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Peter L. Tracey

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COMMENTS

The Delaware Debate on Takeover Legislation: No Small Wonder

> Meanwhile the little community of truck-farmers and clamdiggers have had their cupidity excited by the spectacle of their northern neighbor, New Jersey, becoming rich and bloated through the granting of franchises to trusts which are to do business everywhere except in New Jersey, and which are to go forth panoplied by the sovereign state of New Jersey to afflict and curse other American communities . . . . In other words little Delaware, gangrened with envy at the spectacle of the truck-patchers, sand-duners, clam-diggers and mosquito wafters of New Jersey getting all the money in the country into her coffers, — is determined to get her little tiny, sweet, round baby hand into the grab-bag of sweet things before it is too late.[1]

I. Introduction

In the twentieth century, Delaware has emerged as the "jurisdiction of choice" for business incorporations in the United States. One-half of the Fortune 500 and 40 percent of the companies listed on the New York Stock Exchange are incorporated in Delaware.[2] Attempts by other states to emulate the success of the Delaware General Corporation Law[3] in attracting corporate charter business have been unsuccessful. Bayless Manning, an eminent legal scholar and practitioner, recently stated: "I suggest that we now have a national corporate law — Delaware law."[4]

1. *Little Delaware Makes a Bid for the Organization of Trusts*, 33 AM. L. REV. 418, 419 (1899), *quoted in* Comment, *Law For Sale: A Study Of The Delaware Corporation Law Of 1967*, 117 U. PA. L. REV. 861, 861 (1969).

2. *Delaware Fails to Adopt Law on Takeovers*, Wall St. J., June 16, 1987, at 2, col. 2.

3. DEL. CODE ANN. tit. 8, §§ 101-398 (1983 & Supp. 1986).

4. *State Competition: Panel Response*, 8 CARDOZO L. REV. 779, 783 (1987). *See also* Cary, *Federalism and Corporate Law: Reflections upon Delaware*, 83 YALE L.J. 663, 665

It is hardly surprising that the eyes of corporate America focused on Delaware in the months following the U.S. Supreme Court's April 1987 decision in *CTS Corp. v. Dynamics Corp. of America*.[5] *CTS* represented the most significant Supreme Court pronouncement on state regulation of corporate takeovers since the Court's 1982 ruling in *Edgar v. MITE Corp*.[6] The *CTS* decision appeared to breathe new life into state efforts to restrict hostile takeovers through the use of "control share" statutes.[7] As a number of states rushed to enact control share legislation,[8] the twelve-member Council of the Corporation Law Section of the Delaware State Bar Association (the Council) convened in an effort to articulate Delaware's response to this new development on the takeover battlefield.[9] The *CTS* decision sparked uncertainty and concern among members of the Delaware Bar.[10]

(1974) ("Indeed, Nevada has attempted to become the western Delaware but not with comparable success."). For a history of Delaware's leadership in corporate governance matters, see Arsht, *A History of the Delaware Corporation Law*, 1 DEL. J. CORP. L. 1 (1976); Kirk, *A Case Study in Legislative Opportunism: How Delaware Used the Federal-State System to Attain Corporate Pre-Eminence*, 10 J. CORP. L. 233 (1984), *reprinted in* 28 CORP. PRAC. COMM. 115 (1986).

5. 107 S. Ct. 1637 (1987).

6. 457 U.S. 624 (1982).

7. For examples of early analyses of the *CTS* decision, see Cherno, *Supreme Court's Decision Substantially Changes the Balance Between Bidders and Target Companies*, INSIGHTS, July 1987, at 3; *States Flex Muscle On Takeovers*, Nat'l L.J., June 1, 1987, at 1, col. 4; Pinto, *N.Y.'s Takeover Law After the CTS Ruling*, N.Y.L.J., May 7, 1987, at 5, col. 1; *Sorting it Out: State Takeover Laws Seen Revived by CTS Decision*, *id.* at 1, col. 2 [hereinafter *Takeover Laws*]; Smith, *The CTS Decision: SEC vs. the States*, N.Y.L.J., April 30, 1987, at 5, col. 1.

8. Two days after the CTS decision, North Carolina passed legislation requiring that any outside bidder receive the permission of 95% of the stockholders for a merger, unless certain "fair price" exceptions are met. N.C. GEN. STAT. §§ 55-75 to -80 (Supp. 1988). At the urging of Burlington Industries, North Carolina amended this statute with a control share acquisition law on May 13, 1987. *Id.* §§ 55-90 to -98. Minnesota adopted an anti-takeover bill at the behest of Dayton-Hudson, a target of the Dart Group. MINN. STAT. ANN. §§ 302A.671-73 (West Supp. 1988) (control share acquisition statute and business combination statute). Arizona approved similar legislation to protect Phoenix-based Greyhound. ARIZ. REV. STAT. ANN. §§ 10-1211 to -1223 (Supp. 1987) (control share acquisition statute and business combination statute). *See* Mendelsohn & Berg, *Anti-Takeover Bill Would Shift Balance of Power*, Nat'l L.J., Feb. 8, 1988, at 41, col. 4; *Expropriation at Home*, Wall St. J., Oct. 9, 1987, at 24, col. 1; *States Flex Muscle on Takeovers, supra* note 7, at 1, col. 4. *See also infra* note 47.

9. *States Flex Muscle on Takeovers, supra* note 7, at 35, col. 4. The Council had already established a Takeover Law Subcommittee, chaired by Michael D. Goldman of Wilmington's Potter Anderson & Corroon. *See* Sontag, *A Takeover Law Grows in Delaware*, Nat'l L.J., Apr. 11, 1988, at 19, col. 2; Goldman, *Delaware Anti-Takeover Legislation Is Needed*, Nat'l L.J., Feb. 8, 1988, at 34, col. 1.

10. A letter from Michael Harkins, Delaware's Secretary of State, to A. Gilchrist Sparks, III, Chairman of the Council, dated April 24, 1987, only three days after the release of the *CTS* opinion, evidences the interest of the State:

> In light of the Supreme Court's recent decision on Indiana's corporate law regarding takeovers, I believe that it is imperative that the Corporate Law Section of the Delaware State Bar Association conduct a thorough review of our

The concern generated in Wilmington and Dover by the *CTS* decision provides the impetus for this Comment. Delaware's struggle over takeover legislation has attracted national attention. To the extent that the Delaware General Corporation Law serves as a national standard, the controversy surrounding such legislation illuminates some important questions of policy in the waning years of the twentieth century.

A particularly significant consideration is the manner in which the decision-making process functions in shaping the Delaware General Corporation Law. The process must respond to numerous constituencies in order to keep Delaware "on top" in state competition for corporate charters. The popular image of a small circle of lawyers controlling the corporate destiny of the nation from a boardroom in Wilmington hardly commends itself to reality.

II. Some Background on State Regulation of Takeovers

A. *The Hostile Takeover: Boardroom as Fortress*

In the past two decades, the mergers and acquisitions field has emerged as a growth industry.[11] The statistics are numbing — in

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> own corporate statutes and present recommendations for adjustments that may be necessary to my office for consideration in this legislative session.
>
> Delaware has always been in the forefront of the corporate field. We continue to be a leader through a combination of judicial precedents and enlightened legislation. Speaking for the Governor, the Delaware Legislature and the Office of the Secretary of the State, you have our combined pledge that we will entertain any reasonable proposal which will continue to keep our State as the state of choice when incorporating.
>
> I caution, however, against "knee-jerk" reactions to other states' attempts, legislative, judicial or otherwise, to secure an advantage in the incorporating field over Delaware. We have stayed on top in this business because we have been cautious as well as enlightened.

Letter from Michael E. Harkins to A. Gilchrist Sparks, III, Esq. (Apr. 24, 1987), *reprinted in* Cherno, *supra* note 7, at 7.

11.

> Takeover activity appears to be the product of several factors: a stock market that may price the shares of a company significantly below the value of the entire company; the ready availability of junk bond and bank financing; the strong desire for diversification, particularly by companies in industries with low rates of return on investment; economic conditions that make it more desirable to expand by acquisition rather than capital investment; the political and economic fears of foreign investors; the large surplus of dollars in foreign hands; the acceptability of the aggressive takeover created by the willingness of the major investment bankers to act for raiders and the willingness of established companies to be raiders; and the ownership of a majority of shares of many major companies in the hands of institutional investors, who are actively promoting takeovers.

1 M. LIPTON & E. STEINBERGER, TAKEOVERS & FREEZEOUTS § 1.03 (1988) [hereinafter LIPTON].

1985, there were 3,165 transactions, with a total value of $139.1 billion.[12] Of these transactions, 121 were tender offers and 43 were hostile bids.[13] The total value of tender offers in 1985 was $46.8 billion.[14] While tax reform dampened takeover enthusiasm in the second half of 1986,[15] subsequent shakedowns in the financial markets may generate an unprecedented number of hostile takeovers as raiders make their plays for undervalued targets.[16]

The takeover game has engendered a jargon all of its own, as bidders and targets constantly develop new strategies for achieving

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12. STAFF OF HOUSE COMM. ON ENERGY AND COMMERCE, 99TH CONG., 2D SESS., CORPORATE TAKEOVERS: PUBLIC POLICY IMPLICATIONS FOR THE ECONOMY AND CORPORATE GOVERNANCE 2 n.1 (Comm. Print 1987) [hereinafter CORPORATE TAKEOVERS] (citing *Almanac and Index*, MERGERS & ACQUISITIONS, May 1986). These figures are comprised of leveraged buyouts, divestitures, tender offers, and mergers and acquisitions valued at more than $1 million, based on the effective date of each transaction. *Id. Cf.* CORPORATE TAKEOVERS, *supra* at 2 n.1. (citing W.T. GRIMM & CO., MERGERSTAT REVIEW, 1985 (1986)). Grimm reported 3,001 transactions for 1985, an increase of 18% from 1984, with a total value of $179.8 billion. This value was 47% higher than 1984's record of $122.2 billion. For the first half of 1986, Grimm estimated that there were 1,528 transactions valued at $77.1 billion. By comparison, for the first half of 1985, Grimm counted 1,563 transactions valued at $100 billion. *Id.* The Grimm figures are based on the date of announcement of each transaction. *Id.*

13. CORPORATE TAKEOVERS, *supra* note 12, at 2 n.1 (citing MERGERS & ACQUISITIONS, July-Aug. 1986, at 55-56). In 1984, of a total of 3,064 completed deals, 142 were tender offers and 33 were hostile bids. The total value of these tender offers was $42 billion. *Id.*

14. *Id.*

15. *Deals Down in '86 Second Half: Uncertain Outlook for '87*, CORPORATE CONTROL ALERT, Jan. 1987, 1, 3:

> [D]eals dropped from a high of 76 in the first half of 1986 to 62 in the latter half. That is particularly surprising because M & A specialists report that the second half of 1986 was much busier than the first part of the year. The biggest dip was reflected in hostile tender offers, which dropped 18% from 56 in the first half of the year to 46 in the second half.
>
> Skadden, Arps, Slate, Meagher & Flom corporate partner Donald Drapkin says that until the tax reform bill of 1986 was finalized in late September, uncertainty over tax revisions may have led to the lull in . . . deals. In fact, in the months of August and September, there were only seven contested tender offers whereas in October, November, and December, after the tax law changes were settled, there were 24.
>
> George Hornig, vice-president of The First Boston Corporation, agrees that the tax laws affected M & A activity: In the rush to complete deals by the end of the year, Hornig suggests, some mergers, which might otherwise have started out as hostile bids, were done as friendly deals to insure completion before year-end.

