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CTS Corp. v. Dynamics Corp. of America: Of State Regulation, Tender Offers, and Necromancy

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Notes

*CTS Corp. v. Dynamics Corp. of America: Of State Regulation, Tender Offers, and Necromancy**

*And when he thus had spoken, he cried with a loud voice,
"Lazarus, come forth."*

*And he that was dead came forth, bound hand and foot with
graveclothes: and his face was bound about with a napkin.
Jesus saith unto them, "Loose him, and let him go."****

INTRODUCTION

In 1982 the Supreme Court decided *Edgar v. MITE Corp.*,¹ striking down the Illinois Business Takeover Act² as unconstitutional under both the supremacy³ and commerce clauses.⁴ Since then, state regulation of cash tender offers,⁵ once a booming

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** *St. John* 11:43-44 (King James).

¹ 457 U.S. 624 (1982).

² 1978 Ill. Laws 80-1421 (codified at ILL. REV. STAT. ch. 121 1/2, ¶ 137.5 (1979)) (repealed 1983).

³ U.S. CONST. art. I, § 6, cl. 2.

⁴ U.S. CONST. art. I, § 8, cl. 3.

⁵ "Tender offer" (or "takeover offer") has been defined as:

An offer to purchase shares made by one company direct to the stockholders of another company, sometimes subject to a minimum and/or a maximum that the offeror will accept, communicated to the shareholders by means of newspaper advertisements and (if the offeror can obtain the shareholders list, which is not often unless it is a friendly tender) by a general mailing to the entire list of shareholders, with a view to acquiring control of the second company. Used in an effort to go around the management of the second company, which is resisting acquisition.

BLACK'S LAW DICTIONARY 1316 (5th ed. 1979).

pastime of state legislatures,⁶ has become almost a contradiction in terms. The *MITE* decision became known as the “death knell”⁷ of state authority in this area, marking the “demise of traditional state takeover statutes.”⁸ After *MITE*, all that appeared to be left to the states was the ability to enact “cotton candy” statutes—lots of fluff, but little substance. As state and federal courts applied the *MITE* rationale, statute after statute was struck down as either being pre-empted by the Williams

⁶ Thirty-eight jurisdictions have tried some form of takeover provision in their corporate regulatory laws. See ALASKA STAT. §§ 45.57.010 to .120 (1980); ARK. STAT. ANN. §§ 67-1264 to 1264.14 (1980); COLO. REV. STAT. §§ 11-51.5-101 to .5-108 (repealed 1984); CONN. GEN. STAT. ANN. §§ 36-456 to -468 (West 1981 & Supp. 1984); DEL. CODE ANN. tit. 8, § 203 (1983); FLA. STAT. ANN. §§ 517.35 to .363 (repealed 1979); GA. CODE ANN. §§ 22-1901 to -1915 (1977 & Supp. 1982); HAWAII REV. STAT. §§ 417E-1 to -15 (1976 & Supp. 1984); IDAHO CODE §§ 30-1501 to -1513 (1980 & Supp. 1985); 1978 ILL. LAWS 80-1421 (repealed 1983); IND. CODE ANN. §§ 23-1-17-1 to -54-2 (West Supp. 1986); IOWA CODE ANN. §§ 502.211 to .215 (West Supp. 1984-85); KAN. STAT. ANN. §§ 17-1276 to -1284 (1981); KY. REV. STAT. ANN. §§ 292.560 to .991 (Michie/Bobbs-Merrill 1981 & Supp. 1982); *id.* §§ 271A.396 to .399 (Supp. 1984); LA. REV. STAT. ANN. §§ 51:1500 to :1512 (West Supp. 1985) (repealed 1987); ME. REV. STAT. ANN. tit. 13, §§ 801 to 817 (Supp. 1984-85) (repealed 1985); MD. CORPS. & ASS'NS CODE ANN. §§ 11-901 to -908 (1985) (repealed 1986); *id.* §§ 3-601 to -603 (repealed 1986); MASS. GEN. LAW ANN. ch. 110c, §§ 1 to 13 (West Supp. 1985); MICH. COMP. LAWS ANN. §§ 451.810 to .814 (West 1983 & Supp. 1985); MINN. STAT. ANN. §§ 80B.01 to .13 (West Supp. 1984); MISS. CODE ANN. §§ 75-72-101 to -121 (Supp. 1985); MO. ANN. STAT. §§ 404.500 to .565 (Vernon 1979); *id.* § 351.407 (Vernon Supp. 1985-86); NEB. REV. STAT. §§ 21-2419 to -2430 (1983); NEV. REV. STAT. §§ 78.376 to .3788 (1979) (amended 1981, 1983, repealed 1988); N.H. REV. STAT. ANN. §§ 421.A:1 to :16 (1983 & Supp. 1985) (found unconstitutional in part 1983, amended in part 1983); N.J. STAT. ANN. §§ 49:5-1 to :19 (West Supp. 1985); N.Y. BUS. CORP. LAW §§ 1600 to 1614 (McKinney Supp. 1985) (amended 1983); N.C. GEN. STAT. §§ 78B-1 to -11 (1985); OHIO REV. CODE ANN. §§ 1701.83.1 to .83.2, 1707.04.1 to .04.2 (Anderson 1985); OKLA. STAT. ANN. tit. 71, §§ 431 to 450 (repealed 1985); PA. STAT. ANN. tit. 70, §§ 71 to 85 (Purdon Supp. 1985); S.C. CODE ANN. §§ 35-2-10 to -110 (Law. Co-op Supp. 1984); S.D. CODIFIED LAWS ANN. §§ 47-32-1 to -48 (Supp. 1983) (various sections amended and repealed 1983); TENN. CODE ANN. §§ 48-21-101 to -21-114 (1979 & Supp. 1983); Texas Administrative Guidelines for Minimum Standards in Tender Offers, §§ 065.15.00.100 to .800, *reprinted in* 3 BLUE SKY L. REP. (CCH) 55, 671-55, 682; UTAH CODE ANN. §§ 61-4-1 to -13 (repealed 1983); VA. CODE ANN. §§ 13.1528 to -541 (1978 & Supp. 1983) (amended 1983); WIS. STAT. ANN. §§ 552.01 to .25 (West Supplemental Pamphlet 1983) (amended 1985).

⁷ See Note, Edgar v. MITE Corp.: *The Death Knell for the Indiana Takeover Offers Act*, 16 IND. L. REV. 517 (1983).

⁸ Note, *The Demise of State Takeover Regulations*, 11 N. KY. L. REV. 613, 634 (1984). The author concluded that states will have to “completely revise their statutes so they do not burden interstate commerce . . . States whose statutes follow the traditional pattern will most certainly be determined unconstitutional.” *Id.* at 634.

Act⁹ (in all but the most mundane of matters) or as being burdensome to interstate commerce, or both.¹⁰

In April 1987, with the art of a necromancer,¹¹ the Supreme Court breathed life back into state regulation of tender offers. In *CTS Corp. v. Dynamics Corp. of America*,¹² the Court held, this time with a majority voice,¹³ that the Indiana Control Shares Acquisitions Act,¹⁴ a statute similar to the one ruled unconstitutional in *MITE*, was neither pre-empted by the Williams Act¹⁵ nor violative of the commerce clause.¹⁶ Once again, it appears that states can enact tender offer regulation with teeth.

This Note first discusses the legislative history of the Williams Act,¹⁷ the *MITE* decision,¹⁸ statutes enacted after *MITE*,¹⁹ and the *Dynamics* decision.²⁰ Second, it discusses (1) whether *MITE* has effectively been overruled despite the Supreme Court's elaborate distinctions between the two cases,²¹ and (2) what ramifications the *Dynamics* decision will have on future corporate statutes.²²

⁹ Pub. L. No. 90-439, 82 Stat. 454 (1968) (codified at 15 U.S.C.A. §§ 78m(d)-(e), 78n(d)-(f) (West 1981)).

¹⁰ See, e.g., *Nat'l City Lines, Inc. v. LLC Corp.*, 687 F.2d 1122 (8th Cir. 1982) (Missouri statute unconstitutional under supremacy and commerce clauses); *Icahn v. Blunt*, 612 F. Supp. 1400 (W.D. Mo. 1985) (Missouri statute unconstitutional under both clauses); *Esmark, Inc. v. Strode*, 639 S.W.2d 768 (Ky. 1982) (Kentucky statute invalidated on commerce clause grounds). For a more comprehensive list of cases in which state statutes have been held unconstitutional, see Recent Case, *The Resurrection of State Regulation of Cash Tender Offers: Cardiff Acquisitions, Inc. v. Hatch*, 751 F.2d [sic] (8th Cir. 1984), 34 DEPAUL L. REV. 1109, 1115 n.44 (1985).

¹¹ A necromancer can, among other things, conjure spirits from the dead. WEBSTER'S THIRD NEW INTERNATIONAL DICTIONARY 1511 (1986).

¹² 107 S. Ct. 1637 (1987).

¹³ Justice Powell wrote the majority opinion and was joined by Chief Justice Rehnquist and Justices Brennan, Marshall, and O'Connor. *Id.* at 1640. In *MITE*, Justice White wrote for a plurality. Parts I, II, and V-B became the opinion of the Court and were joined by Chief Justice Burger and Justices Stevens and O'Connor. See 457 U.S. at 626 n.1.

¹⁴ IND. CODE at §§ 23-1-42-1 to -10(a).

¹⁵ See *infra* notes 164-76 and accompanying text.

¹⁶ See *infra* notes 177-96 and accompanying text.

¹⁷ See *infra* notes 23-41 and accompanying text.

¹⁸ See *infra* notes 42-111 and accompanying text.

¹⁹ See *infra* notes 112-38 and accompanying text.

²⁰ See *infra* notes 139-96 and accompanying text.

²¹ See *infra* notes 197-239 and accompanying text.

²² See *infra* notes 240-58 and accompanying text.

I. THE WILLIAMS ACT

Regulation of cash tender offers at any level began with the enactment of the Securities Exchange Act of 1934,²³ as amended in 1968 by the Williams Act.²⁴ The legislative history behind the Act shows that Congress was trying "to protect the shareholders of target companies."²⁵ Prior to the enactment, a corporate raider could try to acquire control of a target corporation by using a cash tender offer without stating from where he got his money, who his associates were, or what his intentions were for the future of the target once acquired. Such secrecy enabled raiders to act quickly and silently, often forcing rushed decisions by the shareholders of the target.²⁶ To remedy these situations, the Act, among other things, prohibits an offeror from using the mails or any "instrumentality of interstate commerce" to make a tender offer for any class of a registered equity security if immediately after the consummation the offeror would be the owner of more than five percent of the class, unless the offeror first files specific information with the Securities and Exchange Commission.²⁷

²³ 15 U.S.C.A. §§ 78a-78kk (West 1981).

²⁴ 15 U.S.C.A. at §§ 78m(d)-(e), 78n(d)-(f).

²⁵ *Piper v. Chris-Craft Industries, Inc.*, 430 U.S. 1, 28 (1977). The Court quoted Sen. Kuchel as proof that "tender offerors were not the intended beneficiaries" of the Act:

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 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.

Id. (quoting 113 CONG. REC. 857-58 (1967)) (emphasis supplied by Supreme Court).

