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THE ECONOMICS AND CONSTITUTIONALITY OF PENNSYLVANIA'S THIRD GENERATION OF ANTI-TAKEOVER LEGISLATION

I. INTRODUCTION

In October of 1989, Pennsylvania's new Business Corporation Law took effect.¹ Included in the law are previously enacted provisions² which severely limit the ability of any party to effect a hostile takeover of a Pennsylvania corporation. These provisions are generally referred to as Pennsylvania's Third Generation of Anti-Takeover Legislation.³

Pennsylvania is not the only state to enact legislation which actively curtails hostile takeovers. New York, Delaware, Wisconsin and a number of other states have similar laws in effect.⁴ Most of these laws pass under the rubric of "Shareholder Protection Statutes." All benefit incumbent management to the disadvantage of prospective corporate raiders.

During the 1960's, the tender offer replaced the traditional proxy contest as a method for gaining control of a corporation.⁵ Corporate takeovers were praised in the law and economics literature for promoting efficient reallocation of economic resources and for enhancing shareholder wealth.⁶

Not all commentators have such a sanguine opinion of the tender

1. Act of December 21, 1988 (P.L. 1444 No. 177), 15 PA. CONS. STAT. §§ 1101-4162 (1989).

2. The primary anti-takeover provisions referred to are sections 2541 to 2548 (relating to Control Transactions), 2551 to 2556 (relating to Business Combinations), 2513 (relating to Disparate Treatment of Certain Persons), and 2502 (relating to Registered Corporation Status), Act of March 3, 1988, No. 27, 1988 Pa. Laws 27, 15 PA. CONS. STAT. §§ 2541-2548, 2551-2556, 2513 and 2502.

3. In general, and for the purposes of our discussion, "Third Generation" Anti-Takeover legislation involves statutes passed subsequent to the United States Supreme Court's decision in *CTS Corp. v. Dynamics Corp. of America*, 41 U.S. 69 (1987). "Second Generation" statutes are those passed prior to *Dynamics* but subsequent to the Court's decision in *Edgar v. MITE Corp.*, 457 U.S. 624 (1982). "First Generation" statutes are those which were enacted prior to *MITE*.

4. Among the states which have enacted anti-takeover legislation in the wake of *Dynamics* are Delaware, see DEL. CODE ANN. tit. 8, § 203 (1988); New York, see N.Y. BUS. CORP. LAW § 912(a)(5) (McKinney 1986); and Wisconsin, see WIS. STAT. ANN. § 180.726. See also Comment, *An Analysis of Pennsylvania's Third Generation Anti-Takeover Legislation*, 27 DUQ. L. REV. 721 n.4 (1989).

5. E. ARONOW, H. EINHORN & G. BERNSTEIN, DEVELOPMENTS IN TENDER OFFERS FOR CORPORATE CONTROL 1-2 (1977).

6. *Id.*

offer, however. The adverse impact of certain corporate takeovers on local labor markets, the coercive effect of tender offers on shareholders, and the high degree of financial leverage involved in most takeovers have been criticized.⁷ Such concerns lead to passage of legislation regulating and restricting tender offers.

The first attempts by the states to regulate the tender offer fell victim to constitutional attack. First generation anti-takeover statutes such as Pennsylvania's 1976 Takeover Disclosure Law⁸ were found to violate the federal supremacy clause,⁹ the commerce clause¹⁰ or both.¹¹ Legislatures responded by enacting a second generation of anti-takeover laws, and the United States Supreme Court sustained this kind of legislation in 1987 in *CTS Corp. v. Dynamics Corp. of America*.¹²

Pennsylvania enacted its third generation anti-takeover legislation as a part of its Business Corporation Law in 1989.¹³ While similar in several respects to the kind of statute upheld in *Dynamics*, the Pennsylvania law goes much further in restricting the tender offer. Under the new law, hostile takeovers of Pennsylvania corporations will be virtually eliminated.¹⁴ Not surprisingly, the Pennsylvania statute has come under constitutional attack.¹⁵

This note will analyze the new legislation in light of the Supreme Court's decision in *Dynamics*, and several recent district and appellate court decisions on third generation statutes in Delaware¹⁶ and Wisconsin.¹⁷ The note concludes that Pennsylvania's legislation should survive constitutional scrutiny.