Id.

16. *See, e.g.*, Sontag, *Takeovers Are On The Rise Again*, Nat'l L.J., Feb. 1, 1988, at 8, col. 4 (Edward O. Herlihy of the New York law firm Wachtell, Lipton, Rosen & Katz states: "Takeovers will continue because the basic reasons that contributed to them have not disappeared. It is still cheaper to buy than to build."); *Takeovers: A New Ball Game*, N.Y. Times, Oct. 27, 1987, at D1, col. 3. ("'A lot of people are buying things,' said a leading corporate raider, 'and a lot of others are thinking of it.'"); *Pickens Sees Plunge Spurring Takeovers*, N.Y. Times, Oct. 28, 1987, at D14, col. 4 (Corporate raider T. Boone Pickens states, "If companies were attractive targets when the Dow was at 2,500, they will be even more attractive with the Dow at 1,800.").

their respective goals.[17] While most takeovers are considered "friendly," the proliferation of "hostile" offers in recent years has been a source of growing concern at the state and federal level.[18] Hostile takeovers are the stuff of which headlines and corporate legends are made; these takeovers are frequently accomplished by means of a tender offer to a target's stockholders.[19]

Martin Lipton, an expert in the mergers and acquisitions field, has identified a number of factors that, singly or in combination, may put glimmers in the eyes of raiders, and cause sleepless nights for target directors and officers:

> - a highly liquid financial condition, or readily salable undervalued assets — such assets can facilitate a "boot-strap" ac-

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17. The literature on corporate takeovers is extensive; for a thorough overview of the subject, see LIPTON, *supra* note 11.

18. The principal takeover approaches include a "friendly" transaction negotiated with management; a "bear hug," in which the raider notifies the target of a proposed acquisition transaction; a "hostile" offer made directly to target shareholders, without management approval; and, as a supplement or alternative to these approaches, large open market and/or privately negotiated purchases of target stock. LIPTON, *supra* note 11, § 1.01[1]. For state reaction to hostile takeovers, see generally *New Directions in State Takeover Regulation: The Second Generation Statutes*, ALI-ABA COURSE OF STUDY MATERIALS (1986) [hereinafter *State Takeover Regulation*]; for federal concerns, see generally CORPORATE TAKEOVERS, *supra* note 12.

19. Note that the Williams Act, Pub. L. No. 90-439, 82 Stat. 954 (codified as amended at 15 U.S.C. §§ 78m(d)-(e), 78n(d)-(f) (1982)), does not define the term "tender offer." However, takeover specialists have developed a working definition:

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

E. ARANOW & H. EINHORN, TENDER OFFERS FOR CORPORATE CONTROL 70 (1973). While an extended discussion of the mechanics of tender offers is beyond the scope of this Comment, a brief outline of the cash tender offer process is useful:

> The tender invitation or announcement advising shareholders of the cash tender offer serves as the offeror's "prospectus" and is the basic tool employed in the solicitation of tenders. As such, it is essential that the invitation contain all the information necessary to enable any shareholder to evaluate the offer and properly tender his shares. Where access to the shareholders list has been obtained, the offeror can be expected to transmit copies of the invitation to each registered owner of the target's shares. Arrangements will also be made with broker-dealers to provide beneficial owners of securities held in street name with the tender invitation. To assure maximum exposure for the offer, the bidder will usually publish the invitation in general and financial newspapers of national daily circulation. Regional or local publications may also be used where there is some evidence of concentrated share ownership in a particular geographic area.
>
> Invitations for cash tenders generally consist of three principal parts:
> 1. The basic terms and conditions of the offer;
> 2. The mechanics of tendering shares; and
> 3. The information required by Rule 14d-1(c) promulgated pursuant to Section 14(d)(1) of the Securities Exchange Act of 1934.

Id. at 46-47 (footnotes omitted). For thorough descriptions of the tender offer process, see *id.* at 46-63; LIPTON, *supra* note 11, §§ 1.03-1.07.

> quisition in which the target's stockholders are, in effect, paid out of the target's own assets; . . .
>
> - exceptionally high cash flow, unused borrowing capacity, above-average return on net worth, or an imminent turn-around from depressed earnings — all of which also facilitate boot-strap acquisitions;
>
> - a low price earnings ratio and high book value in relation to market price — however, in recent years there have been a number of raids on high quality, high multiple companies;
>
> - undervalued assets (e.g., natural resources acquired long ago), especially if conservatively valued for accounting purposes and if their true worth is not reflected in the market price;
>
> - a business that [the raider] knows and understands;
>
> - no concentrated blocks [of stock] in inside hands — however, large institutional or street holdings are desirable, and large holdings by estates or other fiduciaries, even if identified with insiders, may create vulnerability;
>
> - no antitrust or other regulatory problems — banks, insurance companies, radio stations and defense contractors are particularly difficult targets, although it appears that regulatory agencies and the courts are increasingly reluctant to interfere with tender offers by requiring approval of transfer of control prior to consummation of a tender offer;
>
> - insiders with a low tax basis for their shares who may be receptive to conversion of a cash tender offer to a complete or partial tax-free merger [or an installment sale purchase of their shares prior to or after a cash tender offer]; and
>
> - a management that probably will not fight too hard — the perception of management as "hard" or "soft" is one of the most important factors in the selection of a takeover target.[20]

As hostile takeovers create major corporate realignments on what seems to be an almost weekly basis, a serious policy debate has emerged concerning the merits of this activity. Proponents of the game, as it is presently played, argue that the threat of a hostile takeover serves to invigorate a management team that would otherwise become complacent.[21] In the face of a challenge from a would-be acquirer, managers who wish to retain their titles will man the corporate bastion, improving business efficiency in an attempt to increase the market price of the target's equity securities. Takeover proponents also submit that takeovers promote economies of scale, and facilitate corporate restructurings as an appropriate response to

20. LIPTON, *supra* note 11, § 1.03[2] (footnotes omitted).
21. *See generally* CORPORATE TAKEOVERS, *supra* note 12.

changed economic conditions.[22] Those who see a dark side to all of this assert that the threat of hostile takeovers unduly diverts management attention from important long-range planning concerns to short-term takeover defense strategies.[23] In what may prove to be a particularly prescient observation, critics observe that the wave of takeover-induced restructurings has resulted in a highly leveraged corporate structure, a situation that poses a significant threat to long-term financial stability and economic growth.[24]

The principal evil that state antitakeover legislation purports to address is not the takeover itself, but rather the coercive nature of certain types of takeover tactics, particularly the front-end-loaded, two-tier tender offer. The classic two-tier scenario involves a bidder's offer to purchase slightly more than half of a corporation's stock at a premium over the market price.[25] Once the bidder obtains a majority of the stock, the bidder will subsequently "cash out" the remaining minority in a "back-end" merger.[26] This second-tier cash-out process is perceived as unfair. Frequently the price offered at the back end is less than that offered at the front end, or stockholders are offered "junk bonds" in lieu of cash.[27] Stockholder knowledge that the bidder contemplates a two-tier offer tends to create a herd mentality, with the goal of tendering in the first tier of the offer in order to avoid a later cash out on less favorable terms.[28]

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22. *Id.*

23. *See* Lipton, *Corporate Governance in the Age of Finance Corporatism*, 136 U. PA. L. REV. 1, 23-25 (1987) ("[T]he current wave of takeover activity has caused both raider and target to expend resources on inherently non-productive activity . . . .").

24. CORPORATE TAKEOVERS, *supra* note 12, at 14. *See also Corporate Takeovers: Hearings Before the Subcomm. on Telecommunications, Consumer Protection, and Finance of the House Comm. on Energy and Commerce* (pts. 1-2), 99th Cong., 1st Sess. (1985).

25. Lipton, *supra* note 23, at 18.

26. *Id.*

27. *See* Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 956 (Del. 1985) (characterizing two-tier offer as "a classic coercive measure designed to stampede shareholders into tendering"); *accord* Ivanhoe Partners v. Newmont Mining Corp., 535 A.2d 1334, 1342 (Del. 1987).

28. For a discussion of target defenses to such techniques, see LIPTON, *supra* note 11, § 6.03[3]. *See also* Moran v. Household Int'l, Inc., 500 A.2d 1346 (Del. 1985) (upholding target board's decision to declare a "poison pill" dividend of preferred stock purchase rights in response to perceived vulnerability of target). " '[P]oison pill' generically refers to various defensive measures adopted by boards of directors in response to takeover attempts or in advance of possible takeover attempts that can cause severe economic repercussions in an acquirer or potential controlling person." Dawson, Pence & Stone, *Poison Pill Defensive Measures*, 42 BUS. LAW. 423, 423 (1987). *See also* Helman & Junewicz, *A Fresh Look at Poison Pills*, 42 BUS. LAW. 771 (1987) (discussing proliferation of poison pill plans in the wake of the *Household* decision).