²⁶ H.R. 1711, 90th Cong., 2d Sess. § 2 (1968), *reprinted in* 1968 U.S. CODE CONG. & ADMIN. NEWS 2811, 2812. *See also* 113 CONG. REC. 24,664 (1967) (statement of Sen. Williams).

²⁷ 15 U.S.C.A. at § 78n(d)(1) in its entirety provides:

It shall be unlawful for any person, directly or indirectly, by use of the mails or by any means or instrumentality of interstate commerce or of any facility of a national securities exchange or otherwise, to make a tender offer for, or a request or invitation for tenders of, any class of any equity

Nevertheless, the Act was criticized for discouraging takeover bids "since they often serve a useful purpose by providing a check on entrenched but inefficient management."²⁸ These criticisms notwithstanding, the sponsoring Senator Williams replied that such discouragement could be justified as "but a small price to pay for adequate investor protection,"²⁹ and the bill was eventually passed.³⁰

In *Piper v. Chris-Craft Industries, Inc.*³¹ the Supreme Court concluded that Congress was adopting a "policy of neutrality in contests for control."³² The sole concern of Congress, the Court concluded, was the protection of investors who had been made an offer for their shares.³³ The Court re-emphasized in *Edgar v. MITE Corp.*³⁴ that neutrality was an important characteristic of

security which is registered pursuant to section 781 of this title, or any equity security of an insurance company which would have been required to be so registered except for the exemption contained in section 781(g)(2)(G) of this title, or any equity security issued by a closed-end investment company registered under the Investment Company Act of 1940, if, after consummation thereof, such person would, directly or indirectly, be the beneficial owner of more than 5 per centum of such class, unless at the time copies of the offer or request or invitation are first published or sent or given to security holders such person has filed with the Commission a statement containing such of the information specified in section 78m(d) of this title, and such additional information as the Commission may by rules and regulations prescribe as necessary or appropriate in the public interest or for the protection of investors. All requests or invitations for tenders or advertisements making a tender offer or requesting or inviting tenders of such a security shall be filed as part of such statement and shall contain such of the information contained in such statement as the Commission may by rules and regulations prescribe. Copies of any additional material soliciting or requesting such tender offers subsequent to the initial solicitation or request shall contain such information as the Commission may by rules and regulations prescribe as necessary or appropriate in the public interest or for the protection of investors, and shall be filed with the Commission not later than the time copies of such material are first published or sent or given to security holders. Copies of all statements, in the form in which such material is furnished by security holders and the Commission, shall be sent to the issuer not later than the date such material is first published or sent or given to any security holders.

²⁸ 113 CONG. REC. 24,664 (1967).

²⁹ *Id.*

³⁰ *See supra* note 24.

³¹ 430 U.S. 1 (1977).

³² *Id.* at 29.

³³ *Id.* at 35.

³⁴ 457 U.S. 624 (1982).

the Williams Act, which was designed to "avoid favoring either management or the takeover bidder."³⁵

Although both Congress and the Supreme Court considered neutrality a key component of the Williams Act, neither made clear whether such neutrality was a characteristic required to be present in any state regulation modeled after the Williams Act.³⁶ State and lower federal courts, however, embraced the idea that even-handed treatment of management and takeover bidders was mandatory.³⁷ This idea was likely the result of the *MITE* decision, even though the plurality's opinion did not mention neutrality as an affirmative regulatory goal.³⁸ In *CTS Corp. v.*

³⁵ *Id.* at 633.

³⁶ The district court in *Dynamics Corp. of America v. CTS Corp.*, 637 F. Supp. 389 (N.D. Ill. 1986), in granting a tender offeror's motion for declaratory judgment on the constitutionality of Indiana's state regulatory scheme, relied upon Justice Powell's concurrence in *MITE*, 457 U.S. 624, and noted that "[w]hether the policy of neutrality behind the Williams Act was but a characteristic of legislation directed toward investor knowledge, or was an affirmative regulatory goal, is in the abstract debatable." *Dynamics*, 637 F. Supp. at 396.

Justice Powell concurred in the judgment because he agreed that the takeover act violated the commerce clause. *MITE*, 457 U.S. at 654. However, Justice Powell was "not persuaded . . . 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." *Id.* at 655. In fact, *less* than a majority was so persuaded, and Part V-A, which contained the provision in question, did not become part of the plurality's opinion. *Id.* at 626.

³⁷ See, e.g., cases cited *supra* note 10.

³⁸ See *supra* note 36. The district court in *Dynamics* referred to Powell's concurrence as a "cautionary signal" that had been ignored by the state courts. *Dynamics*, 637 F. Supp. at 396.

Justice White in his dissent in *Dynamics* also believed that the *MITE* plurality had embraced neutrality as an affirmative goal:

[I]t is clear to me that Indiana's scheme conflicts with the Williams Act's careful balance which was intended to protect individual investors and permit them to decide whether it is in their best interests to tender their stock. *As noted by the plurality in MITE*, "Congress . . . did not want to deny shareholders 'the opportunities which result from the competitive bidding for a block of stock of a given company,' namely, the opportunity to sell shares for a premium over their market price."

Dynamics, 107 S. Ct. at 1654 (White, J., dissenting) (quoting *MITE*, 457 U.S. at 633, n.9) (emphasis added). White dissented partly because he believed the majority in *Dynamics* had confused the protection of the shareholders as a group with the protection of the individual investor, the latter being the policy of the Williams Act. The Indiana Act did not further this policy, according to White, and thus should be stricken as being against congressional policy. See *Dynamics*, 107 S. Ct. at 1654.

Dynamics Corp. of America,³⁹ the Court vocally supported any state law that furthers shareholder protection.⁴⁰ Yet, the question remains whether the statute approved by the Court actually favors shareholders, rather than management or offerors.⁴¹

II. *EDGAR V. MITE CORP.* AND THE DEATH OF STATE REGULATION

In 1982 the Supreme Court decided *Edgar v. MITE Corp.*⁴² and effectively put a stop to state regulation of cash tender offers. MITE, a Delaware corporation with its principal offices in Connecticut, attempted to acquire by a cash tender offer all of the outstanding shares of Chicago Rivet & Machine Co., an Illinois corporation.⁴³ In compliance with the Williams Act,⁴⁴ MITE filed a Schedule 14D-1⁴⁵ with the Securities and Exchange Commission, which stated that MITE was offering \$28 a share, four dollars greater than current over-the-counter prices of the same shares.⁴⁶

MITE, however, did not comply with the provisions of the Illinois Business Take-Overs Act,⁴⁷ but filed an action in federal district court⁴⁸ seeking a declaratory judgment that the Illinois Act violated the commerce clause⁴⁹ and was pre-empted by the

³⁹ 107 S. Ct. 1637 (1987).

⁴⁰ See *infra* text accompanying notes 216-19.

⁴¹ See *infra* text accompanying notes 210-16.

⁴² 457 U.S. 624 (1982).

⁴³ *Id.* at 626-27.

⁴⁴ 15 U.S.C.A. §§ 78m(d)-(e), 78n(d)-(f) (West 1981).

⁴⁵ A "Schedule 14D-1," named after § 14(d)(1) of the Securities and Exchange Act of 1934, requires a takeover offeror who seeks to acquire more than 5% of any class of equity security, voting or non-voting, to disclose the source of funds used to acquire the shares, any past transactions with the target company, and any anti-trust considerations or other problems that might result from the offer. *MITE*, 457 U.S. at 627-28 n.2 (citing 17 C.F.R. § 240.14d-100 (1981)). A copy of the schedule must be sent to the target's shareholders. *Id.*

⁴⁶ *Id.* at 627-28.

⁴⁷ 1978 Ill. Laws 80-1421 (codified at ILL. REV. STAT. ch. 121 1/2, ¶ 137.51 (1979)) (repealed 1983).

⁴⁸ The Northern District of Illinois (unreported opinion).

⁴⁹ U.S. CONST. art. I, § 8, cl. 3. The commerce clause provides: "Congress shall have Power . . . [t]o regulate Commerce among the several states."

Williams Act.⁵⁰ Illinois Secretary of State James Edgar responded on February 1, 1979, by notifying MITE that he "intended to issue an order requiring it to cease and desist further efforts to make a tender offer for Chicago Rivet."⁵¹ The next day the district court "issued a preliminary injunction prohibiting the Secretary of State from enforcing the Illinois Act against the takeover offer."⁵² On February 9, the court entered final judgment, agreeing with MITE's pre-emption and commerce clause arguments.⁵³ The United States Court of Appeals for the Seventh Circuit affirmed.⁵⁴ The Supreme Court, after noting that the case was not moot,⁵⁵ affirmed the decision of the lower courts two years later.⁵⁶

A. *The Illinois Act*

The purpose of the Illinois Act was to protect "the interests of Illinois security holders of companies having a close connection with [Illinois] without unduly impeding take-over offers, and . . . [strike] a balance that does not favor either management of a target company⁵⁷ or an offeror."⁵⁸ The Act required an

⁵⁰ See *MITE*, 457 U.S. at 628. By arguing that the Williams Act pre-empted the Illinois Act, MITE was arguing that the Illinois Act was unconstitutional under the supremacy clause, U.S. CONST. art. I, § 6, cl. 2, which provides that: "This Constitution, and the Laws of the United States which shall be made in Pursuance thereof . . . shall be the Supreme law of the land. . . ."

⁵¹ *MITE*, 457 U.S. at 629.

⁵² *Id.*

⁵³ See *id.*

⁵⁴ See *MITE Corp. v. Dixon*, 633 F.2d 486, 488 (7th Cir. 1980).

⁵⁵ MITE never actually went through with its tender offer. Chicago Rivet competed with MITE by offering \$30 a share. Subsequently, MITE and Chicago Rivet agreed to withdraw their offers, and MITE agreed to either offer \$31 a share by March 12, 1979, or otherwise decide not to acquire Chicago Rivet's shares. MITE elected to not make an offer. See *MITE*, 457 U.S. at 629.

The court of appeals held that the case was not moot since Secretary Edgar had voiced his intention to enforce the Act as against MITE, and therefore, should the district court's judgment be reversed, MITE would be liable criminally and civilly. See *MITE*, 633 F.2d at 490.

The Supreme Court agreed with the court of appeals' assessment of MITE's situation and agreed that the case was not moot. See *MITE*, 457 U.S. at 630.

⁵⁶ See *id.*

⁵⁷ "Target company" as defined by the Act means:

a corporation or other issuer of securities (1) of which 10% of the out-

offeror to file with the Illinois Secretary of State a registration statement that publicly disclosed the intent to make a takeover offer and the material terms of such offer.⁵⁹ In addition, the following information had to be included in the registration statement: (1) the identity of and material information about the offeror, (2) the sources and amounts of funds to be used in acquiring the shares, (3) the purposes of the takeover including whether the offeror intended to liquidate, partially liquidate, or otherwise make a material change in the structure of the target corporation, (4) the number of shares of the target company already owned by the offeror (in addition to any rights the offeror may have to direct the voting of other shares), and (5) any contracts, deals, arrangements or negotiations currently underway which involve directly or indirectly the target's shares.⁶⁰ Failure to comply with these provisions was unlawful and subject to criminal as well as civil liability.⁶¹

After filing, an offeror had to wait twenty business days before the offer became effective. During this time, the offeror

standing securities of the class of its equity securities which is the subject of a take-over offer is held of record by securityholders located in [Illinois] as determined by post office address as shown on the records of the issuer, or (2) which meets any two of the following conditions:

- (a) has its principal executive office in [Illinois];
- (b) is organized under the laws of [Illinois];
- (c) has at least 10% of its stated capital and paid-in surplus represented in [Illinois].