7. Langevoort, *The Supreme Court and the Politics of Corporate Takeovers: A Comment on CTS Corp. v. Dynamics Corp. of America*, 101 HARV. L. REV. 96 (1987).

8. Act of March 3, 1976 (P.L. 41 No. 19), PA. CONS. STAT. ANN. tit. 70, §§ 71-85 (Purdon Supp. 1990).

9. U.S. CONST. art. VI.

10. U.S. CONST. art. I, § 8 cl. 3.

11. See *Crane Co. v. Laim*, 509 F. Supp. 782 (E.D. Pa. 1981).

12. 481 U.S. 69 (1987).

13. Act of December 21, 1988 (P.L. 1444 No. 177), 15 PA. CONS. STAT. §§ 1101-4162.

14. Comment, *supra* note 4.

15. *First City Financial Corp. Ltd. v. Armstrong World Indus., Inc.*, No. 89-4858 (E.D. Pa. 1989).

16. *BNS, Inc. v. Koppers Co.*, 683 F. Supp. 458 (D. Del. 1988); *RP Acquisition Corp. v. Staley Continental, Inc.*, 686 F. Supp. 476 (D. Del. 1988).

17. *Amanda Acquisition Corp. v. Universal Foods Corp.*, 877 F.2d 496 (7th Cir. 1989), *cert. denied*, ___ U.S. ___, 107 L. Ed. 2d 353 (1989).

II. HISTORICAL PERSPECTIVE

A. *In the Beginning* . . .

The traditional method for gaining control of a corporation is the proxy contest.¹⁸ But proxy contests are costly¹⁹ and well-regulated under federal law.²⁰ During the 1960's a new strategy, the tender offer, was developed as an alternative for taking control of a target corporation.²¹ The tender offer had the advantage of being unregulated under existing securities laws,²² and its popularity as a strategy for the corporate raider grew through the decade.²³

Hostile tender offers worked to the advantage of the corporate raider and to the disadvantage of incumbent management and shareholders in several ways. First, the raider could restrict the tender offer's duration, allowing the target's management little time to analyze the offer and make a recommendation on the offer to its shareholders.²⁴ Second, the raider could acquire information on the corporation's financial condition, strategic business plan and capitalization without making similar information on its own status available to the corporation or its shareholders.²⁵ This put the corporation's management and shareholders at a disadvantage in obtaining information.²⁶ Third, the practice of making two-tier, front-end loaded tender offers coerced shareholders into quickly tendering their shares to the raider at less than optimal prices.²⁷

18. Sell, *A Critical Analysis of a New Approach to State Takeover Legislation After MITE*, 23 WASHBURN L.J. 473 (1984). See also *Piper v. Chris-Craft Indus., Inc.*, 430 U.S. 1, 22 (1977) (noting that "prior to the 1960's, corporate takeover attempts had typically involved either proxy solicitations, regulated under § 14 of the Securities Exchange Act [15 U.S.C. § 78n] or exchange offers of securities, subject to the registration requirements of the 1933 Act").

19. Sell, *supra* note 18. In addition to their cost, Dean Sell argues that another disadvantage of proxy contests is that unless the proxy is coupled with an interest, it is revocable at the will of the shareholder.

20. See *infra* notes 28-37 and accompanying text.

21. See E. ARONOW, H. EINHORN & G. BERNSTEIN, *supra* note 5, at pp. v-vi.

22. See *Piper v. Chris-Craft Indus., Inc.*, 430 U.S. 1, 22 (1977).

23. Comment, *supra* note 4, at 722.

24. See *BNS Inc. v. Koppers Co.*, 683 F. Supp. 458, 467 (D. Del. 1988).

25. *Id.*

26. *Piper*, 430 U.S. at 27.

27. In a "two-tier front-end loaded" tender offer, or "freezeout," the hostile raider makes a tender offer at a certain attractive price for a specified percentage (such as 50%) of the shares of the target corporation in the first tier of the offer. The raider expresses his intention that the remaining shares of the target corporation will be "frozen out" at a reduced price in a subsequent merger of the corporation. The effect of an offer of this type is to coerce the shareholders of the target corporation to quickly accept the first offer from the raider, out of fear of being frozen out at a lower price later.