B. *State Takeover Regulation Prior to the CTS Decision*

At the time of the Supreme Court decision in *CTS*,[29] twenty-nine states had some form of regulation concerning tender offers for shares of corporations connected in various ways with those states.[30] Many of these statutes are so-called "second generation" takeover laws, which were enacted in response to the Supreme Court's 1982 ruling in *Edgar v. MITE Corp.*[31] In *MITE*, the Supreme Court invalidated the Illinois Business Take-Over Act,[32] holding that the Act unduly burdened interstate commerce in violation of the commerce clause.[33] Three Justices also joined in holding that the Act was preempted by the Williams Act.[34] The Illinois statute required a tender offeror to notify the Secretary of State and the target company of the material terms of the offer twenty business days before the offer was to become effective.[35] During that time, the Act permitted no communication between the offeror and shareholders, although target management was free to disseminate information to shareholders.[36] The Illinois Secretary of State was allowed to call a hearing with respect to any tender offer subject to the Act at any time prior to the commencement of the offer. There was, however, no deadline for the completion of the hearing.[37] In terms of buying time for target management, however, the Act contained a useful provision that allowed Illinois residents who held at least ten percent of the target's outstanding shares to request that the Secretary of State hold a hearing on the tender offer.[38] Justice White noted that

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

30. Comment, *Beyond CTS: A Limited Defense of State Tender Offer Disclosure Requirements*, 54 U. CHI. L. REV. 657, 664 n.39 (1987).

31. 457 U.S. 624 (1982).

32. ILL. REV. STAT. ch. 121 ½, ¶¶ 137.51-137.70 (1979) (repealed 1983).

33. U.S. CONST. art. I, § 8, cl. 3.

34. Pub. L. No. 90-439, 82 Stat. 954 (codified as amended at 15 U.S.C. §§ 78m(d)-(e), 78n(d)-(f) (1982 & Supp. IV 1986)). The Williams Act Amendments to the Securities Exchange Act of 1934 were intended to ensure that investors responding to tender offers received full and fair disclosure. *See Full Disclosure of Corporate Equity Ownership and in Corporate Takeover Bids: Hearings on S. 510 Before the Subcomm. on Securities of the Senate Comm. on Banking and Currency*, 90th Cong., 1st Sess. (1967); *Takeover Bids: Hearing on H.R. 14475, and S. 510 Before the Subcomm. on Commerce and Finance of the House Comm. on Interstate and Foreign Commerce*, 90th Cong., 2d Sess. (1968).

35. ILL. REV. STAT. ch. 121 ½, ¶ 137.54.B .E. The Act defined a "target company" as a corporation in which Illinois shareholders owned 10% of the class of securities subject to the takeover offer or for which any two of the following conditions were met: the corporation had its principal office in Illinois, was organized under Illinois law, or had at least 10% of its stated capital and paid-in surplus represented within the state. *Id.*, ¶ 137.52-10.

36. *Id.* ¶ 137.54.A.

37. *Id.* ¶ 137.54.A-D.

38. *Id.* ¶ 137.57.A.

> [s]ince incumbent management in many cases will control, either directly or indirectly, 10% of the target company's shares, this provision allows management to delay the commencement of an offer by insisting on a hearing. As the Court of Appeals observed, these provisions potentially afford management a "powerful weapon to stymie indefinitely a takeover." In enacting the Williams Act, Congress itself "recognized that delay can seriously impede a tender offer" and sought to avoid it.[39]

In White's view, that the Illinois Act allowed the Secretary of State to consider the substantive fairness of the tender offer[40] constituted an additional conflict with the Williams Act. Justice White reasoned that in enacting the Williams Act Congress reaffirmed the rights of investors to make independent investment decisions.[41]

The majority in *MITE* found the Illinois statute unconstitutional under the commerce clause.[42] Applying the balancing test espoused in *Pike v. Bruce Church, Inc.*,[43] Justice White noted that the statute's purported national scope, allowing the Illinois Secretary of State to block any tender offer falling within the Act, was clearly excessive in relation to the local interests served by the statute.[44] Additionally, Justice White could find no legitimate state interest in protecting nonresident shareholders, and remained unconvinced that the statute substantially enhanced shareholders' positions beyond the provisions already embodied in the Williams Act.[45] The *MITE* majority held that state securities regulation must survive a *Pike* commerce clause analysis; Justice White's preemption argument failed to

39. *MITE*, 457 U.S. at 637 (quoting MITE Corp. v. Dixon, 633 F.2d 486, 494 (7th Cir. 1980); Great W. United Corp. v. Kidwell, 577 F.2d 1256, 1277 (5th Cir. 1978), *rev'd on venue grounds sub nom.* Leroy v. Great W. United Corp., 443 U.S. 173 (1979)) (footnotes omitted).

40. The Secretary of State was required to deny registration of a takeover offer if he found that the offer "fail[ed] to provide full and fair disclosure to the offerees . . . or that the takeover offer [was] inequitable . . . ." ILL. REV. STAT. ch. 121 ½, ¶ 137.57.E.

41.

> The Court of Appeals understood the Williams Act and its legislative history to indicate that Congress intended for investors to be free to make their own decisions. We agree . . . . [A]s the Court of Appeals said, "[t]he state thus offers investor protection at the expense of investor autonomy — an approach quite in conflict with that adopted by Congress."

MITE, 457 U.S. at 639-40 (quoting MITE Corp. v. Dixon, 633 F.2d at 494).

42. *Id.* at 643.

43. 397 U.S. 137 (1970) ("Where the [state] statute regulates evenhandedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits." *Id.* at 142.).

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

45. *Id.* at 644.

attract a majority of the Court.[46]

Although the Supreme Court's decision in *MITE* may have closed the front door on certain forms of state securities regulation, states quickly made an end run to the service entrance.[47] A common thread among post-*MITE* "second generation" statutes is that they generally apply only to domestically incorporated firms, conforming to the traditional choice-of-law rule in corporate law.[48] In addition, when a second generation statute requires approval of a transaction, it is only the firm's shareholders, and not a state agency, whose decision determines the outcome.[49] As a final response to *MITE*, firms may generally elect to "opt out" of the state tender offer regulatory scheme.[50]

C. *CTS Validates Indiana's Control Share Statute*

[T]he heart of this case is whether federal law bars the States

46. The opinion of the Court in *MITE* consisted of Parts I, II, and V-B, which included the facts of the case, a holding that the case was not moot, and Justice White's commerce clause analysis employing the *Pike* test. For the allocation of the Justices' votes in the complex set of opinions in *MITE*, see Note, *The Unsung Death of State Takeover Statutes: Edgar v. MITE Corp.*, 24 B.C.L. REV. 1017, 1039-44 (1983).

47. The *MITE* decision has generated a substantial body of commentary. For a basic bibliography, see *State Takeover Regulation, supra* note 18, at 289-90; *see also* Goelzer & Cohen, *The Empires Strike Back — Post-MITE Developments in State Antitakeover Regulation*, in TENDER OFFERS 49 (M. Steinberg ed. 1985); Sargent, *Do The Second-Generation State Takeover Statutes Violate the Commerce Clause? A Preliminary Inquiry*, *id.* at 75. For analyses written shortly before the *CTS* decision, see Pinto, *Takeover Statutes: The Dormant Commerce Clause and State Corporation Law*, 41 U. MIAMI L. REV. 473 (1987); Note, *The Constitutionality of Second Generation Takeover Statutes*, 73 VA. L. REV. 203 (1987). Four types of statutes have evolved in the post-*MITE* era. These include: (1) "fair-price" provisions; (2) redemption rights provisions; (3) control share acquisition laws; and (4) business combination statutes. "Fair-price provisions" regulate the second step of a front-end-loaded, two-tier offer, typically requiring that shareholders who tender in the second or later stage of an acquisition receive a price at least equal to the highest paid by the offeror within the past two years. LIPTON, *supra* note 11, § 5.02[4][d]. *See also* Romano, *The Political Economy of Takeover Statutes*, 73 VA. L. REV. 111, 117-20 (1987). A "redemption rights statute," such as that enacted in Pennsylvania, mandates that the acquirer of a certain percentage of a firm's stock must be prepared to buy out all of the remaining shareholders at a cash amount equal to the fair value of the stock, which may include a control premium. *See* PA. STAT. ANN. tit. 15, § 1910 (Purdon Supp. 1986) (30% threshold). *See also* LIPTON, *supra* note 11, § 5.02[4][d]; Comment, *The 1983 Amendments to Pennsylvania's Business Corporation Law: Unconstitutional? MITE Be*, 89 DICK. L. REV. 401, 424-40 (1985). A "control share acquisition statute" attempts to protect shareholders from front-end-loaded, two-tier tender offers by allowing shareholders to evaluate the tender offer as a group, thus lessening the pressure to tender early lest they be "frozen out" at a lower price in the second step of the transaction. *See* Pinto, *supra* note 7, at 5, col. 1. Finally, "business combination statutes" seek to restrict mergers or certain other business combinations between a successful acquirer and the target for a given period of time. The New York statute provides for a five-year merger restriction. *See* N.Y. BUS. CORP. LAW § 912 (McKinney 1987).

48. Romano, *supra* note 47, at 115.

49. *Id.*

50. *Id.*

> from developing their generic corporation laws in ways that do *not* restrict or regulate the purchase or sale of securities or any other transaction in interstate commerce, but that may (depending on the intentions of a potential bidder) make a State's domestic corporations less attractive as hostile takeover targets.[51]

The Indiana Control Share Acquisitions Chapter[52] is a classic response to the Supreme Court's decision in *MITE*. Signed into law on March 4, 1986, the Indiana Act applies only to "issuing public corporations"[53] incorporated in the State of Indiana.[54] The Act defines an "issuing public corporation" as 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 10 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.[55]

The Act is addressed to the "control share" acquirer. Under the Indiana statute, "control shares" are those that would give their acquirer voting power equal to or greater than any one of three thresholds — 20 percent, 33-⅓ percent, or 50 percent.[56] An acquirer's plan for a would-be target may prove to be illusory, however, because once the acquirer has crossed a threshold, his voting power can be exercised "only to the extent granted by resolution approved by the shareholders of the issuing public corporation."[57] The statute requires a majority vote of all shares, "excluding all interested shares," in order for voting rights to attach to control shares.[58] "The practical effect of this requirement is to condition acquisition of control of a corporation on approval of a majority of the pre-existing disinter-

51. Brief for Appellants at 9-10, CTS Corp. v. Dynamics Corp. of America, 107 S. Ct. 1637 (1987) (No. 86-71).

52. IND. CODE §§ 23-1-42-1 to -11 (Supp. 1986).

53. *Id.* § 23-1-42-4.