1978 Ill. Laws 80-1421 § 2.10.

⁵⁸ *Id.* at § 1.1. An "offeror" is defined as:

a person who makes or in any way participates in making a take-over offer, and includes all affiliates of that person. The term does not include a financial institution or dealer loaning funds, or extending credit to any offeror in the ordinary course of its business, or any accountant, attorney, financial institution, dealer, soliciting dealer, newspaper or magazine of general circulation, consultant, or other person, furnishing information, services, or advice to, or performing ministerial or administrative duties for, an offeror and not otherwise participating in the takeover offer.

Id. at § 2.05.

⁵⁹ *See id.* at § 4B.

⁶⁰ *See id.* at § 4C(1)-(8).

⁶¹ *See id.* at § 14. Violators of the Act, depending upon which parts of the Act were violated, could be guilty of a Class A misdemeanor or a Class 4 felony or both. *See id.* at §§ 14A-B.

could disseminate information concerning the offer, but could not make or consummate the actual offer itself.⁶²

B. *The Pre-emption Analysis*

The Supreme Court began its pre-emption analysis by noting that while Congress enacted the Williams Act as an amendment to the Securities and Exchange Act of 1934, Congress chose not to amend section 28(a) of the 1934 Act.⁶³ Section 28(a) provides that “[n]othing in this title shall affect the jurisdiction of the securities commission (or any agency or officer performing like functions) of any [s]tate over any security or any person insofar as it does not conflict with the provisions of this title or the rules and regulations thereunder.”⁶⁴ Therefore, the Court reasoned, a state statute was void only if it “actually conflict[ed]” with a federal law.⁶⁵ A conflict exists “where compliance with both federal and state regulation is a physical impossibility . . .,”⁶⁶ or “where the state ‘law stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.’”⁶⁷ Since MITE did not allege that compliance with both the Illinois Act and the Williams Act was impossible, the Court limited its analysis to “whether the Illinois Act frustrate[d] the objectives of the Williams Act. . . .”⁶⁸

The Court agreed with the court of appeals that there were three provisions of the Illinois Act that stood as “obstacles to the accomplishment and execution of the full purposes and objectives of Congress.”⁶⁹ First, the provision for a twenty-business-day wait after filing, after which the takeover offer becomes effective,⁷⁰ had no counterpart in the Williams Act.⁷¹ Under the Williams Act, “there is no precommencement notifi-

⁶² See *id.* at §§ 4E, 8(1).

⁶³ 15 U.S.C.A. at § 78bb(a).

⁶⁴ *MITE*, 457 U.S. at 631 (quoting 15 U.S.C.A. § 78bb(a)).

⁶⁵ See *id.* at 631.

⁶⁶ *Id.* (quoting *Florida Lime & Avocado Growers, Inc. v. Paul*, 373 U.S. 132, 142-43 (1963)).

⁶⁷ *Id.* (quoting *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941)).

⁶⁸ *Id.* at 631-32.

⁶⁹ *Id.* at 634.

⁷⁰ *Id.* at 634-35. See *supra* note 62 and accompanying text.

⁷¹ *MITE*, 457 U.S. at 635.

cation requirement; the critical date is the date a tender offer is 'first published or sent or given to security holders.'⁷² The Court held that:

[B]y providing the target company with additional time within which to take steps to combat the offer, the precommencement notification provisions furnish incumbent management with a powerful tool to combat tender offers, perhaps to the detriment of the stockholders who will not have an offer before them during this period. These consequences are precisely what Congress determined should be avoided, and for this reason, the precommencement notification provision frustrates the objectives of the Williams Act.⁷³

The second objectionable provision of the Illinois Act was a hearing provision⁷⁴ that introduced "extended delay into the tender offer process."⁷⁵ The Court found of chief importance the fact that there was no absolute deadline for the hearing's completion.⁷⁶ The Court explained that since under the terms of the provision management will almost always insist upon a hear-

⁷² *Id.* (quoting 15 U.S.C.A. at § 78n(d)(1)).

⁷³ *MITE*, 457 U.S. at 635 (footnotes omitted). The Court noted that Congress had chosen not to adopt a precommencement disclosure requirement three times in the past. In 1965, Sen. Williams proposed a 20-day requirement that the S.E.C. deemed unnecessary for shareholder protection. *See id.* (quoting 112 CONG. REC. 19,005 (1966)). In 1967, Sen. Williams tried again, this time introducing a five-day precommencement disclosure requirement. Again the bill was rejected. *See id.* at 636. Finally, a third attempt was rebutted in 1970. *See id.*

⁷⁴ 1978 Ill. Laws 80-1421 § 7A-E. Subsection A provides in full:

The Secretary shall call a hearing if the Secretary deems it necessary for the protection of offerees in [Illinois] or if within 15 business days after the date of filing the registration statement a written request for a hearing is submitted to the Secretary, by a majority of the directors of the target company who are not officers or employees of the target company or by a person or persons who are located in [Illinois] as determined by post office addresses as shown on the records of the target company and who hold of record or beneficially, or both, at least 10% of the outstanding shares of any class of equity securities which is the subject of the take-over offer.

⁷⁵ *MITE*, 457 U.S. at 637.

⁷⁶ *See id.* Subsection 7D of the Illinois Act provides in full that "[a] determination shall be made within 15 business days after the conclusion of the hearing, *unless such time is extended* by the Secretary as being in the interest of offerees in this state." 1978 Ill. Law 80-1421 § 7D (emphasis added).

ing,⁷⁷ management would have a “ ‘powerful weapon to stymie indefinitely a takeover.’ ”⁷⁸ Such “ ‘potential for delay provided by the hearing provisions upset the balance struck by Congress. . . .’ ”⁷⁹

Finally, the Court agreed with the court of appeals that the Illinois Act was pre-empted “ ‘insofar as it allow[ed] the Secretary of State . . . to pass on the substantive fairness of a tender offer.’ ”⁸⁰ The legislative history of the Williams Act indicated that “ ‘Congress intended for investors to be free to make their own decisions. . . . The act was ‘designed to make the relevant facts known so that *shareholders* have a fair opportunity to make their decision.’ ”⁸¹ The Court quoted the court of appeals: “ ‘[t]he state thus offers investor protection at the expense of investor autonomy—an approach quite in conflict with that adopted by Congress.’ ”⁸²

C. *The Commerce Clause Analysis*

The Supreme Court then held that the Illinois statute was invalid under the commerce clause by applying the test in *Pike*

⁷⁷ See *MITE*, 457 U.S. at 637. Management need only control 10% of its company's shares to insist on a hearing. See also 1978 Ill. Laws 80-1421, § 7A.

⁷⁸ *MITE*, 457 U.S. at 637 (quoting *MITE Corp. v. Dixon*, 633 F.2d 486, 494 (7th Cir. 1980)).

⁷⁹ *MITE*, 457 U.S. at 639. The Court cited numerous authorities that Congress was against any delay which might successfully thwart a takeover offer. See, e.g., *Great W. United Corp. v. Kidwell*, 577 F.2d 1256, 1277 (5th Cir. 1978). The Court noted the position of the S.E.C. as explained in the S.E.C.'s Brief for Securities and Exchange Commission as Amicus Curiae at 10 n.8:

[D]elay enables a target company to:

- “(1) repurchase its own securities;
- “(2) announce dividend increases or stock splits;
- “(3) issue additional shares of stock;
- “(4) acquire other companies to produce an antitrust violation should the tender offer succeed;
- “(5) arrange a defensive merger;
- “(6) enter into restrictive loan agreements; and
- “(7) institute litigation challenging the tender offer.”

MITE, 457 U.S. at 638 n.13.

⁸⁰ *Id.* at 639. The Court was referring to 80-1421 § 7E which required the Secretary of State to deny registration of a takeover offer if, *inter alia*, he found that the takeover offer was “ ‘inequitable.’ ” *Id.*

⁸¹ *MITE*, 457 U.S. at 639 (quoting H.R. 1711, 90th Cong., 2d Sess. 4 (1968)) (emphasis added).

⁸² *Id.* at 640 (quoting *Dixon*, 633 F.2d at 494).

v. *Bruce Church, Inc.*⁸³ The Court noted that “[a] state statute must be upheld if it ‘regulates evenhandedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental . . . unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits.’ ”⁸⁴ Adopting the language of *Shafer v. Farmer’s Grain Co.*,⁸⁵ the plurality found that the Illinois Act directly regulated and prevented interstate takeover offers.⁸⁶ Furthermore, “the burden the Act impose[d] on interstate commerce [was] excessive in light of the local interests the Act purport[ed] to further.”⁸⁷

1. “Direct” Regulation of Interstate Commerce

Although states have been free to enact “blue-sky” laws,⁸⁸ which regulate intrastate securities,⁸⁹ such freedom has been allowed by the courts because the laws “only regulated trans-

⁸³ 397 U.S. 137 (1970).

⁸⁴ *MITE*, 457 U.S. at 640 (quoting *Pike*, 397 U.S. at 142). The Court in *Pike* went on to say that “[i]f a legitimate local purpose is found, then the question becomes one of degree. . . . Occasionally the Court has candidly undertaken a balancing approach in resolving these issues, [citations], but more frequently it has spoken in terms of ‘direct’ and ‘indirect’ effects and burdens.” *Pike*, 397 U.S. at 142 (quoting *Shafer v. Farmer’s Grain Co.*, 268 U.S. 189, 199 (1925)).

⁸⁵ 268 U.S. 189, 199 (1925).

⁸⁶ *MITE*, 457 U.S. at 640.

⁸⁷ *Id.* The Court stated that the “most obvious” burden was the: nationwide reach which purports to give Illinois the power to determine whether a tender offer may proceed anywhere. . . . Shareholders are deprived of the opportunity to sell their shares at a premium. The reallocation of economic resources to their highest valued use, a process which can improve efficiency and competition, is hindered. The incentive the tender offer mechanism provides incumbent management to perform well so that stock prices remain high is reduced.

Id. at 643. The local interests which the Act purported to further were not given much weight: “While protecting local investors is plainly a legitimate state objective, the State has no legitimate interest in protecting nonresident shareholders.” *Id.* at 644. The Court also doubted that the Illinois Act added any significant protections to the shareholders that were not already provided by the Williams Act. *See id.*

⁸⁸ “Blue-Sky” laws are “state statutes [which provide] for the regulation and supervision of securities offerings and sales, for the protection of citizen-investors from investing in fraudulent companies. . . . [Such statutes are called ‘blue-sky’ laws] because [they pertain] to speculative schemes which have no more basis than so many feet of blue sky.” *BLACK’S LAW DICTIONARY* 157 (5th ed. 1979).