B. Federal Legislation

The federal government acted to regulate tender offers in 1968 by passing the Williams Act, which amended the Securities and Exchange Act of 1934.²⁸ The Williams Act regulates the process of tender offers and imposes certain disclosure requirements on parties making tender offers.²⁹ The Act's purpose is to ensure that shareholders are provided with sufficient information about both the tender offer and the offeror, so that the shareholders may make an informed decision on whether to tender their shares.³⁰ The Act expresses a policy of neutrality as between the tender offeror and incumbent management.³¹

The Williams Act requires the bidder to disclose its identity and background, the source and amount of funds or other consideration to be used in purchasing the tendered shares, the extent of its holdings in the target corporation, and the bidder's plans with respect to the target corporation's business or corporate structure.³² The Act requires the bidder to file the disclosure statement with the SEC and the target corporation.³³

The Williams Act allows tendering shareholders to withdraw their shares during the first seven days of the offer and at any time after sixty days from the commencement of the tender offer.³⁴ If more shares are tendered than the bidder seeks to purchase, the Act requires that the tendered shares be purchased from each tendering shareholder on a pro-rata basis during the first ten days of the offer.³⁵ Additionally, if during the course of the offer the amount paid for the shares is increased, the Act requires that all tendering shareholders receive the same consideration, even if they tendered their shares before the price increase was announced.³⁶

Because the Williams Act regulates only process and disclosure, and not the substantive aspects of tender offers, target corporations have little federal statutory protection from the hostile raider.³⁷ Man-

For a discussion of the coercive element of these two-tier tender offers, see *Koppers*, 683 F. Supp. at 468 n.23.

28. 15 U.S.C. §§ 78m(d)-78m(e), 78n(d)-78n(f) (1981).

29. 15 U.S.C. § 78n(d)(1) (1981).

30. 113 CONG. REC. 854-55 (1967) (statement of Sen. Williams).

31. Sell, *supra* note 18, at 474.

32. 15 U.S.C. § 78n(d)(1) (1981).

33. *Id.*

34. *Id.* § 78n(d)(5).

35. *Id.* § 78n(d)(6).

36. *Id.* § 78n(d)(7).

37. See Sell, *supra* note 18, at 474.

agement therefore developed and implemented a number of practical defensive techniques. These include the adoption of shareholder rights plans, commonly known as "poison pills,"³⁸ employee stock ownership plans, repurchasing company stock, paying "greenmail"³⁹ to the raider, providing "golden parachutes"⁴⁰ to top management, searching for a "white knight,"⁴¹ selling off the "crown jewels"⁴² and lobbying state legislators to pass "shark repellent"⁴³ statutes.

C. State Legislation

State legislation with respect to tender offers generally proceeds on the premise that hostile takeovers of state-chartered corporations are undesirable.⁴⁴ State statutes are designed to protect the corporations and shareholders in the state, but usually have the effect of protecting the incumbent corporate management against the hostile raider.⁴⁵ State

38. Shareholder rights plans, or "poison pills" are expressly validated as a matter of state corporation law under sections 2513 and 1525 of the 1988 Pennsylvania Business Corporation Act. Act of Dec. 21, 1988 (P.L. 1444 No. 177), PA. CONS. STAT. §§ 2513, 1525.

39. "Greenmail" refers to "[a]n antitakeover maneuver in which the target firm purchases the raider's stock at a price above that available to other stockholders. The funds for the purchase are often borrowed; other stockholders are ordinarily excluded from the transaction." D. SCOTT, WALL STREET WORDS 159 (1988).

40. A "Golden Parachute" is "[a]n employment agreement that provides a firm's key executives with lucrative severance benefits in the event that control of the firm changes hands, and shifts in management subsequently occur. A golden parachute benefits management more than stockholders." *Id.* at 157.

41. A "White Knight" is "[a] person or company that rescues a target firm from a takeover attempt by buying the firm." *Id.* at 385.