54. *Id.* § 23-1-20-5.

55. *Id.* § 23-1-42-4(a).

56. *Id.* § 23-1-42-1.

57. *Id.* § 23-1-42-9(a).

58. *Id.* § 23-1-42-9(b)(2). "Interested shares" include the shares of an acquiring person, and those of an inside director or officer of the issuer, which may be used to "exercise or direct the exercise of the voting power of the corporation in the election of directors." *Id.* § 23-1-42-3.

ested shareholders."[59]

The timing of this activity is obviously crucial to the acquirer. If the acquiring person files an "acquiring person statement" with the target, the acquirer can request a special shareholders' meeting for a vote within fifty days of the target's receipt of the request.[60] If no request is made, the vote on control shares will be held at the next special or annual meeting of the shareholders.[61] If, during the course of this meeting, the acquirer's plans are defeated, the corporation may redeem the acquirer's shares at fair market value, although the corporation is not required to do so.[62]

In *CTS Corp. v. Dynamics Corp. of America*,[63] the Supreme Court once again focused its attention on state regulation of takeover activity. Dynamics owned 9.6 percent of the common stock of CTS, an Indiana corporation. On March 10, 1986, Dynamics announced a tender offer for another million shares of CTS.[64] Six days prior to this time, the Indiana Control Share Acquisition Chapter had gone into effect; the Dynamics tender offer threatened to increase Dynamics' ownership interest in CTS to 27.5 percent.[65] Interestingly, it was not until March 27, 1986, that the CTS Board elected to be governed by the provisions of the Act.[66] Dynamics had previously filed suit against CTS on March 10, 1986 alleging violations of federal securities laws.[67] When CTS sought the protection of the Indiana Act, Dynamics moved to amend its complaint on the grounds that the Indiana Act violated the Williams Act[68] and the commerce

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59. CTS Corp. v. Dynamics Corp. of America, 107 S. Ct. 1637, 1641 (1987) (footnote omitted).

60. IND. CODE § 23-1-42-7(a), (b). The "acquiring person statement" identifies the acquirer and purports to outline the structure of the acquisition plan. *Id.* § 23-1-42-6. The acquirer agrees to pay the expenses of a special meeting. *Id.* § 23-1-42-7(a).

61. *Id.* § 23-1-42-7(c).

62. *Id.* § 23-1-42-10(b). If the acquirer has not filed an acquiring person statement, the corporation may, if its articles or bylaws permit, redeem the acquirer's shares at any time during the 60 days following the acquirer's last acquisition. *Id.* § 23-1-42-10(a).

63. 107 S. Ct. 1637 (1987).

64. *Id.* at 1642.

65. *Id.*

66. *Id. See also* IND. CODE § 23-1-17-3.

67. *CTS*, 107 S. Ct. at 1642. Dynamics filed suit in the United States District Court for the Northern District of Illinois. The District Court ruled that the Williams Act preempted the Indiana Act and that the Indiana Act violated the commerce clause. *Id.* at 1642. *See* Dynamics Corp. of America v. CTS Corp., 637 F. Supp. 389 (N.D. Ill. 1986) *aff'd*, 794 F.2d 250 (7th Cir. 1986), *rev'd*, 107 S. Ct. 1637 (1987). The Seventh Circuit affirmed the judgment of the District Court. *CTS*, 107 S. Ct. at 1643. *See* Dynamics Corp. of America v. CTS Corp., 794 F.2d 250 (7th Cir. 1986), *aff'g* 637 F. Supp. 389 (N.D. Ill. 1986), *rev'd*, 107 S. Ct. 1637 (1987).

68. Pub. L. No. 90-439, 89 Stat. 954 (codified as amended at 15 U.S.C. §§ 78m(d)-(e), 78n(d)-(f) (1982 & Supp. IV 1986)).

clause.[69]

Although the antitakeover statutes at issue in *CTS* and *MITE* were substantially similar, the Supreme Court upheld the Indiana statute and distinguished it from its ill-fated Illinois predecessor. Finding no violation of the Williams Act, Justice Powell, writing for the majority, stated that the Indiana Act "furthers the federal policy of investor protection."[70] Justice Powell drew a distinct comparison with *MITE*:

> In implementing its goal, the Indiana Act avoids the problems the plurality discussed in *MITE*. Unlike the *MITE* statute, the Indiana Act does not give either management or the offeror an advantage in communicating with the shareholders about the impending offer. The Act also does not impose an indefinite delay on tender offers. Nothing in the Act prohibits an offeror from consummating an offer on the 20th business day, the earliest day permitted under applicable federal regulations. Nor does the Act 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 effectiveness of the offer collectively.[71]

The Court was unreceptive to Dynamics' argument that the fifty-day waiting period prior to a shareholders' meeting and decision on voting rights conflicted with the twenty-day federal minimum period for which a tender offer must be held open.[72] "If the offeror fears an adverse stockholder vote under the Act, it can make a conditional tender offer, offering to accept shares on the condition that the shares receive voting rights within a certain period of time."[73] The Court espoused the argument that delay *qua* delay did not create an inherent conflict with the Williams Act; as the Court indicated in *MITE*, only "*unreasonable* delay" will disqualify a state statute.[74]

The Court in *CTS* rejected Dynamics' assertion that the Indiana statute violated the commerce clause. "[T]his Act does not prohibit any entity — resident or nonresident — from offering to

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69. U.S. CONST. art. I, § 8, cl. 3. *See CTS*, 107 S. Ct. at 1642.

70. *CTS*, 107 S. Ct. at 1637. Justice Powell was joined in the majority by Justices Rehnquist, Brennan, Marshall, and O'Connor. Justice Scalia concurred in part and concurred in the judgment. Justice White filed a dissenting opinion which was joined in part by Justices Blackmun and Stevens.

71. *Id.* at 1646 (citation omitted).

72. *Id.* at 1647. *See* 17 C.F.R. § 240.14e-1(a) (1986).

73. *CTS*, 107 S. Ct. at 1647.

74. *Id.* (quoting Edgar v. MITE Corp., 457 U.S. 624, 639 (1982)). *See also* 15 U.S.C. § 78n(d)5 (establishing 60-day maximum period for tender offers).

purchase, or from purchasing, shares in Indiana corporations, or from attempting thereby to gain control. It only provides regulatory procedures designed for the better protection of the corporations' shareholders."[75] The commerce clause analysis in *CTS* focused on Indiana's dual rights — first, to regulate the corporations that it charters, and second, to protect shareholders who are Indiana residents.[76] The basic distinction that the Court in *CTS* appeared to draw between the Illinois statute invalidated in *MITE*, and the Indiana statute, was that the Indiana statute represented an attempt to define shareholder rights in a takeover attempt, while the Illinois statute effectively restrained the alienation of shares.[77] Although a share that is stripped of its voting power is certainly of questionable value to a would-be acquirer, Indiana does not attempt to prevent an "acquiring person" from making a play for an attractive target; no one is denied a chance to roll the dice at the craps table of corporate control. However, to the extent that an acquirer contemplates the use of "loaded dice," such as the two-tier approach,[78] the *CTS* decision validates state action.[79]

75. *Id.* at 1652. One commentator opined that the Court in *CTS* viewed the statute as "well-intended, benign, and favorable to shareholders." Cherno, *supra* note 7, at 3-4.

76. In a key passage, Justice Powell noted:

> We agree that Indiana has no interest in protecting nonresident shareholders *of nonresident corporations*. But this Act applies only to corporations incorporated in Indiana. We reject the contention that Indiana has no interest in providing for the shareholders of its corporations the voting autonomy granted by the Act. Indiana has a substantial interest in preventing the corporate form from becoming a shield for unfair business dealing. Moreover, unlike the Illinois statute invalidated in *MITE*, the Indiana Act applies only to corporations that have a substantial number of shareholders in Indiana. Thus, every application of the Indiana Act will affect a substantial number of Indiana residents, whom Indiana indisputably has an interest in protecting.

CTS, 107 S. Ct. at 1651-52 (citation omitted).

77. *See* Comment, *supra* note 30, at 669 & n.66.

78. *See supra* notes 27-28 and accompanying text.

79.

> The Indiana Act operates on the assumption, implicit in the Williams Act, that independent shareholders faced with tender offers often are at a disadvantage. By allowing such shareholders to vote as a group, the Act protects them from the coercive aspects of some tender offers. If, for example, shareholders believe that a successful tender offer will be followed by a purchase of nontendering shares at a depressed price, individual shareholders may tender their shares — even if they doubt the tender offer is in the corporation's best interest — to protect themselves from being forced to sell their shares at a depressed price . . . . The desire of the Indiana Legislature to protect shareholders of Indiana corporations from this type of coercive offer does not conflict with the Williams Act. Rather, it furthers the federal policy of investor protection.

CTS, 107 S. Ct. at 1646.

D. *Reaction to CTS*

The initial reaction of the corporate bar and the academic community to the *CTS* decision was one of uncertainty. There seemed to be little doubt that a control share statute might be a valuable defensive weapon for a potential target, since it could provide the target with a longer period of time in which to react to a takeover attempt.[80] A persistent bidder, however, might simply make offers contingent upon receiving the voting rights of shares, launch a proxy fight for control of the board, or undertake an effort to persuade shareholders to adopt a charter amendment "opting out" of the statute.[81] Noting the strong local ties required for a target corporation to fall within the ambit of the Indiana statute, some observers felt that while acquirers would shy away from "bullet-proof" local companies, large national firms would not be similarly affected.[82]

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80. *Takeover Laws, supra* note 7, at 7, col. 1. Arthur Fleishcher, Jr., a partner at Fried, Frank, Harris, Shriver & Jacobsen, has commented, "Time is the great ally of the target. This provision gives management more time to restructure, more time to find a white knight, and more time to make various legal maneuvers." *Delaware Plan on Takeovers*, N.Y. Times, June 1, 1987, at D2, col. 1.