⁸⁹ *See MITE*, 457 U.S. at 641.

actions occurring within the regulating [s]tates.”⁹⁰ Whenever such laws affected interstate commerce, it was only “incidentally.”⁹¹ However, the Court observed, the Illinois Act went further than the scope of any constitutionally valid blue-sky law because it directly regulated transactions that took place outside of Illinois.⁹² Tender offers are normally communicated to shareholders everywhere through the mails or some other method of interstate commerce.⁹³ Since MITE was a Delaware corporation and Chicago Rivet’s shareholders resided in Illinois and elsewhere,⁹⁴ some method of interstate trafficking had to be used in order to make the tender.⁹⁵ The Illinois Act, “unless complied with, sought to prevent MITE from making its offer and concluding interstate transactions not only with Chicago Rivet’s stockholders living in Illinois, but also with those living in other States and having no connection with Illinois.”⁹⁶ More significantly, the Illinois Act could have prevented a takeover even if the corporation was not organized under the laws of Illinois and there had not been a single shareholder of Chicago Rivet residing in Illinois.⁹⁷ Such “sweeping extraterritorial effect” made the Illinois Act a “direct restraint on interstate commerce.”⁹⁸ This logic did not represent the views of a majority of the Court, however. Only Chief Justice Burger, Justice Stevens and Justice O’Connor joined this part of Justice White’s opinion.⁹⁹ Nevertheless, a majority of the Court did find a violation of the commerce clause under another test.

⁹⁰ *Id.* (citing *Hall v. Geiger-Jones Co.*, 242 U.S. 539, 557-58 (1917)).

⁹¹ *See id.* (quoting *Hall*, 242 U.S. at 557-58)).

⁹² *See id.*

⁹³ *See id.*

⁹⁴ Approximately 27% of Chicago Rivet’s stockholders were residents of Illinois. *See id.* at 642.

⁹⁵ *See id.*

⁹⁶ *Id.*

⁹⁷ *See id.* The Illinois Act applied when *any two* of the following conditions existed: (1) the corporation had its executive office in Illinois, (2) was organized under the laws of Illinois, or (3) had at least 10% of its stated capital and paid-in surplus represented by stockholders who were residents of Illinois. *See supra* note 57.

⁹⁸ *MITE*, 457 U.S. at 642.

⁹⁹ *See id.* at 626.

2. *Excessive Burden on Interstate Commerce*

The Supreme Court applied the *Pike* test¹⁰⁰ and found that even though, *arguendo*, the Illinois Act may be said to have “indirectly” regulated interstate commerce, such regulation was too burdensome.¹⁰¹ An obvious burden which the Act placed on interstate commerce was the “nationwide reach” of the Act that gave Illinois the power to prevent takeover offers which occurred outside of Illinois.¹⁰² The state’s interest in protecting local affairs was a valid one, but the Court found no legitimate interest in protecting nonresident stockholders.¹⁰³

Finally, the Court rejected an argument by the Illinois Secretary of State that Illinois had “an interest in regulating the internal affairs of a corporation incorporated under its laws.”¹⁰⁴ The Court explained that takeover offers are not considered to involve internal affairs of a corporation. “Tender offers contemplate transfers of stock by stockholders to a third party and do not themselves implicate the internal affairs of the target company.”¹⁰⁵ In addition, the Act could apply to a corporation which is not an Illinois corporation and which does not have its principal place of business in the state, since the Act applies to takeover offers of *any* corporation which has ten percent of its shares owned by Illinois residents.¹⁰⁶

After this analysis, the Supreme Court affirmed the court of appeals’ decision striking down the Illinois Act as unconstitu-

¹⁰⁰ See *supra* notes 83-84 and accompanying text.

¹⁰¹ *MITE*, 457 U.S. at 643-46.

¹⁰² See *supra* notes 92-99 and accompanying text. Apparently, while a majority of the court was not willing to call such pervasive reach a “direct” regulation of interstate commerce, a majority was willing to call it a “burden.”

¹⁰³ See *MITE*, 457 U.S. at 644.

¹⁰⁴ *Id.* at 645.

The internal affairs doctrine is a conflict of laws principle which recognizes that only one State should have the authority to regulate a corporation’s internal affairs [which include] matters peculiar to the relationships among or between the corporation and its current officers, directors, and shareholders—because otherwise a corporation could be faced with conflicting demands.

Id. (citing RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 302 comment b (1971)).

¹⁰⁵ *Id.*

¹⁰⁶ See *id.*; see also 1978 Ill. Laws 80-1421 § 2.10(1).

tional. However, the fragmented decision left some clues that state regulation of tender offers might not be completely dead. Justice Powell concurred with the "burden on interstate commerce" analysis because "its Commerce Clause reasoning [left] some room for state regulation of tender offers."¹⁰⁷ Justice Stevens joined Justice White's commerce clause analysis but elected against joining the pre-emption segment.¹⁰⁸ Justice O'Connor also joined in the commerce clause reasoning but thought the pre-emption issue was unnecessarily decided.¹⁰⁹ Justice Marshall dissented, finding the case moot, and was joined by Justice Brennan.¹¹⁰ Justice Rehnquist also found the case non-justiciable.¹¹¹ The *MITE* decision, then, did not stand on the most solid of foundations. Yet in the years that followed *MITE*, courts struck down a vast array of tender offer statutes as if the Supreme Court had laid down a unanimous mandate that states were to steer clear of takeover offer regulation. The highly fragmented *MITE* decision should have been recognized as a harbinger that the last word in state regulation of tender offers had not been written.

III. THE SECOND GENERATION TAKEOVER STATUTES

After the *MITE*¹¹² decision, several states went back to the drawing board in an effort to correct the flaws that were fatal to the Illinois statute. Generally, three "types"¹¹³ of statutes emerged, and each type has been named for the state which originally brought it into existence.

¹⁰⁷ *MITE*, 457 U.S. at 646 (Powell, J., concurring in part).

¹⁰⁸ *Id.* at 654-55 (Stevens, J., concurring in part and concurring in the judgment).
See supra note 13 and accompanying text.

¹⁰⁹ *MITE*, 457 U.S. at 655 (O'Connor, J., concurring in part).

¹¹⁰ *See id.* (Marshall, J., dissenting).

¹¹¹ *See id.* at 664 (Rehnquist, J., dissenting).

¹¹² *Edgar v. MITE Corp.*, 457 U.S. 624 (1982).

¹¹³ Lipton & Brownstein, *Takeover Responses and Directors' Responsibilities—An Update*, 40 BUS. LAW. 1403, 1429-30 (1985). "Type" is the word chosen by Mr. Lipton and Mr. Brownstein. They provide a basic description of each type. Because of the impossibility of improving upon their already concise and informative analyses of these statutes, this author will attempt to do no more than paraphrase Mr. Lipton's and Mr. Brownstein's ideas. The reader is encouraged to look to their article and the statutes themselves for the exact wording.

A. *The Ohio Type*

Ohio's law¹¹⁴ requires shareholder approval prior to the consummation of any tender offer, public or private, for shares whose percentage of the corporation totalled above 20%, 33 1/3%, and 50% thresholds.¹¹⁵ If a quorum of the disinterested shareholders then voted on the tender offer, and a majority of these votes were in favor of the offer, then the purchase would be authorized.¹¹⁶ A corporation could opt out of the statute's application if its by-laws or articles of incorporation expressly provided.¹¹⁷ Minnesota¹¹⁸ and Wisconsin¹¹⁹ have enacted similar statutes.¹²⁰

This type of statute was viewed as a "promising alternative" to the Illinois Act:¹²¹

The *MITE* opinion apparently leaves room for regulation of a corporation's internal affairs. Justice White wrote in his Commerce Clause analysis that "tender offers . . . do not *themselves* implicate the internal affairs of the target company." The Ohio Act, however, does not purport to regulate tender offers themselves. . . . Rather, . . . [the Act] regulates acquisitions of controlling interests of corporate stock—fundamental changes in the internal structure of corporations.¹²²

The Ohio Act had the additional saving grace of applying only to Ohio corporations that have their principal place of business, principal executive offices, or substantial assets located in that state.¹²³ Thus, while the Act seemed to fit within the constitu-

¹¹⁴ OHIO REV. CODE ANN. § 1701.83.1 (Anderson 1985).

¹¹⁵ See *id.* at 1701.01(Z)(1). Obtaining voting power at any of these three levels is classified as a "control share acquisition." *Id.*

¹¹⁶ See *id.* at § 1701.83.1(E)(1). In addition, the acquisition must be consummated "not later than three hundred sixty days following shareholder authorization of the control share acquisition." *Id.*

¹¹⁷ See *id.* at § 1701.83.1(A).

¹¹⁸ MINN. STAT. ANN. § 302A.671 (West Supp. 1985).

¹¹⁹ WIS. STAT. ANN. § 180.69 (West Supp. 1984-85) (repealed 1985).

¹²⁰ See Lipton & Brownstein, *supra* note 113, at 1429.

¹²¹ Note, *The Constitutionality of Alaska's Takeover Bid Disclosure Act*, 1 ALASKA L. REV. 335, 346 (1984).

¹²² *Id.* at 347 (quoting *MITE*, 457 U.S. at 645) (emphasis in original).

¹²³ See OHIO REV. CODE ANN. at § 1701.01(Y). This section defines "issuing public corporation" to which section 1701.83.1 purports to apply. See *id.* at § 1701.83.1(A).

tional guidelines set out by *MITE*, much of the state's power was necessarily limited.

B. *The Maryland Type*

Maryland's Act¹²⁴ imposed super majority voting requirements for mergers, sales of assets, liquidations, and recapitalizations (excluding takeover offers) between an in-state corporation and an interested shareholder, unless the transaction met fair price requirements set forth in the statute.¹²⁵ If such fair price requirements¹²⁶ were not met, approval could be obtained only

¹²⁴ MD. CORPS. & ASS'NS CODE ANN. §§ 3-601 - 3-603 (1984) (amended 1985).

¹²⁵ See *id.* at § 3-601(e)(1)-(5).

¹²⁶ See *id.* at § 3-603(b)(1)-(2). The section provides for an exemption from § 3-602 if each of the following conditions is met:

(1) The aggregate amount of the cash and the market value as of the valuation date of consideration other than cash to be received per share by holders of common stock in such business combination is at least equal to the highest of the following:

(i) The highest per share price (including any brokerage commissions, transfer taxes and soliciting dealers' fees) paid by the interested stockholder for any shares of common stock of the same class or series acquired by it:

1. Within the 2 year period immediately prior to the announcement date of the proposal of the business combination; or
2. In the transaction in which it became an interested stockholder, whichever is higher; or

(ii) The market value per share of common stock of the same class or series on the announcement date or on the determination date, whichever is higher; or

(iii) The price per share equal to the market value per share of common stock of the same class or series determined pursuant to subparagraph (ii) of this paragraph, multiplied by the fraction of:

1. The highest per share price (including any brokerage commissions, transfer taxes and soliciting dealers' fees) paid by the interested stockholders for any shares of common stock of the same class or series acquired by it within the 2 year period immediately prior to the announcement date, over
2. The market value per share of common stock of the same class or series on the first day in such 2 year period on which the interested stockholder acquired any shares of common stock.