42. A "crown jewel" is "[a] prized asset of a company." The term is "[o]ften used to refer to a part of a business that is sought by another firm or an investor in a takeover attempt that is hostile to the target firm's management." *Id.* at 82. As a takeover defense, a firm may enter into a "crown jewel lockup agreement," which is "[a] contractual offer of valuable assets or stock made by a takeover target to the suitor deemed most acceptable to management. A lockup agreement tends to discourage unwanted suitors but it may penalize the target firm's stockholders because it eliminates counteroffers." *Id.* at 202. As an alternative to a crown jewel lockup agreement, a firm may adopt a "scorched earth" strategy, which is "[a]n anti-takeover strategy in which the target firm disposes of those assets or divisions considered particularly desirable by the raider. Thus, by making itself less attractive, the target discourages the takeover attempt. Such a strategy is almost certain to penalize the shareholders of the target firm." *Id.* at 311.

43. A "shark repellent" is "[a] strategy used by corporations to ward off unwanted takeovers. Examples of shark repellents include a major acquisition, the issuance of new shares of stock or securities convertible into stock, and the staggered election of directors. Shark repellents often benefit corporate officers more than stockholders." *Id.* at 322. Sometimes called "show stoppers," a shark repellent statute is "[a] legal barrier to a takeover attempt that is virtually impossible for a suitor to overcome. For example, a target company may convince state legislators to pass various anti-takeover laws that would preclude the takeover." *Id.* at 324.

44. See Sell, *supra* note 18, at 474.

45. *Id.* at 475.

anti-takeover laws generally impose disclosure requirements on the raider and interpose procedural steps designed to slow down the tender procedure.⁴⁶ These steps provide management with valuable time to adopt defensive techniques to fend off the hostile raider.⁴⁷

Tender offerors attacked these statutes on two constitutional grounds. First, the raiders argued that the Williams Act preempted the field, and therefore state tender offer legislation violated the Supremacy Clause of the United States Constitution.⁴⁸ Second, the raiders argued that state anti-takeover legislation was unconstitutional under the Commerce Clause.⁴⁹

The first attack was launched in *Great Western United Corp. v. Kidwell*.⁵⁰ There, the United States Court of Appeals for the Fifth Circuit held that the Idaho takeover statute⁵¹ was preempted by the Williams Act.⁵² The court also found that the statute imposed an unreasonable burden on interstate commerce.⁵³ But an Ohio statute similar to the Idaho law invalidated in *Kidwell* was upheld by the United States District Court for the Southern District of Ohio in *AMCA International Corp. v. Krouse*.⁵⁴ Thus, the federal circuits disagreed on the constitutionality of first generation anti-takeover statutes.

Following the *Krouse* decision, the Securities and Exchange Commission enacted certain regulations under the Williams Act.⁵⁵ Rule 14d-2(b) requires a tender offeror to file a schedule 14D-1 and to disseminate certain information within five business days of public announcement of a tender offer.⁵⁶ Many state laws, however, required that hearings be conducted on any tender offer. These hearings often ran for a period longer than five days, and in some cases state law provided for waiting periods of longer than five days before disclosure

46. *Id.* See also Wilner & Landy, *The Tender Trap: State Takeover Statutes and Their Constitutionality*, 45 *FORDHAM L. REV.* 1 (1976).

47. See Garrett, *Third Generation Anti-Takeover Statutes in Oregon and Indiana After Dynamics: Target Corporations Control the Ship and Raiders are Foiled*, 24 *WILLIAMETTE L. REV.* 73, 79 (1988).

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

49. U.S. CONST. art. I, § 8, cl. 3.

50. 577 F.2d 1256 (5th Cir. 1978), *rev'd on other grounds sub nom. Leroy v. Great W. United Corp.*, 443 U.S. 173 (1979) (improper venue).

51. IDAHO CODE §§ 30-1501-1513 (Supp. 1977).

52. See *supra* note 28.

53. 577 F.2d 1256.

54. 482 F. Supp. 929 (S.D. Ohio 1979).

55. [1979-1980 Transfer Binders] Fed. Sec. L. Rep. (CCH) ¶ 82,373 (Nov. 29, 1979).