81. *Deleware Plan on Takeovers, supra* note 80 at D2, col. 1.

82. *Id.* Professor John Coffee of Columbia University stated:

> For most New York Stock Exchange Companies, you will not find that percentage of shares or shareholders in any one state, with the exception of New York or California. General Motors and Bank of America won't have that kind of contact with this kind of statute; although there may be new statutes that may go down the slippery slope even further.

Id. at D6, col. 3. *See* IND. CODE § 23-1-42-4 (Supp. 1986). Law firms expressed similar uncertainty in their client memos. Gibson, Dunn & Crutcher of Los Angeles believed that:

> [s]ome takeover tactics, such as "creeping takeovers," and "street sweeps," would be radically restricted in states having such laws. It is important to recognize, however, that the Indiana approach to the regulation of takeovers facilitates the ability of an acquiror to put its offer before the shareholders of the target, and could, depending upon future judicial developments, lead to new constraints on the ability of a Board of Directors to maintain a target company's independence. It could also enhance the opportunities for competitive bidding in "friendly" transactions. It is *possible* that the Supreme Court's decision will have the effect of validating tougher, more defense-oriented, statutes than Indiana's. This is far from clear, however.

Cherno, *supra* note 7, at 4.

In a "creeping" acquisition, stock is acquired in small blocks to avoid SEC filings and a public announcement of a tender offer. *See* LIPTON, *supra* note 11, § 2.02[2].

When an acquirer attempts a "street sweep," he seeks to take control in the market during and shortly after a tender offer for the same class of securities. Stephen Volk, the head of the mergers and acquisitions department at Shearman & Sterling, predicted that control share legislation will cause acquirers to limit their open market accumulations to below 20%. *See Takeover Laws, supra* note 7, at 7, col. 1.

While a target's use of a street sweep as a defensive tactic was approved by the Delaware Supreme Court in Ivanhoe Partners v. Newmont Mining Corp., 535 A.2d 1334 (Del. 1987), the SEC opposes street sweeps as a violation of the Williams Act. *See* Hanson Trust PLC v. SCM Corp., 774 F.2d 47 (2d Cir. 1985); SEC v. Carter Hawley Hale Stores, Inc., 760 F.2d 945 (9th Cir. 1985). A proposed SEC rule would treat market sweeps similarly to tender offers

III. "Delaware Is Flashing A Yellow Caution Signal."[83]

A. *Initial Reaction to CTS In Delaware*

As members of the corporate community considered the implications of *CTS*, the Council of the Corporation Law Section of the Delaware State Bar Association began preparing recommendations for the state legislature.[84] An early concern of the Council was language in the *CTS* opinion indicating that Indiana's right to regulate takeovers stemmed from something more than Indiana's role as the target's chartering state.[85] Justice Powell, in his commerce clause analysis, justified Indiana's interest in protecting its resident shareholders, stating:

> [T]his Act applies only to corporations incorporated in Indiana. We reject the contention that Indiana has no interest in providing for the shareholders of its corporations the voting autonomy granted by the Act. Indiana has a substantial interest in preventing the corporate form from becoming a shield for unfair business dealing. *Moreover, unlike the Illinois statute invalidated in MITE, the Indiana Act applies only to corporations that have a substantial number of shareholders in Indiana. Thus, every application of the Indiana Act will affect a substantial number of Indiana residents, whom Indiana indisputably has an interest in protecting.*[86]

Any hint that a state's ability to regulate takeover activity might be predicated on more than its status as the state of incorporation would of course be anathema in Delaware.[87] One leader of the Dela-

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for regulatory purposes. Acquisitions of Substantial Amounts of Securities and Related Activities Undertaken During and Following a Tender Offer for Those Securities, Exchange Act Release No. 24,976, [1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,160 (Oct. 1, 1987).

In New York, Skadden, Arps, Slate, Meagher & Flom surmised that:

> [w]e are likely to see a wave of "second generation" takeover statutes adopted on the heels of the *CTS Corp.* decision . . . . In general, to the extent they add more time, complexity, uncertainty and cost to a bid, these statutes can be anticipated to result in fewer takeovers and in a greater tendency toward higher priced offers to all shareholders for those offers that are made.

Cherno, *supra* note 7, at 4-5. A Debevoise and Plimpton memo to clients was somewhat less hesitant, noting that "[w]hile the *CTS* decision clearly represents a victory for the defensive side of the takeover process, it should not change the prevailing principle that to the highest bidder go the spoils." *Takeover Laws, supra* note 7, at 7, col. 1.

83. *Delaware Fails to Adopt Plan on Takeovers*, Wall St. J., June 16, 1987, at 2, col. 2.

84. *See supra* notes 1-10 and accompanying text.

85. *See States Flex Muscle on Takeovers, supra* note 7, at 35, col. 4.

86. CTS Corp. v. Dynamics Corp. of America, 107 S. Ct. 1637, 1651-52 (1987) (citation omitted) (emphasis added).

87. Delaware receives a higher percentage of taxes and fees associated with incorporation than any other state. *Delaware Plan on Takeovers, supra* note 80, at D2, col. 1. *See also*

ware Bar moved quickly to characterize the "moreover" language as "surplusage — it's not what the court based its decision on. The only fair reading is that internal affairs should only be governed by the state of incorporation."[88]

In *McDermott, Inc. v. Lewis*,[89] decided on September 16, 1987, the Delaware Supreme Court defended the internal affairs doctrine. The court recognized the traditional conflict of laws rule that "internal corporate relationships are governed by the laws of the forum of incorporation."[90] The court also recognized that corporate directors and officers, as well as shareholders, have a constitutional right to know what laws govern the conduct of corporate officers.[91] The Delaware Supreme Court ignored the "moreover" language in *CTS*, focusing instead on the distinction that the *CTS* Court drew between the Indiana statute and the Illinois statute invalidated in *MITE*. While Illinois "purported to govern the internal affairs of foreign corporations,"[92] Indiana "is merely regulating the internal affairs of its own corporations,"[93] and therefore, is not in violation of the commerce clause.[94]

Romano, *Law as a Product: Some Pieces of the Incorporation Puzzle*, 1 J. L., ECON., & ORGANIZATION 225, 238-42 (1985). However, while many companies incorporate in Delaware, only a handful of major companies have their headquarters in the state. *Sophistication, Tradition Mix in Wilmington*, Legal Times, September 26, 1983, at 32.

88. *States Flex Muscle on Takeovers, supra* note 7, at 35, col. 4 (quoting A. Gilchrist Sparks, III, of Wilmington's Morris, Nichols, Arsht & Tunnell, Chairman, Council of the Corporation Law Section of the Delaware State Bar Association).

89. 531 A.2d 206 (Del. 1987).

90. *Id.* at 215. The Delaware Supreme Court reasoned,

> [A]pplication of the internal affairs doctrine is not merely a principle of conflicts law. It is also one of serious constitutional proportions — under due process, the commerce clause and the full faith and credit clause — so that the law of one state governs the relationships of a corporation to its stockholders, directors and officers in matters of internal corporate governance. The alternatives present almost intolerable consequences to the corporate enterprise and its managers.

Id. at 216.

91.

> With the existence of multistate and multinational organizations, directors and officers have a significant right, under the fourteenth amendment's due process clause, to know what law will be applied to their actions. Stockholders also have a right to know by what standards of accountability they may hold those managing the corporation's business and affairs.

Id. at 216-17.

92. *Id.* at 217 n.12.

93. *Id.*

94. For discussions of the internal affairs doctrine, see Kaplan, *Foreign Corporations and Local Corporate Policy*, 21 VAND. L. REV. 433 (1968); Kozyris, *Corporate Wars and Choice of Law*, 1985 DUKE L.J. 1 (1985). Delaware may actually be in a stronger position to regulate, on the strength of its status as the chartering state, than states that seek to protect "pseudo foreign corporations." Such corporations may have extensive ties to a given state, but are not incorporated in that state. *See Takeover Laws, supra* note 7, at 6, cols. 3, 4. This problem was addressed in TLX Acquisition Corp. v. Telex Corp., 679 F. Supp. 1022 (W.D.

While defending the internal affairs doctrine the guardians of the Delaware General Corporation Law appeared to be moving toward their own control share proposal.[95] In early June, however, the Council of the Corporation Law Section of the Delaware State Bar Association decided against submitting a proposal to the state legislature before the legislative session ended on June 30, 1987.[96] Lewis S. Black, Jr., a member of the Council, stated: "There were enough unanswered questions and enough problems as to how the statute would work in practice. Delaware is flashing a yellow caution signal."[97]

Black identified a number of questions that were raised in the Council's deliberations.[98] There seemed to be a general concern that while a control share statute was designed on its face to protect shareholders, various provisions of the statute could become powerful weapons in the hands of clever managements or bidders.[99] Extending the tender offer waiting period from the twenty days required under the Williams Act[100] to the fifty days allowed before a shareholder vote under the Indiana statute[101] might be intended to deter raiders, but what sort of insurance is such a provision in an era of creative takeover financing such as bridge loans and junk bonds?[102] Similarly unsettled was the question of defensive actions that target management could take during the fifty-day waiting period.[103] Since every control share acquisition would launch a proxy fight, both the courts and the SEC would presumably act as referees, defining limits to which bidders and targets could go in advancing their respective interests.[104]

Okla. 1987) (declaring unconstitutional the Oklahoma Control Shares Acquisition Act, OKLA. STAT. ANN. tit. 18, §§ 1145-55 (West. Supp. 1988), which purported to regulate foreign corporations having substantial ties with the State of Oklahoma).

95. *See Delaware Plan on Takeovers, supra* note 80, at D2, col. 1. The Delaware plan was substantially similar to the Indiana legislation discussed in *CTS*. *See supra* notes 52-62 and accompanying text. Unlike the Indiana statute, however, the Delaware plan would have applied to any Delaware-incorporated business that chose to adopt it. *Delaware Plan on Takeovers, supra* note 80, at D2, col. 1.