(2) The aggregate amount of the cash and the market value as of the valuation date of consideration other than cash to be received per share by holders of shares of any class or series of outstanding stock other than common stock is at least equal to the highest of the following (whether or not the interested stockholder has previously acquired any shares of a

by *both* an 80% vote of all outstanding shares *and* a 66 2/3% vote of all disinterested shares.¹²⁷ Like the Ohio statute, a corporation could opt out of the Act's application.¹²⁸ Connecticut,¹²⁹ Kentucky,¹³⁰ Michigan,¹³¹ and Wisconsin¹³² all enacted statutes similar to that of Maryland.¹³³

C. *The Pennsylvania Type*

Pennsylvania's statute¹³⁴ requires the acquirer of 30% or more of a Pennsylvania corporation's voting shares to pay a

particular class or series of stock):

(i) The highest per share price (including any brokerage commissions, transfer taxes and soliciting dealers' fees) paid by the interested stockholder for any shares of such class of stock acquired by it:

1. Within the 2 year period immediately prior to the announcement date of the proposal of the business combination; or
2. In the transaction in which it became an interested stockholder, whichever is higher; or

(ii) The highest preferential amount per share to which the holders of shares of such class of stock are entitled in the event of any voluntary or involuntary liquidation, dissolution or winding up of the corporation; or

(iii) The market value per share of such class of stock on the announcement date or on the determination date, whichever is higher; or

(iv) The price per share equal to the market value per share of such class of stock determined pursuant to subparagraph (iii) of this paragraph, multiplied by the fraction of:

1. The highest per share price (including any brokerage commissions, transfer taxes and soliciting dealers' fees) paid by the interested stockholder for any shares of any class of voting stock acquired by it within the 2 year period immediately prior to the announcement date, over
2. The market value per share of the same class of voting stock on the first day in such 2 year period on which the interested stockholder acquired any shares of the same class of voting stock.

¹²⁷ See *id.* at § 3-602(1)-(2).

¹²⁸ See *id.* at § 3-603(c).

¹²⁹ See 1984 CONN. ACTS § 84-431 (Reg. Sess.).

¹³⁰ See KY. REV. STAT. ANN. § 271A.397-.399 (Baldwin 1984) (renumbered 271B.12-210 to .12-230 effective Jan. 1, 1989).

¹³¹ See MICH. COMP. LAWS ANN. § 450.1775-.1784 (West 1984).

¹³² See WIS. STAT. ANN. at § 180.725 (amended 1983). Note that Wisconsin's statute contains attributes of both the Ohio type and the Maryland type.

¹³³ See Lipton & Brownstein, *supra* note 113 at 1429-30.

¹³⁴ PA. STAT. ANN. tit. 15, § 1910 (Purdon Supp. 1987).

“fair value” price to any remaining shareholders desiring to sell their shares.¹³⁵ A corporation had the opportunity to opt out if, within ninety days after enactment, the corporation amended its by-laws accordingly.¹³⁶

Both the Maryland and Pennsylvania type statutes are “fair value” statutes and, as such, have been highly praised as “comport[ing] with the goals of tender offer regulation.”¹³⁷

The Maryland and Pennsylvania statutes have been narrowly tailored to achieve [the] legitimate state interests [of regulating the internal affairs of domestic corporations and protecting local shareholders]. They apply only to domestic corporations and become effective only after the offeror has become a shareholder of significant size. Further, they are directed at the fairness of transactions, an area historically left to the states. Lastly, they are simply extensions of traditional state internal affairs regulation of appraisal rights and shareholder approval of mergers.¹³⁸

Again, although the pitfalls of *MITE* were apparently avoided, any teeth left in the statutes were baby teeth. Indiana found the choice of statute types unacceptable and proceeded to enact a statute with a healthier set of orthodontia. Indiana did take one hint from the statutes—the internal affairs doctrine *was* made a more central feature of the statute.

¹³⁵ See *id.* at § 1910E:

A shareholder making written demand . . . shall be entitled to receive cash for each of his shares in an amount equal to the fair value of each voting share as of the day prior to the date on which the control transaction occurs, taking into account all relevant factors, including in increment representing a proportion of any value payable for acquisition of control of the corporation. Either the controlling person or group or the shareholder may proceed under subsections F through I of section 515 for a determination of the fair value of such share as defined in this subsection.

¹³⁶ See *id.* at § 1910A.

¹³⁷ Bainbridge, *State Takeover and Tender Offer Regulations Post-MITE: The Maryland, Ohio and Pennsylvania Attempts*, 90 *DICK. L. REV.* 731, 774 (1986).

¹³⁸ *Id.* at 773. Incidentally, Mr. Bainbridge dismissed the Ohio type statute as unconstitutional because it went beyond the traditional limits of the internal affairs doctrine by governing shareholder relations with non-shareholders. See *id.* at 775.

IV. CTS CORP. v. DYNAMICS CORP. OF AMERICA: THE REBIRTH OF STATE REGULATION

In *CTS Corp. v. Dynamics Corp. of America*,¹³⁹ the Supreme Court once again addressed the question of how far a state may go in regulating tender offers in an effort to protect resident shareholders. At issue was whether the Indiana Business Corporation Law¹⁴⁰ was constitutional, notwithstanding *Edgar v. MITE Corp.*,¹⁴¹ which was decided four years prior to the enactment of the Indiana statute.

A. *The Indiana Act*

In 1986 the Indiana legislature enacted the Business Corporation Law, a part of which was the Control Shares Acquisitions Chapter.¹⁴² Under the Act (unless a corporation elected to opt out of its application before August 1, 1987),¹⁴³ any Indiana corporation which is an "issuing public corporation" is subject to the provisions of the Control Shares Acquisitions Chapter.¹⁴⁴ An "issuing public corporation" is defined by the Act to be:

[A] corporation that has:

- (1) One hundred (100) or more shareholders;
- (2) Its principal place of business, its principal office, or substantial assets within Indiana; and
- (3) Either:
 - (A) More than ten percent (10%) of its shareholders resident in Indiana;
 - (B) More than ten percent (10%) of its shares owned by Indiana residents; or
 - (C) Ten thousand (10,000) shareholders resident in Indiana.¹⁴⁵

¹³⁹ 107 S. Ct. 1637 (1987).

¹⁴⁰ IND. CODE ANN. §§ 23-1-17-1 to -54-2 (Burns Supp. 1986) (various sections amended 1987 and 1988).

¹⁴¹ 457 U.S. 624 (1982).

¹⁴² IND. CODE ANN. at §§ 23-1-42-1 to -11.

¹⁴³ *Id.* at § 23-1-42-5.

¹⁴⁴ *See id.*

¹⁴⁵ *Id.* at § 23-1-42-4(a).

The Court summarized the material provisions of the Act as follows:

The Act focuses on the acquisition of “control shares” in an issuing public corporation. . . . [A]n entity acquires “control shares” whenever it acquires shares that, but for the operation of the Act, would bring its voting power in the corporation to or above any of three thresholds: 20%, 33 1/3%, or 50%.¹⁴⁶

Once an entity acquires the control shares, it can vote the shares only “to the extent granted by resolution approved by the shareholders of the issuing public corporation.”¹⁴⁷ A majority vote of the disinterested¹⁴⁸ shareholders of each class is necessary before the acquiring corporation can vote its shares.¹⁴⁹ Thus, the pre-existing disinterested stockholders effectively have the power to decide whether the merger can go through.¹⁵⁰

The shareholders have fifty days to hold a special meeting, after the acquiring corporation demands such meeting, to vote and decide whether to allow the acquirer to vote its shares.¹⁵¹ If the shareholders choose not to restore the voting rights, the corporation may redeem the acquired shares if redemptions are permitted under the target corporation’s own articles or bylaws. However, there is no requirement that the target must do so.¹⁵²

¹⁴⁶ *Dynamics*, 107 S. Ct. at 1641 (quoting IND. CODE ANN. § 23-1-42-1).

¹⁴⁷ *Id.* (quoting IND. CODE ANN. § 23-1-42-9(a)).

¹⁴⁸ “Disinterested” shares are those shares which are not “interested” shares; “interested” shares are defined by the Act to mean:

[T]he 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.
- (3) Any employee of the issuing public corporation who is also a director of the corporation.

IND. CODE ANN. at § 23-1-42-3.

¹⁴⁹ *Dynamics*, 107 S. Ct. at 1641 (citing IND. CODE ANN. § 23-1-42-9(b)).

¹⁵⁰ *Id.*

¹⁵¹ *See* IND. CODE ANN. at § 23-1-42-7.

¹⁵² *See id.* at § 23-1-42-10. Even if the target corporation decides to redeem the shares, the redemption price may not necessarily allow the acquiring corporation to get back all of its investment. The shares are redeemable at their fair market value, and any control premium paid over this amount will not be recoverable. *See id.*

B. *The Facts of the Case*

On March 10, 1986, Dynamics Corporation of America (Dynamics) owned slightly under ten percent of the stock of an Indiana corporation, CTS Corporation (CTS). On that date, Dynamics publicly declared a tender offer for enough shares to put it above the twenty percent threshold.¹⁵³ Relying upon the *MITE* decision, Dynamics, on March 31, sought to have the Indiana Act declared unconstitutional under the supremacy clause and the commerce clause. The United States District Court for the Northern District of Illinois granted declaratory relief to Dynamics,¹⁵⁴ holding that the Act “wholly frustrat[ed] the purpose and objective of Congress in striking a balance between the investor, management, and the takeover bidder in takeover contests.”¹⁵⁵ One week later, the district court agreed with Dynamics’ commerce clause arguments and held that the Act “create[d] an impermissible indirect burden on interstate commerce.”¹⁵⁶ Because a majority of courts had held that state laws which unfairly advantaged management in takeover battles were in conflict with the Williams Act, despite the “cautionary signals” of *MITE*, the court “accept[ed] as given” that the Indiana Act was also invalid under the supremacy clause.¹⁵⁷

On appeal, the Court of Appeals for the Seventh Circuit affirmed the lower court’s decision and re-examined Dynamics’ pre-emption argument.¹⁵⁸ The court found the rationale of *MITE* to be “straightforward” in its application:

The Indiana statute upsets the balance struck by the Williams Act. Whether it does so more than the Illinois statute struck down in *MITE* is hard to say. The statutes are incommensurable. . . . If we had to guess we would guess that the Indiana statute is less inimical to the tender offer, but that is unimportant. The Indiana statute is a lethal dose; the fact that the Illinois statute may have been two or three lethal doses has no

¹⁵³ See *Dynamics*, 107 S. Ct. at 1642. Dynamics’ ownership would have been increased to 27.5%. See *id.*

¹⁵⁴ *Dynamics Corp. of America v. CTS Corp.*, 637 F. Supp. 389 (N.D. Ill. 1986).

¹⁵⁵ *Id.* at 399.

¹⁵⁶ *Id.* at 406.

¹⁵⁷ See *id.* at 396-97.

¹⁵⁸ *Dynamics Corp. of America v. CTS Corp.*, 794 F.2d 250 (7th Cir. 1986).

practical significance. . . . In any event, if the Williams Act is to be taken as a congressional determination that a month (roughly)¹⁵⁹ is enough time to force a tender offer to be kept open, 50 days is too much; and 50 days is the minimum under the Indiana Act if the target corporation so chooses.¹⁶⁰

The court then went on to affirm the commerce clause challenge¹⁶¹ and the internal affairs challenge.¹⁶²

On April 21, 1987, the Supreme Court reversed.¹⁶³

C. *The Pre-emption Analysis*

The Supreme Court began its analysis by noting that the pre-emption part of the opinion in *MITE* did not carry a majority of the Court and hence was not binding. Furthermore, the Court held that the Indiana Act passed muster even if the pre-emption argument had been backed by a majority.¹⁶⁴ The Court reasoned that "the overriding concern of the *MITE* plurality was that the Illinois statute . . . operated to favor management against offerors, to the detriment of shareholders. By contrast, the [Indiana] statute . . . protects the independent shareholder against both of the contending parties."¹⁶⁵ Such protection came within the spirit of the Williams Act—even-handed treatment of bidder and investor.¹⁶⁶

The Court then pointed out the key differences between the Illinois and Indiana statutes: The Indiana Act did not provide "either management or the offeror an advantage in communi-

¹⁵⁹ Under the Williams Act, a tender offer normally must be held open for at least 20 business days. See 17 C.F.R. § 240.14e-1(a) (1986). Counting weekends and any holidays, this period of time could be anywhere from 26 to 30 days.

