. By focusing on this state interest, however, the Court downplayed the overall effect of the statute on tender offerors. Regardless of the importance of the state interest, the burdens on interstate commerce are substantial. When the effects of second-generation statutes on nonresident tender offerors are considered under the *Pike* balancing test, the state's interest in regulating its corporate affairs is insignificant in light of the virtual complete prohibition such regulation places on hostile takeovers.

By affirming the Indiana Control Share Acquisition Act, the Supreme Court has effectively silenced similar suits in the future. Because many states adopted second-generation, control share legislation similar to Indiana's, these statutes will survive constitutional scrutiny and corporations will be able to use state law to thwart unwanted takeovers by out-of-state corporations.

175. See Warren, *supra* note 2, at 684.

176. 457 U.S. 624 (1982).

177. 107 S. Ct. 1637 (1987).