96. *Delaware Fails to Adopt Plan on Takeovers, supra* note 83, at 2, col. 2.

97. *Id.*

98. *See* Black, *Why Delaware is Wary of Anti-Takeover Law*, Wall St. J., July 10, 1987, at 18, col. 3.

99. *Id.*

100. 17 C.F.R. § 240.14e-1(a) (1986).

101. IND. CODE § 23-1-42-7 (Supp. 1986).

102. Black, *supra* note 98, at 18, col. 3.

103. *Id.* As Dennis Block of New York's Weil, Gotshal & Manges has observed, "The whole question of whatever defensive tactics are taken during the 50-day period — restructuring, recapitalization — will be litigated in state court." *Takeover Laws, supra* note 7, at 7, col. 1.

104. Black, *supra* note 98, at 18, col. 3.

The Council maintained a healthy skepticism concerning the motivations of the players in the takeover drama. A bidder seeking to put a target into play, or with the less noble goal of harassment, need merely notify the company of an intention to make a control share acquisition in order to trigger a stockholder plebescite.[105] If one takes a hard look at who would be voting in such a plebescite — frequently institutions and arbitrageurs seeking the highest margin of profit — there would seem to be few occasions when the bidder offering the largest premium would not carry the day.[106] This is a particularly important consideration for Delaware; firms incorporated in Delaware tend to have a higher percentage of institutional investors than firms incorporated elsewhere.[107]

The Council was also faced with the looming spectre of federal intervention in the takeover game. Legislation was pending before both houses of Congress that, if enacted, would have effectively preempted key provisions in state control share legislation.[108] Similarly,

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105. *Id.* Professor James Cox of the Duke University Law School refers to this feature as the "Boesky provision." In the Cox scenario,

> [i]f a Carl Icahn or a Jack-the-Liquidator wants to put a company into play, he can trigger a stockholder meeting. During the interim period of 50 days, the arbs buy large blocks of shares that are seemingly independent of Icahn or Jack-the-Liquidator but in actuality can be voted in favor of the takeover so that their stock rises in value.

Delaware Plan on Takeovers, *supra* note 80, at D2, col. 1.

106. Black, *supra* note 98, at 18, col. 3.

107. Macey & Miller, *Toward an Interest-Group Theory of Delaware Corporate Law*, 65 TEX. L. REV. 469, 478-79 (1987). *But cf.* Baysinger & Butler, *The Role of Corporate Law in the Theory of the Firm*, 28 J. L. & ECON. 179, 184-89 (1985) (arguing that firms with large proportions of stock held by identifiable ownership groups are more likely to prefer a "strict" jurisdiction, as opposed to Delaware's "liberal" regime; empirical results for preferences of institutional investors, however, vary depending on the type of analysis used).

108. Black, *supra* note 98, at 18, col. 3. In the 99th Congress, 64 bills were introduced relating to corporate takeovers. CORPORATE TAKEOVERS, *supra* note 12, at 5 n.11. For hearings and takeover legislation introduced in the 99th Congress, see K. WINCH & M. JICKLING, CORPORATE MERGER LEGISLATION IN THE 99TH CONGRESS: AN OVERVIEW (Economics Division, Congressional Research Service, Library of Congress, Order Code IB85146, 1986). During the 100th Congress, the House considered a bill, sponsored by Representatives Dingell and Markey, that would have extended the time an offer must remain open under the Williams Act to 60 days. The bill would also have imposed a one-share, one-vote rule on all shares listed on the national exchanges or quoted on NASDAQ. H.R. 2172, 100th Cong., 1st Sess., 133 CONG. REC. H2540 (1987). On September 30, 1988, the Senate Banking Committee adopted the proposed Tender Offer Disclosure and Fairness Act. The bill, sponsored by Senator Proxmire, stressed disclosure to shareholders as an integral part of the tender offer process. The bill would also have lengthened the tender offer period to 35 days. S. 1323, 100th Cong., 1st Sess., 133 CONG. REC. S7601-7603 (1987). *See* Subcommittee on Annual Review, Federal Regulation of Securities Committee, ABA Section of Corporation, Banking and Business Law, *Federal Securities Regulation: Significant 1987 Regulatory and Legislative Developments*, 43 BUS. LAW. 917, 923-29 (1988). *See also* Proxmire, *The M & A 'Game' Is Not a Productive Enterprise*, Nat'l L.J., Nov. 9, 1987, at 21, col. 1; *Shifts in Bill on Takeovers*, N.Y. Times, Oct. 1, 1987, at D2, col. 4. For criticism of the Proxmire bill, see Jensen, *A Helping Hand for Entrenched Managers*, Wall St. J., Nov. 4, 1987, at 36, col. 3.

the SEC might ultimately step in to prohibit any corporate action that would unduly limit the voting power of shares.[109] The Council was troubled by the fact that the Indiana statute could be construed as a license for "greenmail,"[110] a practice which would be curbed under proposed federal legislation.[111]

Finally, the Council noted that the Indiana legislation presented a number of technical problems. For example, existing control share positions were not grandfathered. If Delaware were to adopt such a statute, it might inadvertently confiscate the control premium attached to existing blocks.[112] A further consideration was the ability of a corporation to "opt in" or "opt out" of the statute — should such a right inhere in the board, or in the shareholders?[113]

B. *The Delaware Decision-Making Process*

The Council does not operate in a vacuum when it considers changes in the Delaware General Corporation Law. Delaware must be responsive to a variety of constituencies on any given corporate matter.[114] The question of a takeover statute is particularly thorny "because in Delaware there are probably as many sharks as there are targets."[115] This is more than mere speculation, since statistical

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109. Black, *supra* note 98, at 18, col. 3. This action would not be without precedent. Following the Delaware Supreme Court's holding in Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985), permitting a target's discriminatory self-tender which excluded a raider, the SEC enacted an "all-holders" rule, requiring that a bidder's or issuer's tender offer be open to all holders of the class of securities subject to the tender offer. *See* Amendments to Tender Offer Rules: All-Holders and Best Price, Exchange Act Release No. 23,421, 51 Fed. Reg. 25,873 (July 17, 1986).

110. "Greenmail" is a stock accumulation coupled with a proxy fight or takeover attempt in an effort to force a company to buy back its shares from the acquirer at a premium. LIPTON, *supra* note 11, § 6.06[2]. *See* Mesa Partners v. Phillips Petroleum Co., 488 A.2d 107 (Del. Ch. 1984).

111. Black, *supra* note 98, at 18, col. 3. Senate Bill 1323 dictated that those who purchased more than 3% of a company could not receive an above-market price if they subsequently resold the stock to the company. S. 1323, 100th Cong., 1st Sess. § 8 (1987). *See also* Proxmire, *supra* note 108, at 22, col. 3.

112. Black, *supra* note 98, at 18, col. 3.

113. *Id.* The availability of an "opt-in" provision was to become a focal point in the battle over Delaware's takeover law. Companies argued that such a provision would emasculate the law, since large institutional investors would vote against the takeover law's protection in order to preserve their profits from takeover battles. Sontag, *supra* note 9, at 20, col. 2. As enacted, DEL. CODE ANN. tit. 8, § 203 (Supp. 1988) carries an "opt-out" provision, consistent with the format of the Delaware General Corporation Law, "which sets standards to be followed unless the corporation's certificate of incorporation or bylaws authorize a departure from the statutory norm." Goldman, *supra* note 9, at 34, col. 4. *See infra* notes 121, 148 and accompanying text.

114. *See, e.g.*, Macey & Miller, *supra* note 107; Romano, *supra* note 87; Romano, *supra* note 47.

115. *Delaware Plan on Takeovers, supra* note 80, at D2, col. 1 (quoting Professor James Cox of Duke University Law School).

analyses demonstrate that manufacturing firms incorporated in Delaware have engaged in a greater number of acquisitions, averaged out over firm lifetimes, than their counterparts in other states.[116] Of the firms that change their state of incorporation in order to engage in a mergers and acquisitions program, more relocate in Delaware than any other state.[117]

This is not to suggest, however, that would-be raiders can have their way with the Delaware Legislature.[118] In order to achieve its success in the corporate chartering market, Delaware has had to develop a corporation law "package" that is singularly attractive to incumbent managers, the individuals who are ultimately responsible for the incorporation decision.[119] The Delaware "package" includes: (1) a highly developed case law that provides useful precedents and substantial certainty about legal outcomes;[120] (2) a corporation code that is convenient for managers and corporate lawyers;[121] and (3) a degree of certainty that Delaware incorporation will remain highly attractive to managers for many years to come.[122]

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116. Romano, *supra* note 47, at 140. *See also* Romano, *supra* note 87, at 255, 256, 263.

117. Romano, *supra* note 47, at 140.

118. Somewhat cryptically, Professor Romano has written, "In conversations with legal and banking professionals, I was told that investment bankers frequently advise clients to switch to Delaware for antitakeover reasons. But . . . survey responses do not uncover such activity." Romano, *supra* note 87, at 275 n.72. T. Boone Pickens' eleventh-hour remarks on the floor of the Delaware Senate in opposition to Delaware's takeover legislation excited great curiosity, but had little effect; the legislation subsequently passed by a vote of 19-1. *See* Gilligan, *In Remarks to Senators, Pickens Raps Legislation*, The Morning News (Wilmington, Del.), Jan. 27, 1988, at 1, col. 4.

119. *See generally* Macey & Miller, *supra* note 107, at 484-91. Note that corporate counsel and investment bankers also play important roles in the incorporation decision. *Id.* at 486-87.

120. *Id.* at 484. *See, e.g.*, Schwartz, *The Delaware Chancery Court: A National Court of Corporate Law*, DEL. LAW., Spring 1984, at 54. ("The Delaware Chancery Court has a nation-wide impact and responsibility in shaping and defining corporation law, since it is the tribunal of first impression that finds the facts and initially disposes of the cases." *Id.* at 57.)