¹⁶⁰ See *Dynamics*, 794 F.2d at 262-63.

¹⁶¹ See *id.* at 264.

¹⁶² See *id.* The court held that "the effect on the interstate market in securities and corporate control is direct, intended, and substantial; it is not merely the incidental effect of a general regulation of internal corporate governance." *Id.*

¹⁶³ *Dynamics*, 107 S. Ct. at 1644.

¹⁶⁴ See *id.* at 1645. This is of key importance. The court did not affirm the *MITE* analysis but only purported to pass the Indiana statute under it.

¹⁶⁵ *Id.*

¹⁶⁶ See *id.* at 1645-46.

cating with the shareholders about the impending offer.”¹⁶⁷ The Court also found that the Act did not “impose an indefinite delay on tender offers.”¹⁶⁸ Theoretically, an offeror could complete his purchase of shares by the twentieth business day, the earliest day permitted under the Williams Act.¹⁶⁹

The Court ignored the court of appeals finding that, from a practical point of view, the Indiana Act can “delay consummation of tender offers until 50 days after the commencement of the offer.”¹⁷⁰ The reasoning of both the court of appeals and Dynamics was that:

[N]o rational offeror will purchase shares until it gains assurance that those shares will carry voting rights. Because it is possible that voting rights will not be conferred until a shareholder meeting 50 days after commencement of the offer, Dynamics concludes that the Act imposes a 50-day delay. This, it argues, conflicts with the shorter 20-business-day period established by the SEC as the minimum period for which a tender offer may be held open.¹⁷¹

But the Supreme Court found the conflict “illusory.”¹⁷² In the first place, there was still no “absolute 50-day delay on tender offers,”¹⁷³ and nothing prevented a would-be purchaser from making a conditional tender offer—an “offering to accept shares on the condition that the shares receive voting rights within a certain period of time.”¹⁷⁴

¹⁶⁷ *Id.* at 1646. The Illinois Act provided that a takeover offer could not become effective until after a 20-business-day wait after filing with the Secretary of State. *See supra* note 62 and accompanying text. During that period management would have nearly a month to dissuade shareholders from selling without worrying that some shareholders might sell immediately.

¹⁶⁸ *Dynamics*, 107 S. Ct. at 1646.

¹⁶⁹ *Id.* See 17 C.F.R. § 240.14e-1(a).

¹⁷⁰ *Dynamics*, 107 S. Ct. at 1646-47.

¹⁷¹ *Id.* at 1647.

¹⁷² *Id.*

¹⁷³ *Id.*

¹⁷⁴ *Id.* The Court surmised that since conditional tender offers were valid under the Williams Act (the condition being subsequent regulatory approval), there was “no reason to doubt” that a condition that the shares must receive voting rights is also valid. *Id.*

Dynamics responded by arguing that “conditional tender offers are not an adequate alternative because they leave management in place for three extra weeks, with ‘free rein to take other defensive steps that [would] diminish the value of tendered shares.’” *Id.*

Finally, even if the Act did cause some delay to the takeover process, "nothing in *MITE* suggested that *any* delay imposed by state regulation, however short, would create a conflict with the Williams Act."¹⁷⁵ Only "unreasonable" delay creates such conflict.¹⁷⁶

The Court then turned its attention to the commerce clause analysis of the court of appeals.

D. *The Commerce Clause Analysis*

After describing the history of the commerce clause,¹⁷⁷ the Court noted that statutes which are held to infringe upon the clause do so because (1) the statutes discriminate against interstate commerce,¹⁷⁸ or (2) the statutes subject certain commercial activities to inconsistent regulations.¹⁷⁹ The Court found neither of these two problems to exist with respect to the Indiana Act.¹⁸⁰

In holding that the Indiana Act did not discriminate against interstate commerce, the Court noted that the Act had the same effects on takeover offers regardless of whether the offeror was a domiciliary or a resident of Indiana.¹⁸¹ Neither was the Court impressed by Dynamics' contention that the Act would most often apply to non-Indiana entities.¹⁸² Even though empirical evidence showed that most hostile takeover attempts came from offerors outside of that state,¹⁸³ "[t]he fact that the burden of

at n.9 (quoting Brief for Appellee Dynamics Corp. of America 37).

The Court rejected the argument, saying that such actions on the part of management would be unlikely, and even if management did take steps to diminish the shares' value, remedies at the state court level would become available to the acquirer. *Id.*

¹⁷⁵ *Id.* at 1647 (emphasis supplied by Court).

¹⁷⁶ *Id.* The Court noted that under the Williams Act there is a 60-day maximum period for tender offers to be consummated. See 15 U.S.C.A. § 78n(d)(5) (West 1981). Since the Indiana Act provides for the voting rights to either vest or not vest within 50 days of the making of the offer, the Court could not find the delay unreasonable. *Dynamics*, 107 S. Ct. at 1647.

¹⁷⁷ See *Dynamics*, 107 S. Ct. at 1648.

¹⁷⁸ See *id.* (citing *Lewis v. BT Investment Managers, Inc.*, 447 U.S. 27, 36-37 (1980)).

¹⁷⁹ *Id.* at 1649 (citing *Brown-Forman Distillers Corp. v. New York State Liquor Auth.*, 106 S. Ct. 2080 (1986)).

¹⁸⁰ *Id.*

¹⁸¹ See *id.* at 1648-49.

¹⁸² See *id.* at 1649.

¹⁸³ *Id.*

a state regulation falls on some interstate companies does not, by itself, establish a claim of discrimination against interstate commerce.’”¹⁸⁴ Since the Indiana Act imposed no greater burden on out-of-state tender offerors than it did on in-state tender offerors, the Court found no discrimination.¹⁸⁵

In holding that the Indiana Act did not subject tender offerors to inconsistent regulation, the Court explained 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.”¹⁸⁶ The Court relied heavily upon the definition of “corporation” found earlier in the Act,¹⁸⁷ and apparently came to the conclusion that the definition of “issuing public corporation”¹⁸⁸ incorporated the earlier definition of corporation and did not constitute a specific exception to the general definition.¹⁸⁹

The Court did not apply the *Pike v. Bruce Church, Inc.*¹⁹⁰ test which was used by both the plurality in *MITE* and the court

¹⁸⁴ See *id.* (quoting *Exxon Corp. v. Governor of Md.*, 437 U.S. 117, 126 (1978)).

¹⁸⁵ See *id.*

¹⁸⁶ *Id.*

¹⁸⁷ “‘Corporation’ . . . means a corporation for profit that is not a foreign corporation, incorporated under or subject to the provisions of this article.” IND. CODE ANN. § 23-1-20-5 (Burns Supp. 1987). A “foreign corporation” means “a corporation for profit incorporated under a law other than the law of Indiana.” *Id.* at § 23-1-20-11.

¹⁸⁸ The definitions section of the Act provided that “[t]he definitions in this chapter apply throughout the article.” *Id.* at § 23-1-20-1. The definition of “issuing public corporation” presupposes that there is first a “corporation” as defined earlier in the Act. See *supra* text accompanying note 145.

¹⁸⁹ There is a strong argument that the Indiana legislature intended that “issuing public corporation” be an exception to the general definition of “corporation.” “Issuing public corporation” is defined only for the purposes of “this [Control Shares Acquisition] Chapter.” IND. CODE ANN. § 23-1-42-4 (Burns Supp. 1987). The definition then goes on to define “issuing public corporation” as having . . . “[i]ts principal place of business, its principal office, or substantial assets within Indiana . . .” *Id.* at § 23-1-42-4(2). It seems an unreasonable assumption that the Indiana legislature intended that an Indiana corporation with over 100 shareholders, more than 10% of which were Indiana residents (or more than 10% of the shares were owned by Indiana residents), would not be subject to the Act simply because they had no substantial assets within the state, and their principal place of business and office were elsewhere. A more likely assumption is that the definition of “issuing public corporation” meant to include foreign corporations which had substantial ties with Indiana.

Whatever the intent of the legislature, however, the Supreme Court interpreted Indiana’s Act only to apply to Indiana corporations.

¹⁹⁰ 397 U.S. 137 (1969).

of appeals in *Dynamics*.¹⁹¹ The Court criticized the lower court for “fail[ing] 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. . . . By prohibiting certain transactions, and regulating others, such laws necessarily affect certain aspects of interstate commerce.”¹⁹²

In concluding its analysis, the Court posited that “*Dynamics*’ argument that the Act is unconstitutional ultimately rests on its contention that the Act [would] limit the number of successful tender offers.”¹⁹³ The Court found “little evidence” that this result would occur.¹⁹⁴ But, even if it did, it would not have seriously affected the Court’s commerce clause analysis: The Act did not foreclose “any entity—resident or nonresident—from offering to purchase . . . shares in Indiana corporations, or from attempting thereby to gain control.”¹⁹⁵ The Act’s only purpose was to supply better protection for the shareholders.¹⁹⁶

V. RATIONALIZING *MITE* AND *DYNAMICS*

After *Dynamics*, two similar state statutes have been analyzed by the Supreme Court—the Illinois Act having been struck and the Indiana Act having survived. The question remains whether *Edgar v. MITE Corp.*¹⁹⁷ has been effectively overruled by *CTS Corp. v. Dynamics Corp. of Am.*,¹⁹⁸ or whether the Supreme Court has changed its method of analyzing state tender offer statutes.

A. *The Current Status of the Pre-emption Argument*

Few should be surprised that the Court in *Dynamics* did not find the Indiana Act pre-empted by the Williams Act, since only

¹⁹¹ See *Dynamics*, 794 F.2d at 263.

¹⁹² *Dynamics*, 107 S. Ct. at 1649-50.

¹⁹³ *Id.* at 1652.

¹⁹⁴ *Id.*

¹⁹⁵ *Id.*

¹⁹⁶ See *id.*

¹⁹⁷ 457 U.S. 624 (1982).

¹⁹⁸ 107 S. Ct. 1637 (1987).

three justices¹⁹⁹ found the Illinois statute pre-empted in *MITE*. Justices Brennan, Marshall, and Rehnquist did not even reach the merits in *MITE*,²⁰⁰ so their positions on the pre-emption issue were not taken into account. These three justices were in the majority in *Dynamics*, which did not find pre-emption by the Williams Act.²⁰¹ Also in the majority were Justice O'Connor and Justice Powell, who were in the *MITE* plurality but did not join the pre-emption part of the opinion.²⁰² Justice Blackmun and Justice White, dissenters on the pre-emption issue in *Dynamics*, were two of the three justices in favor of pre-emption in *MITE*.²⁰³ Chief Justice Burger, the third justice in favor of pre-emption in *MITE*, had retired by the time of *Dynamics*.

To that extent, *MITE* has never been overruled—*MITE* was never holding, only dicta. However, the reliance of lower courts, both state and federal, on the pre-emption part of the *MITE* opinion had effectively turned the dicta into law.²⁰⁴ Thus, it is not overstepping the bounds of propriety to say that the pre-emption aspect of *MITE* has been “overruled.”