56. *Id.*

would be possible.⁵⁷ It became impossible for a raider to meet the conflicting requirements of federal and state laws. Because of this direct conflict in the requirements of federal and state laws, some lower courts invalidated state statutes⁵⁸ as unconstitutional in light of the Williams Act.⁵⁹ In 1982, the United States Supreme Court resolved the conflict between the circuits and addressed the constitutionality of a state anti-takeover statute in *Edgar v. MITE Corporation*.⁶⁰

D. *Edgar v. MITE Corporation*

In its 1982 decision in *Edgar v. MITE Corp.*,⁶¹ the United States Supreme Court struck down, on Commerce Clause grounds, an Illinois tender offer statute that subjected bids for locally based companies to an intricate scheme of precommencement delay and state administrative review.⁶² Drawing on law and economics literature emphasizing the social value of a free market for corporate control, the court seemed to place the nationwide securities market beyond the reach of individual states. *MITE* became the authority for lower federal courts to strike down all but the most limited efforts by the states to regulate takeovers.⁶³

State legislators reacted by drafting a second generation of anti-takeover legislation designed to meet the uncertain criteria set out in *MITE*.⁶⁴ These new laws resembled traditional state corporation laws more than securities regulation, and were thus likely to run afoul of the Constitution. Typical of this second generation legislation were control share acquisition statutes,⁶⁵ fair price provision statutes,⁶⁶ right of re-

57. See, e.g., PA. STAT. ANN. tit. 70, §§ 71 to 85 (Purdon Supp. 1990).

58. For a list of state statutes invalidated, see Profusek & Gompf, *State Takeover Legislation After MITE: Standing Pat, Blue Sky, or Corporate Law Concepts?*, 7 CORP. L. REV. 3, 14 n.64 (1984).

59. Pennsylvania's First Generation statute came under constitutional attack in *Crane Co. v. Lam*, 509 F. Supp. 782, 792 (E.D. Pa. 1981) (granting a preliminary injunction against the enforcement of the Pennsylvania law on the ground that the twenty day waiting period required by the state law was in conflict with the five-day requirement of the Williams Act).

60. 457 U.S. 624 (1982).

61. *Id.*

62. *Id.* at 646 (finding that the Illinois statute indirectly burdened interstate commerce, and that the burden imposed outweighed any legitimate state interests promoted by the statute).

63. See Garrett, *supra* note 47.

64. Note, *The Constitutionality of Second Generation Takeover Statutes*, 73 VA. L. REV. 203, 204 (1987).

65. See IND. CODE ANN. § 23-1-42 (Burns Supp. 1986); MINN. STAT. ANN. § 302A.671 (West 1985 & Supp. 1987); MO. ANN. STAT. § 351.407 (Vernon Supp. 1987); OHIO REV. CODE ANN. § 1701.831 (Anderson 1985).

demption statutes⁶⁷ and business combination statutes.⁶⁸ Indiana's second generation control share acquisition statute⁶⁹ successfully withstood challenge in 1987 in *CTS v. Dynamics Corp. of America*.⁷⁰

E. *CTS v. Dynamics Corp. of America*

Enacted in early 1986, the Indiana Control Share Acquisition statute⁷¹ at issue in *Dynamics* was carefully drafted to avoid the constitutional defects of the Illinois statute invalidated in *MITE*. First, unlike the Illinois statute, which regulated all takeover bids for companies with certain minimum contacts in the state, the Indiana legislation was styled as a corporation law provision, predicated on the target's status as an Indiana corporation. Second, the Indiana legislation vests all power in the target's shareholders. Unlike the Illinois law, it neither gives the state administrative body the power to disapprove a bid nor allows target management an opportunity to communicate its opposition while freezing the bidder's activities.

Under the Indiana statute, when any person obtains sufficient shares of an "issuing public corporation" incorporated in Indiana such that its voting interest would pass any of three threshold levels (20%, 33 1/3% or 50%), the ability to vote the controlling block is conditioned on approval by a majority of the target's pre-existing "disinterested shareholders." If the shareholders do not grant voting rights to the acquirer, the target may redeem the control shares at fair market value. The practical effect of the statute is to prevent tender offerors from assuming immediate control of the tendered shares.

On March 10, 1986, Dynamics Corporation announced a tender offer for CTS shares, which, if successful, would have increased Dynamics' ownership interest in CTS from 9.6% to 27.5%. The CTS board reacted by electing to be governed by the new Indiana statute. In early April, the United States District Court for the Northern District of Illinois granted Dynamics' motion for declaratory relief.⁷² The court found that the Indiana statute violated the supremacy clause because it

66. See, e.g., MD. CORPS. & ASS'NS CODE ANN. §§ 3-601-3-603 (1985 & Supp. 1986).

67. See, e.g., PA. STAT. ANN. tit. 15, §§ 1408(B), 1409(C), 1910 (Purdon Supp. 1986); ME. REV. STAT. ANN. tit. 13-A, § 910 (Supp. 1986).