121. Macey & Miller, *supra* note 107, at 484-85. Most sections of the General Corporation Law are "default" provisions that apply only in the absence of a rule to the contrary in the corporate charter or bylaws; conversely, a corporation can "adopt" a rule in the Corporation Law simply by failing to provide an alternative. *Id.* at 484. An action prohibited under one section of the Corporation Law is nevertheless permitted if the same action is authorized under another section. *See* Orzeck v. Englehart, 41 Del. Ch. 361, 365-68, 195 A.2d 375, 377-78 (1963). The Corporation Law is also flexible in allowing managers to obtain substantive personal benefits. *See, e.g.*, DEL. CODE ANN. tit. 8, § 141(h) (1983 & Supp. 1986) (board can fix compensation of directors); *id.* § 144 (director/officer transactions with same corporation or another corporation); *id.* § 145 (director/officer indemnification).

122. Macey & Miller, *supra* note 107, at 488-91. Delaware "guarantees" the continued attractiveness of its corporation law in a number of ways. Note that the Delaware Constitution requires a two-thirds vote of the legislature to change the General Corporation Law. DEL. CONST. art. ix, sec. 1. At the same time, Delaware is responsive to other states' innovations; witness the Corporation Law's recent provision permitting Delaware corporations to limit the personal liability of directors for breach of fiduciary duty. DEL. CODE ANN. tit. 8, § 102(b)(7) (Supp. 1986). *See also* Veasey, Finkelstein & Bigler, *Delaware Supports Directors with a*

One commentator described the *CTS*[123] decision as the product of an ongoing battle pitting the SEC (supported by acquisition-minded companies, securities firms active in the mergers and acquisitions field, risk arbitrageurs, and Chicago-school economists) against state legislatures (urged on by acquisition-resistent companies and frequently, labor unions and municipalities).[124] Delaware is in a peculiar position with respect to this type of conflict; with significant numbers of raiders and targets in the state, no one firm has the clout to push takeover legislation through the state legislature.[125] This puts substantial power into the hands of the Council of the Section on Corporation Law.[126]

The role of the Delaware Bar as a distinct interest group within the state has been a subject of inquiry. In theory, this group would tend to support legislation that increases demand for the services of Delaware lawyers. The portrait that emerges is hardly flattering:

> The bar is small, discrete, and highly organized. Its members tend to have a large personal stake in the subject matter of the regulation. They also tend to be more wealthy than other groups and to have good political connections. Indeed, many members of the Delaware legislature are themselves members of the bar . . . . [T]he bar can be expected to capture much, although not all, of the gains from increasing the amount of legal fees generated by provisions of the Delaware corporate law. Accordingly, the bar is a powerful political force pressing for rules that maximize legal fees but do not necessarily maximize the revenues from corporations chartering in the state.[127]

Delaware and its corporate bar have "taken it on the chin" in the

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Three-Legged Stool of Limited Liability, Indemnification, and Insurance, 42 BUS. LAW. 399 (1987).

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

124. Smith, *supra* note 7, at 5, col. 1.

125. Romano, *supra* note 47, at 141.

126. As Justice Andrew G.T. Moore of the Delaware Supreme Court has noted:

> There is, and always has been, a firm understanding between the General Corporation Law Committee of the Delaware State Bar Association (now the Council of the Section on Corporation Law) and the general assembly, that no amendments to the general corporation law will be considered unless they have first been studied, drafted and approved by the Corporation Law Committee, then by the Bar Association generally, before they go to the floor of the general assembly. That means . . . that no one company is able to enforce its will on the fabric of corporation law. For example, the DuPont Company, while closely identified with Delaware, could no more go into the general assembly and attempt to have the corporation law amended than could anyone else, unless the Corporation Law Committee has first adopted and recommended it.

State Competition: Panel Response, *supra* note 4, at 780-81.

127. Macey & Miller, *supra* note 107, at 506-07 (footnotes omitted).

past; that battle will not be re-fought here.[128] The claim that the motivation behind any change in the General Corporation Law is to maximize revenues for the bar is convenient for Delaware's critics, however, the deliberations over control share legislation belie this axiom. If the "goal" of the General Corporation Law is to generate litigation profitable to the corporate bar, enactment of a control share statute, given the many unanswered questions that the proposed statute raised, would have provided an annuity for many members of the Delaware Bar.[129] The reluctance of the Council of the Corporation Law Section to recommend "off-the-rack" control share legislation suggests that greater forces are at play. Barring irate legislative leaders rewriting highly organized drafts under new demands and pressures arising from various constituencies, the Council's recommendations will be enacted. The Council is well aware that its responsibilities extend beyond the immediate gratification of the corporate bar.[130]

IV. Section 203 — The Controversy Lingers On

A. *"Maybe We've Done Something Right."*[131]

Once the weaknesses of the control share approach became apparent, the Council sought a new focus for its deliberations. The pressure for action increased when the Boeing Company, along with five other major corporations, threatened to reincorporate elsewhere if Delaware did not enact some form of takeover statute.[132] In No-

128. *See, e.g.*, Cary, *supra* note 4 (Professor Cary described state corporation laws as a "race for the bottom, with Delaware in the lead." *Id.* at 705); *see also* Comment, *supra* note 1 ("The sovereign state of Delaware is in the business of selling its corporation law." *Id.* at 861). For more favorable analyses, see Arsht, *supra* note 4; Arsht, *Reply to Professor Cary*, 31 BUS. LAW. 1113 (1976). For recent perspectives on Delaware's domination of the market for corporate charters, see Coffee, *The Future of Corporate Federalism: State Competition and the New Trend Toward De Facto Federal Minimum Standards*, 8 CARDOZO L. REV. 759 (1987); Macey & Miller, *supra* note 107; Romano, *The State Competition Debate in Corporate Law*, 8 CARDOZO L. REV. 709 (1987).

129. *See supra* notes 80-113 and accompanying text. Illinois contemplated adoption of a "clone" of the Indiana control share legislation; the "loopholes and inconsistencies" that a Chicago Bar Association study group found in the Indiana legislation demonstrates that concern over the soundness of the statute was not confined to Delaware. Such inconsistencies are, of course, an invitation to litigation. *See* Position Paper of the Chicago Bar Association With Respect to Amendment to Senate Bill 803 (Sept. 23, 1987).

130. Lewis S. Black, Jr. has characterized the Section's role as stemming from a sense of "noblesse oblige." Black notes that "[i]n the long run, our best interests are served by having good corporate law." *See* Sontag, *supra* note 9, at 20, col. 3.

131. Franklin, *Drafting in Delaware: Bar Group Floats Controversial New Anti-Takeover Bill*, N.Y.L.J., Dec. 3, 1987, at 5, col. 2 (quoting A. Gilchrist Sparks, III).

132. Boeing anticipated a hostile takeover attempt by T. Boone Pickens. *See* Sontag, *supra* note 9, at 19, col. 4; Barrett, *Delaware Moves Closer to Adopting Law to Deter Hostile Takeovers*, Wall St. J., Dec. 9, 1987, at 41, col. 4.

vember 1987, the Council circulated the first draft of a proposed statute.[133] Modeled on New York's "five-year freeze-out" statute,[134] the proposed Delaware legislation imposed a three-year moratorium on any "business combination" between an "interested stockholder," (i.e., a bidder holding more than 15 percent of the company's voting stock) and the target company, unless one of several exceptions was met.[135]

The draft legislation prompted an extensive debate in Delaware. On one side were corporate officers and directors who saw the legislation as deliverance from the likes of T. Boone Pickens, Carl Icahn, and a host of other "raiders." Large institutional investors, which generally opposed the bill, were joined by Pickens himself, who purported to represent the interests of shareholders against entrenched managers. Pickens obtained support from corporate defender Martin Lipton, who argued that the proposal's "barn-door size" exceptions would make it practically useless. Lipton stated: "The takeover frenzy burns as a wall of fire handicapping American corporations in their competition with the Japanese and Europeans. Yet Delaware fiddles with proposals that will exacerbate the problem."[136] Some members of the Delaware Bar took comfort in these reactions. A. Gilchrist Sparks, III, chairman of the Council, mused that if such polar opposites of the takeover spectrum as Lipton and Pickens hated the bill, "[m]aybe we've done something right."[137]

The debate over Delaware's takeover legislation was national in scope,[138] and at times became acrimonious.[139] By its very magnitude, however, the controversy belied the popular perception of Delaware

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133. Barrett, *supra* note 132, at 41, col. 5.

134. N.Y. BUS. CORP. LAW § 912 (McKinney 1987).

135. Goldman, *supra* note 9, at 34, col. 3. As originally drafted, the statute provided that a 10% acquisition threshold would trigger the three-year freeze. *See* Franklin, *supra* note 131, at 5, col. 2. For a discussion of the statute as enacted at DEL. CODE ANN. tit. 8, § 203 (Supp. 1988), see *infra* notes 142-58 and accompanying text.

136. Franklin, *supra* note 131, at 5, col. 2. *See also* Gilligan, *supra* note 118, at A1, col. 4 (Pickens claimed that the proposed anti-takeover legislation would abuse the rights of shareholders: "[a]ll you are doing is insulating management." *Id.*).

137. Franklin, *supra* note 131, at 5, col. 2.

138. *See, e.g.*, Sontag, *supra* note 9, at 1, col. 1 (Delaware Governor Michael N. Castle noted, "Usually all we have to worry about are our little Delaware issues, and all of a sudden we were getting all of this national attention." *Id.* at col. 2); Labaton, *Debate Over a New Takeover Law*, N.Y. Times, Feb. 1, 1988, at D1, col. 3.

139. The United Shareholders Association, founded by Boone Pickens and his wife in 1986, sent letters to Delaware's pensioners indicating (inaccurately) that their retirement benefits would be reduced if takeover legislation was enacted. Chuck Hebner, Chairman of the Delaware House Judiciary Committee, stated, "If you have to explain to enough people in your district that pensions are not going to be cut, you get a little mad at the person who stirs it up." Sontag, *supra* note 9, at 20, col. 4.

as a fiefdom controlled by an inner circle of corporate lawyers.[140] When Governor Michael N. Castle signed the takeover statute into law as Section 203 of the Delaware General Corporation Law[141] on February 2, 1988, there could be no question that the legislative process had afforded a hearing to the broad range of constituencies competing on the corporate playing field. The judicial process would ultimately determine if Delaware had kept that playing field sufficiently level.