It is no wonder, then, that the Supreme Court chose not to rely on the fact that the pre-emption analysis was never law and instead attempted to distinguish the Indiana Act from the Illinois Act on that point.²⁰⁵ The Court distinguished the delays that were inherent in each Act. The Illinois Act did not allow a takeover to take effect until the shareholders had been given twenty business days to consider the proposal.²⁰⁶ The Indiana Act allowed for immediate tender of shares but did not allow voting rights to vest in the acquired shares until an affirmative

¹⁹⁹ Chief Justice Burger, Justice White, and Justice Brennan. See *supra* notes 107-11 and accompanying text.

²⁰⁰ See *supra* notes 110-11 and accompanying text.

²⁰¹ See *Dynamics*, 107 S. Ct. at 1640.

²⁰² See *id.*

²⁰³ Compare *MITE*, 457 U.S. at 626 n.+ with *Dynamics*, 107 S. Ct. at 1640.

²⁰⁴ See *supra* note 10; see also Note, *supra* note 121, at 345 (“Although *MITE* does not completely prohibit state regulation of tender offers, the cases following *MITE* have interpreted its holding broadly. . . . Despite this . . . attitude toward state takeover legislation, there appear to be alternative approaches [which] . . . avoid *direct conflict* with federal securities laws.” (emphasis added)).

²⁰⁵ See *supra* text accompanying notes 165-76.

²⁰⁶ See 1978 Ill. Laws 80-1421 § 4E.

vote to do so was cast by the disinterested shareholders.²⁰⁷ The special meeting at which this vote took place had to occur within fifty days after the tender offer was announced.²⁰⁸ Although Dynamics argued that no corporation headed by rational minds would purchase shares until voting rights vested, the Court reasoned that a conditional offer would be appropriate.²⁰⁹

However, the Court's reasoning seems a little superficial. Although "[t]he [Indiana] Act does not impose an absolute 50-day delay on tender offers,"²¹⁰ it is reasonable to assume that in many cases the special meeting will not take place until several days after the expiration of the twenty-business-day requirement of the Williams Act, which is about twenty-eight calendar days.²¹¹ This leaves twenty-two days beyond the limit imposed by the Williams Act. In *MITE*, however, Justice White's opinion pointed to the legislative history of the Williams Act and noted that even a five-day precommencement notification requirement had been rejected by Congress.²¹² The precommencement notification was therefore rejected in *MITE*, the rationale being that the target company was provided with "additional time within which to take steps to combat the offer."²¹³ While the Indiana Act validates offers from the moment made, without imposing any precommencement wait, the target's management still has plenty of time to combat the offer, three additional weeks after the deadline in the Williams Act, much more than the five days rejected by Congress.

Justice White cited numerous evils of delay, and incorporated into his opinion the S.E.C.'s list of seven ways that target management may benefit from a delay.²¹⁴ This list was cited in connection with the Indiana Act's hearing provision, which left

²⁰⁷ See IND. CODE ANN. § 23-1-42-7 (Burns Supp. 1987).

²⁰⁸ See *id.*

²⁰⁹ See *Dynamics*, 107 S. Ct. at 1647 n.8. The Court pointed to a case in which the S.E.C. approved a tender offer conditioned upon the "removal of a 'lockup option' that would have seriously diminished the value of acquiring the shares of SCM Corporation." See *id.* (citing Hanson Trust PLC v. ML SCM Acquisition, Inc., ML LBO, 781 F.2d 264, 272 n.7 (2d Cir. 1986)).

²¹⁰ *Id.* at 1647.

²¹¹ Assuming four weekends and no holidays.

²¹² See *supra* note 73.

²¹³ *MITE*, 457 U.S. at 635.

²¹⁴ See *supra* note 79.

open the *possibility* that the Secretary of State might render a decision way beyond the time limit imposed by the Act.²¹⁵ In other words, one defect in the Illinois Act was that there was a *possibility* of an extended delay, though the Act sought to limit the time for the Secretary to make his or her decision. On the other hand, one of the saving graces of the Indiana Act was the *possibility* that the offer would be consummated within the twenty-business-day limit of the Williams Act and not extend delay to the fifty-calendar-day deadline allowed by the statute. The White opinion in *MITE* does not give the benefit of doubt to the Illinois statute, whereas the majority opinion in *Dynamics* does. This can be further illustrated by noting that under the Illinois Act, there is also the possibility that the Williams Act deadline will not be exceeded. If, one week after the filing of a tender offer, the Secretary calls a hearing, the entire hearing and decision could be accomplished by twenty calendar days. The bottom line is that both statutes could cause a delay to the takeover process, but the Indiana Act was given the benefit of the doubt.

The fact that one statute, and not the other, had a pre-commencement notification requirement does not make the consequences any less serious. Since under the Indiana Act the target's management had fifty days before any voting rights vest, they would have had ample time to persuade noninterested shareholders to vote not to revest the voting rights by (1) announcing a plan to repurchase its own securities, or (2) announcing a dividend increase, should voting rights not have been granted. Of course, since under the Act the acquiring corporation will already have purchased the shares, it will also be entitled to a chance to submit their shares for repurchase or receive a dividend; nevertheless, its takeover would be thwarted. Furthermore, if the acquiring corporation made its offer subject to a condition precedent that voting rights be revested, then upon a

²¹⁵ See *MITE*, 457 U.S. 637. The Secretary had to make a decision within 15 days after a hearing had been held, which could be called any time prior to the commencement of the offer. See 1978 Ill. Laws 80-1421 § 7. Thus, unless the Secretary found that the offer was inequitable or any disclosure requirement had not been met, the decision had to be completed within 35 days after a tender offer had been filed. This is 15 days less than the 50-day requirement of the Indiana Act.

negative vote by the shareholders the offer would be withdrawn, and the would-be acquirer would not even be entitled to a repurchase or a dividend.

Finally, even if the acquirer made a conditional offer under the Indiana Act, the result would be the same as if there were a fifty-day precommencement notification requirement. The practical effect of not being able to vote purchased shares—lack of control of the target—is the same as if the shares were never purchased. There is delay, there is lack of control of the target, and there is the possibility that a hostile merger will not succeed. Thus the Illinois Act and the Indiana Act are virtually indistinguishable in result.

Apparently, the Court found favor with the Indiana Act because it adopted the “market approach to investor protection,”²¹⁶ which commentators have argued should be the basis for state statutes.²¹⁷ The market approach “is based on the notion that the tendering decision should be made by an informed shareholder alone.”²¹⁸ Certainly the Court was impressed by the absence of any governmental role in the statute: The Act “[does not] allow the state government to interpose its views of fairness between willing buyers and sellers of shares of the target company. Rather the Act allows *shareholders* to evaluate the fairness of the offer collectively.”²¹⁹ This language indicates that the Supreme Court will tolerate state statutes that work to favor the shareholders of a target corporation but not the offeror or the target’s management.

The market approach was adopted in the Minnesota Corporate Take-Overs Act²²⁰ and was upheld in 1984 as constitutional by the Court of Appeals for the Eighth Circuit in *Cardiff*

²¹⁶ Bainbridge, *supra* note 137, at 758.

²¹⁷ See, e.g., *id.* (“In the context of a shareholder tender decision, such an approach is correct; the investor should be allowed to decide whether to accept or reject the offer without management or state interference.”); see also Note, *Can State Tender-Offer Regulation Be Made Constitutional?* Edgar v. MITE Corp., 20 Hous. L. Rev. 1475, 1489 (1983) (suggesting that a state legislature “should repeal all portions of a regulatory statute that suggest a benevolent bureaucratic, rather than a market, approach to investor protection”).

²¹⁸ Bainbridge, *supra* note 137, at 758.

²¹⁹ *Dynamics*, 107 S. Ct. at 1646 (emphasis supplied by Court).

²²⁰ MINN. STAT. §§ 80B.01-.13 (1986) (amended 1987).

*Acquisitions, Inc. v. Hatch.*²²¹ Under the Minnesota statute there was no provision for a precommencement notification period,²²² and both the takeover offeror and the target management were precluded from disseminating information while the takeover offer was “suspended.”²²³ A takeover offer was suspended if the State Commissioner of Commerce determined that “the registration statement [did] not contain all of the information [required by the Act] or that the take-over offer materials provided to offerees [did] not provide full disclosure to offerees of all material information concerning the take-over offer.”²²⁴ The suspension is only temporary—the Commissioner must hold a hearing process within sixteen calendar days,²²⁵ much less than the twenty-business-day period mandated in the Williams Act. No suspension could be based on the “unfairness” of the tender offer,²²⁶ leaving any equity decisions to the shareholder, and not a government official.²²⁷ The shareholders would make their decisions by tendering—or refusing to tender—their shares.

The court of appeals also upheld provisions of the Minnesota Act that required disclosure of certain information,²²⁸ which was not required to be disclosed by the Williams Act:

[T]he additional disclosures required by the Minnesota Act will aid Minnesota shareholders in appraising the value of a tender offer and will not result in the shareholders receiving a mass of irrelevant information that will serve to confuse rather than enlighten. The additional disclosures are primarily concerned with the impacts of the proposed takeover on Minnesota residents, including employees and suppliers.²²⁹

²²¹ 751 F.2d 906 (8th Cir. 1984).

²²² See Recent Case, *supra* note 10, at 1121.

²²³ See MINN. STAT. at § 80B.05(4).

²²⁴ *Id.* at § 80B.03 Subd. 4a.

²²⁵ *Id.* at § 80B.03 Subd. 5.

²²⁶ *Cardiff*, 751 F.2d at 911.

²²⁷ The presence of a government official was a flaw in the Illinois statute. See *supra* text accompanying notes 80-82.

²²⁸ Compare MINN. STAT. § 80B.03(6)(a)-(e) (1986) with 15 U.S.C.A. § 78m(d)(1) (West 1981 & Supp. 1988) and 17 C.F.R. § 240.13d-1 (1984). See *Cardiff*, 751 F.2d at 911-12 n.5.

²²⁹ *Cardiff*, 751 F.2d at 912.

Thus, the Minnesota statute passed muster because it emphasized shareholder protection—with the shareholders as watchdogs—rather than emphasize avoidance of hostile takeovers.

The courts have made it clear in *Dynamics* and *Cardiff* that statutes which favor shareholders, but not offerors or management, will survive the *MITE* scrutiny. Yet, it has already been argued that the Indiana statute protects management to the detriment of the tender offeror.²³⁰ There is still another view that alleges that the *takeover offeror* is given an advantage by the Indiana Act: “[S]hareholders may tender more frequently under a control share acquisition statute than a fair price provision,” and . . . acquirers would prefer an Indiana type statute to either a fair price statute²³¹ like Maryland’s,²³² or a right of redemption statute²³³ like Pennsylvania’s.”²³⁴ In fact, according to one author, “[a] control share acquisition statute actually may work in favor of the acquirer.”²³⁵

The Supreme Court’s opinion [in *Dynamics*] . . . treats the Indiana statute’s mandate of a shareholder vote on a proposed transaction as a deterrent to making a tender offer. Interestingly, the central theme of defensive planners has been precisely the opposite: A successful defensive tactic is one that precludes shareholders from having the opportunity to accept a hostile offer, not one that grants them the right to accept one, whether individually or collectively. . . . Thus, one characterization of an Indiana type statute is that it gives acquirers exactly what they have always wanted—the chance for the

²³⁰ See *supra* text accompanying notes 210-16.