B. *An Overview of Section 203*

The Delaware takeover statute is designed to prevent an "interested stockholder"[142] from effecting a merger or other "business combination"[143] with a Delaware corporation for three years,[144] unless one of a number of exceptions is met:

(1) Prior to the date the acquirer becomes an interested stockholder, the target board approves the business combination or the acquisition of stock;[145] or

(2) The acquirer obtains 85 percent of the company's outstanding voting stock in one transaction;[146] or

(3) On or subsequent to the date the acquirer becomes an interested stockholder, the business combination is approved by the board of directors and authorized by a vote of at least 66-⅔ percent of the outstanding stock not owned by the interested stockholder.[147]

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140. For a sampling of opinions generated by the proposed legislation, see *Antitakeover Legislation: Hearings on HB No. 396 Before the Joint Judicial Committee*, 134th Delaware General Assembly (1988). *See also supra* notes 127-30 and accompanying text.

141. Act of Feb. 2, 1988, 66 Del. Laws 204, § 203 (1988) (codified at DEL. CODE ANN. tit. 8, § 203 (Supp. 1988)). On Jan. 26, 1988, the Delaware House passed the legislation, House Substitute No. 1 to House Bill No. 396, House Amendment No. 3 to House Substitute No. 1 to House Bill No. 396, by a vote of 39-0. 66 Del. Laws 396, § 1 (1988). *See* Montgomery, *House Votes 39-0 for Takeover Bill*, The Morning News (Wilmington, Del.), Jan. 27, 1988, at A1, col. 1. The Delaware Senate approved the bill on Jan. 28, 1988 by a vote of 19-1, with one member not voting. *See* Humphrey, *Takeover Bill is Approved in Delaware*, Wash. Post, Jan. 29, 1988, at F1, col. 6. Governor Castle signed the legislation on February 2, 1988. Court challenges followed almost immediately. *See, e.g.*, Hays, *Delaware's New Anti-Takeover Law Is Contested by Campeau, Black & Decker*, Wall St. J., Feb. 3, 1988, at 26, col. 3; *Takeover Law Tested*, N.Y. Times, Feb. 3, 1988, at D12, col. 5. *See infra* note 159 and accompanying text.

142. An "interested stockholder" is defined in Section 203 as an acquirer of 15 percent or more of the stock of a Delaware corporation. DEL. CODE. ANN. tit. 8, § 203(c)(5).

143. *Id.* § 203(c)(3).

144. *Id.* § 203(a).

145. *Id.* § 203(a)(1).

146. *Id.* § 203(a)(2). The 85% figure does not include shares held by persons who are directors and also officers, nor does it include shares held by employee stock plans in which employee participants cannot make a confidential decision to tender in a tender offer. *Id.*

147. *Id.* § 203(a)(3).

The statute contains a number of other important "outs." For example, stockholders may amend the corporation's bylaws to "opt out" of the statute.[148] If the corporation's continuing directors who were in office prior to a person becoming an interested stockholder approve, or do not oppose, an acquisition by a third person who is not an interested stockholder, any other party is then free to propose and consummate a competing business combination.[149] Interested stockholders must, however, be given twenty days in which to develop competing proposals.[150] Before becoming an interested stockholder, an acquirer may conduct a proxy fight and elect a new board, which could then approve a stock acquisition or merger proposal free of the statutory requirements.[151] Finally, an interested stockholder may take control of the company without board approval and sell off the assets of the corporation, as long as the proceeds are distributed pro rata to all stockholders.[152]

The goal of the Delaware statute is to prevent an acquirer from using the corporation's own assets to finance its acquisition.[153] This is achieved by the three-year moratorium on business combinations; the moratorium can be avoided through prior board approval of an acquisition transaction or, following on an acquisition transaction, board approval coupled with a two-thirds vote of disinterested shares.[154] Discussing these two options, one of the drafters of the statute has observed that "the former provides negotiations strength, the latter guards against entrenchment."[155]

The statute reflects the board's position as a representative of shareholders, a concept that has been thoroughly developed by Delaware courts.[156] Yet the board is not necessarily the final arbiter of any offer. The statute provides a number of ways in which a potential acquirer may take his case directly to shareholders.[157] None of these routes is particularly easy or inexpensive. However, the basic tender offer process survives under the Delaware statute. Tender of-

148. *Id.* § 203(b)(3). A majority of the outstanding shares is required to amend, and the amendment does not come into force until a year after the vote. *Id.*

149. *Id.* § 203(b)(6).

150. *Id.* § 203(b)(6).

151. *See* Goldman, *supra* note 9, at 34, col. 3.

152. *Id.*

153. Goldman & McNally, *The Delaware Takeover Statute: A Report to the Delaware General Assembly*, in THE DELAWARE TAKEOVER STATUTE 8 (Packard Press 1988).

154. *See supra* notes 145, 147.

155. Goldman, *supra* note 9, at 34, col. 4.

156. *See, e.g.*, Revlon v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986); Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985); Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985); Aronson v. Lewis, 473 A.2d 805 (Del. 1984).

157. *See, e.g., supra* notes 146, 147, 151.

fers are neither prohibited nor delayed, and any acquirer remains free to mount a proxy contest in order to remove incumbent management. An acquirer may also purchase sufficient stock to immediately replace existing management.[158]

C. Conclusion

Section 203 has passed constitutional muster on two occasions since its enactment.[159] The takeover game rarely takes a time out, however; new strategies are undoubtedly being mapped out in boardrooms across the country as acquirers seek to adapt to the Delaware legislation.[160]

One of the primary strengths of Section 203 is that it forces an acquirer to pay for the inherent value of the corporation.[161] A recurring theme during the debate over the Delaware statute was the coercive nature of the two-tier offer.[162] Section 203 encourages a "fair deal" for all stockholders; raiders will find it more difficult to capture a premium between the offer price and the price realized in a subsequent sell-off of the corporation's assets.[163]

Delaware, the nation's leader in corporate chartering, has re-

158. Sparks, New Section 203 of the Delaware General Corporation Law: An Analysis 7 (April 1988) (unpublished outline) (available in the *Dickinson Law Review* office).

159. *See* RP Acquisitions Corp. v. Staley Continental, Inc., 686 F. Supp. 476 (D. Del. 1988); BNS, Inc. v. Koppers Co., Inc., 683 F. Supp. 458 (D. Del. 1988). In *RP Acquisitions* and *BNS*, the Delaware District Court applied the reasoning of *CTS* to Section 203, and found that the Delaware statute was neither preempted by the Williams Act, nor in violation of the commerce clause. In *BNS*, Chief Judge Murray M. Schwartz stated that "even statutes with substantial deterrent effects on tender offers do not circumvent Williams Act goals, so long as hostile offers which are beneficial to target shareholders have a meaningful opportunity for success." *BNS*, 683 F. Supp. at 469. Both *RP Acquisitions* and *BNS* tracked Justice Powell's commerce clause analysis in *CTS*, concluding that: (1) the effects of the statute were nondiscriminatory, (2) the statute did not subject interstate activities to inconsistent regulation, and (3) the statute did not place an excessive burden on interstate commerce when compared to its putative local benefits. *See* Goldman & Walsh, *Delaware Case Law Evolves in Wake of Sec. 203*, Nat'l L.J., Sept. 19, 1988, at 32, col. 1.

160. For a hypothetical that effectively illustrates the dynamics of Section 203, see Veasey, Finkelstein & Shaughnessy, *The Delaware Takeover Law: Some Issues, Strategies and Comparisons*, 43 BUS. LAW. 865, 873-75 (1988). Martin Lipton, known for his defense of various takeover targets, has voiced dissatisfaction with Section 203. Cohen, *Lipton Tells Clients That Delaware May Not Be a Place to Incorporate*, Wall St. J., Nov. 11, 1988, at B7, col. 2.

161. Goldman, *supra* note 9, at 34, col. 2.

> It is this value that a raider seeks to appropriate for himself to the exclusion of the stockholders. Such bidders seek out entities whose true value exceeds their market value. Although a raider's offer may exceed market value and attract the tenders of arbitrageurs and other market professionals who seek short-term profits, it does not equal the inherent value of the corporation.

Id.

162. *See supra* notes 27-28 and accompanying text.

163. Goldman, *supra* note 9, at 34, col. 2.

sponded thoughtfully to the challenge posed by the proliferation of takeover legislation in other jurisdictions. The reaction of Delaware's bench and bar to the *CTS* decision was cautious and measured; on the one hand, affirming Delaware's right to enact takeover legislation by virtue of the internal affairs doctrine,[164] on the other, exposing proposed legislation to the scrutiny of the Delaware Bar.[165]

Delaware wisely rejected a clone of the Indiana legislation validated in *CTS*. The Indiana scheme abandons the concept of reasoned board judgment in favor of a potentially endless series of shareholder plebescites; the effect in many instances is to allow institutional investors and arbitrageurs to realize quick profits as votes are "sold" to the highest bidder. Section 203 of the Delaware General Corporation Law reaffirms Delaware's commitment to the principle of board authority in a takeover context. Through the application of the business judgment rule, Delaware courts will continue to scrutinize a given board's decision-making process in the course of a threatened takeover.[166] In less sophisticated jurisdictions, control share legislation may be the panacea of the moment; shareholders in Delaware corporations have been provided with a better reasoned alternative through the diligent efforts of the Delaware Bar.

Peter L. Tracey

164. *See supra* notes 89-94 and accompanying text. "The fact that a vast majority of Delaware's corporations do not have their main office in Delaware or many resident shareholders does not prevent Delaware from regulating tender offers affecting these corporations and does not inevitably create a risk of inconsistent regulation." BNS Inc. v. Koppers Co., Inc., 683 F. Supp. 458, 472 (D. Del. 1988).

165. *See supra* notes 95-113 and accompanying text. Following the debate over Section 203, some Wilmington practitioners have privately voiced the view that while the process of amending the Corporation Law is now more public, the potential for politicization is also greater; outside input does not necessarily result in better statutory schemes.

166. *See supra* note 156 and accompanying text.