²³¹ Under a fair price statute any shareholder has the right to receive the fair market value of his or her shares in the event of a successful merger. How he or she enforces the right is a matter of statute, but generally a shareholder will at least have the right to whatever the price on the market, or, as in the Maryland Statute, *infra* note 232, a value determined by a formula involving the current market price and the price the shareholder paid for the shares, if such price is higher.

²³² MD. CORPS. & ASS’NS CODE ANN. § 11-901-908 (1976).

²³³ A right of redemption is similar to a fair price statute. In fact, one author refers to both Maryland’s and Pennsylvania’s statutes as containing “fair value redemption rights.” Bainbridge, *supra* note 137, at 744. Pennsylvania’s “right of redemption” statute is codified at 15 PA. CONS. STAT. § 1910(A) (1985 Supp.) (amended 1983).

²³⁴ R. GILSON, *THE LAW AND FINANCE OF CORPORATE ACQUISITIONS* 194 (1987 Supp.) (quoting Romano, *The Political Economy of Takeover Statutes*, 73 VA. L. REV. 111, 169 (1987)).

²³⁵ *Id.* at 194.

shareholders to decide whether to accept a premium over market for their shares.²³⁶

The author posits that the best argument that the target management is given an advantage under the Indiana Act is that the fifty-day-delay can force “additional financing costs on the acquirer, and simply increase the chance that something fortuitous will occur—perhaps an increase in interest rates—that will make the acquirer go away of its own accord.”²³⁷ However, the author contends that this is a “thin reed on which to build a pro-target argument.”²³⁸

Thin reed or not, the Supreme Court has made clear that delay is unwanted in the context of tender offers, and whether the target management or the offeror is favored by delay, there seems to be a good argument that the Indiana Act, in the name of shareholder protection, upsets the balance achieved by the Williams Act. The fact that the Indiana Act was held constitutional leads inevitably to the conclusion that the Williams Act does not establish a carved-in-stone balance of investor protection and takeover offer protection that can never be modified. Rather, the Williams Act protects the investors, and attempts by the states to advance that protection will be held valid. Justice Powell stated that “the overriding concern of the *MITE* plurality was that the Illinois Statute . . . operated to favor management against offerors, to the detriment of shareholders. By contrast, the [Indiana Statute] protects the independent shareholder against both of the contending parties.”²³⁹

B. *The Current Status of the Commerce Clause Argument*

The Indiana Act survived the commerce clause challenge because of the Supreme Court’s insistence that the Control Shares Acquisitions Act applied only to corporations which were Indiana residents: “We agree that Indiana has no interest in protecting non-resident shareholders of *non-resident corporations*. But this Act applies only to corporations incorporated in Indi-

²³⁶ *Id.* at 195-96.

²³⁷ *Id.* at 195.

²³⁸ *Id.*

²³⁹ *Dynamics*, 107 S. Ct. at 1645.

ana.”²⁴⁰ The notion has already been suggested that the Indiana legislature might not have intended that the Act apply only to Indiana corporations,²⁴¹ but the above passage seems to make such an interpretation a requirement for constitutionality.

There might be an additional requirement for an Act to be constitutional—that there must be a substantial number of shareholders residing in the state.²⁴² The Court cited the Indiana Act’s provision,²⁴³ which calls for ten percent of the corporation’s shareholders or 10,000 shareholders, whichever is lower, to be residents of Indiana, or, alternatively for ten percent of the corporation’s paid-in surplus to be represented by Indiana residents. “Thus,” said the Court, “every application of the Indiana Act will affect a substantial number of Indiana residents. . . .”²⁴⁴

Therefore, the Supreme Court might have forged a two-prong test: To pass constitutional muster a state tender offer law must provide that (1) the target be a resident of the state, and (2) the target be represented by a substantial number of the state’s residents, or have a substantial number of assets represented in the state.

Under such a test, *Cardiff* appears no longer to be valid. In that case there was no requirement by Minnesota that the target corporation be incorporated in Minnesota. To be a “target company” under the Act, the corporation merely had to be an issuer of publicly traded shares at least twenty percent of which had to be owned by Minnesota residents, and the corporation had to own or control assets, located within Minnesota, which had a fair market value of at least \$1,000,000.²⁴⁵ The court of appeals distinguished the Minnesota Act from the Illinois Act, since the former Act would never apply unless a substantial number of Minnesotans were shareholders of the target, and the latter Act could apply even when none of the shareholders were Illinois residents.²⁴⁶ However valid the distinction, the Minnesota Act does not pass the two-prong test of *Dynamics*.

²⁴⁰ *Id.* at 1651-52.

²⁴¹ See *supra* notes 187-89 and accompanying text.

²⁴² See *Dynamics*, 107 S. Ct. at 1652.

²⁴³ See IND. CODE ANN. § 23-1-42-4(3) (Burns Supp. 1987).

²⁴⁴ *Dynamics*, 107 S. Ct. at 1652.

²⁴⁵ See MINN. STAT. ANN. at § 80B.01 Subd. 9.

²⁴⁶ See *Cardiff*, 751 F.2d at 911.

Another casualty of the two-prong test could be the state of Delaware, notorious for its pro-corporate disposition in its incorporating laws. Assuming that most states enacted a takeover law like Indiana's, Delaware would have little to do with most of its chartered corporations:²⁴⁷

Because of the Indiana statute's jurisdictional focus on shareholders resident in the enacting state, a similar Delaware statute would apply to very few Delaware chartered corporations. . . . If this interpretation of [*Dynamics*] is right, then other states may have the chance to make some headway against Delaware's dominant position in the market for corporate charters.²⁴⁸

Delaware, as might have been expected, has risen to meet the challenge, and is determined to see if the second prong of the test has indeed become a portion of the Court's holding. To Delaware, it is irrelevant how much of a corporation's assets are in the state, provided the corporation is organized under the laws of the state. The Delaware Supreme Court in *McDermott, Inc. v. Lewis*²⁴⁹ summarized the *Dynamics* holding as follows: "In [*Dynamics*], the Court ruled that a state does not violate the commerce clause, notwithstanding heavy burdens imposed upon interstate commerce, if a state is merely *regulating the internal affairs of its own* corporations."²⁵⁰

It is not only Delaware's judiciary which has spoken out on this matter; the Delaware legislature has also embraced the internal affairs doctrine as a panacea for controlling hostile takeovers. Delaware Governor Michael Castle signed a takeover bill into law²⁵¹ on February 2, 1988,²⁵² a law which "bars most hostile takeovers by bidders who own 15 percent of the target's shares

²⁴⁷ R. GILSON, *supra* note 234, at 193.

²⁴⁸ *Id.*

²⁴⁹ 531 A.2d 206 (Del. 1987). The issue in the case was "whether a Delaware subsidiary of a Panamanian corporation [could] vote the shares it holds in its parent company under circumstances which are prohibited by Delaware law, but not the law of Panama." *Id.* at 208. The court answered the question in the affirmative.

²⁵⁰ *Id.* at 217, n.12.

²⁵¹ *Business Combinations with Interested Stockholders*, DEL CODE ANN. tit. 8, § 203 (1988) (reprinted in 20 Sec. Reg. & L. Rep. (BNA) No. 5, at 209 (Feb. 5, 1988)).

²⁵² See 20 Sec. Reg. & L. Rep. (BNA) No. 5, at 188 (Feb. 5, 1988).

unless they gain 85 percent of the target's outstanding stock."²⁵³ The law applies only to Delaware corporations,²⁵⁴ but *nowhere* in the Act is there any requirement that a substantial number of assets or stockholders be located in Delaware, or that the corporation have a principal office within the state.

It remains to be seen what effect the Delaware Statute will have on hostile takeovers. T. Boone Pickens has blasted the law as "an entrenchment device that hurts shareholders."²⁵⁵ Martin Lipton, on the other hand, has said that the Act is "a meaningless statute in terms of protection against takeover abuses."²⁵⁶ William Freeborn, Governor Castle's legislative liaison, asserts that the Act "negates the effects of a potentially hostile takeover," but adds that the Act is an "extremely moderate" piece of legislation.²⁵⁷

Despite Mr. Freeborn's claim that the statute is moderate, two corporations, Black & Decker and Campeau Corp., have already challenged the constitutionality of the Act.²⁵⁸ Should one of these companies pursue and win its claim in court, Delaware will suffer a heavy blow to its position as the guardian of corporate America. Delaware's regulation of the internal affairs

²⁵³ See *id.* The Act provides (omitting a "grandfather" clause for corporate stockholders with holdings of greater than 15% prior to the passage of the Act) that:

[A] corporation shall not engage in any business combination with any interested stockholder for a period of 3 years following the date that such stockholder became an interested stockholder, unless . . . upon consummation of the transactions which resulted in the stockholder becoming an interested stockholder, the interested stockholder owned at least 85% of the voting stock of the corporation outstanding at the time the transaction commenced. . . .

DEL. CODE ANN. tit. 8, § 203(a)(2) (1988). A "business combination" is defined as *inter alia*:

[A]ny merger or consolidation of the corporation or any direct or indirect majority-owned subsidiary of the corporation with (A) the interested stockholder, or (B) with any other corporation if the merger or consolidation is caused by the interested stockholder and as a result of such merger or consolidation subsection (a) [(the "grandfather" clause)] is not applicable to the surviving corporation.

Id. at § 203(c)(3)(i).

²⁵⁴ See 20 Sec. Reg. & L. Rep. (BNA) No. 5, at 188 (Feb. 5, 1988).

²⁵⁵ *Id.*

²⁵⁶ *Id.*

²⁵⁷ *Id.*

²⁵⁸ *Id.*

of only the corporations that have substantial contacts in Delaware could be a job tantamount to that of the Maytag repairman.

CONCLUSION

There is no doubt that a state can pass a takeover statute like Indiana's and have it pass constitutional muster. However, there is a possibility that an act with more stringent requirements than the Indiana Act may also pass muster. To the extent that a statute uses the market approach to shareholder protection, pre-emption can be avoided; but a hearing held by a state official, *ala Cardiff*, might also be permissible providing that the official does not rule on the equity of the offer, but only on the extent to which the acquiring corporation has complied with disclosure requirements.²⁵⁹ Also, a state can force an acquirer to file more information than the Indiana Act required, again thanks to *Cardiff*.²⁶⁰

Finally, as long as the target is incorporated in the state, the state can rely on the internal affairs doctrine to regulate takeovers, as long as the target has a substantial connection to the state.²⁶¹ How much will satisfy the "substantial" test is anybody's guess. In the Indiana Act there are ten percent thresholds,²⁶² but if Delaware gets its way, perhaps one day the "substantial" requirement will be obliterated. Each state would have the sole power to regulate takeovers of corporations chartered there.

At any rate, whether or not *Dynamics* has effectively overruled *MITE*, the spectre of unconstitutionality has been removed from the states' ability to erect takeover laws. In the future, there may well arise state statutes that make the Indiana Act look mild by comparison.

Brian S. West

²⁵⁹ See *supra* text accompanying notes 223-27.

²⁶⁰ See *supra* text accompanying notes 228-29.

²⁶¹ See *supra* text accompanying notes 242-44.

²⁶² See *supra* text accompanying note 145.