68. See, e.g., IND. CODE ANN. §§ 23-1-43 (Burns Supp. 1986); KY. REV. STAT. ANN. § 271A.397(3) (Baldwin Supp. 1986); N.Y. BUS. CORP. LAW § 912(a)(5) (McKinney 1986).

69. IND. CODE ANN. §§ 23-1-42-1 (West Supp. 1987).

70. 481 U.S. 69 (1987).

71. IND. CODE ANN. §§ 23-1-42-1 (West Supp. 1987).

72. 637 F. Supp. 389 (N.D. Ill. 1986).

frustrates (largely through delay) the balance that Congress intends in the Williams Act among shareholder, bidder and management interests. The court also found a Commerce Clause violation. The United States Court of Appeals for the Seventh Circuit affirmed the ruling on both counts.

The Supreme Court reversed. First, the Court found that compliance with the Indiana Act and the Williams Act was "entirely possible."⁷³ The only preemption question, therefore, was whether the Indiana Act violated "the full purposes and objectives of Congress."⁷⁴ Applying, without endorsing, Justice White's preemption analysis from *MITE*, the Court concluded that none of the offending features of the Illinois Act in *MITE* were present in the Indiana Act, and that, even under the *MITE* plurality's broad articulation of the Williams Act's purposes, the Indiana law passed muster.⁷⁵

Next, the Court turned to the Commerce Clause challenge. The majority noted that the statute did not discriminate against interstate commerce because it applied equally to both resident and foreign bidders.⁷⁶ Further, the Court found that the statute did not subject interstate activities to inconsistent regulation because the act only applies to Indiana domestic corporations.⁷⁷

Finally, the Court addressed the merits of the statute. Significantly, the Court declined to balance the statute's putative local benefits against the burdens it imposed on interstate commerce as it had done in *MITE*. Instead, the *Dynamics* Court simply observed that a system that gives states the power to create corporate entities necessarily gives them the power to establish rights and responsibilities among the various interests in the corporate structure. Corporation laws inevitably affect interstate commerce in certain ways, but this alone does not affect their constitutional validity.⁷⁸ Giving deference to the "empirical judgments of lawmakers concerning the utility of legislation," the Court found that the Indiana statute was rationally related to the exercise of this power because it was a nondiscriminatory procedure

73. *Dynamics*, 481 U.S. at 79.

74. *Id.* (quoting *Ray v. Atlantic Richfield Co.*, 435 U.S. 151, 158 (1978)); *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941).

75. *Dynamics*, 481 U.S. at 81-82.

76. "The fact that the burden of a state regulation falls on some interstate companies does not, by itself, establish a claim of discrimination against interstate commerce." *Dynamics*, 481 U.S. at 88.

77. *Id.*

78. *See supra* note 76 and accompanying text.

designed to preserve "an effective voice in corporate affairs" for the shareholders.⁷⁹ Moreover, even if the statute had the effect of decreasing the number of tender offers for Indiana corporations, the Court concluded that it would be valid under the Commerce Clause.

Dynamics paved the way for a number of states, including Pennsylvania, to enact a third generation of anti-takeover legislation.⁸⁰ Two of these statutes were upheld in 1989 in Delaware⁸¹ and Wisconsin.⁸² Pennsylvania's new law was subjected to attack in the United States District Court for the Eastern District of Pennsylvania.⁸³

F. *The Delaware Cases*

In 1988, Delaware enacted the Delaware Business Combination statute,⁸⁴ which was modeled after the kind of second generation statute pioneered in New York.⁸⁵ Section 203 of the Delaware statute generally prohibits a "business combination," broadly defined, between an "interested stockholder" and the target corporation for a three-year period, unless one of the exceptions to the statute applies. Only two exceptions apply to a hostile raider, however, and both are restrictive to the point of making them practically illusory.

First, the restriction on business combinations does not apply if the interested stockholder acquires at least 85% of the outstanding voting stock of the corporation, exclusive of shares owned by director-officers and certain employee stock ownership plans (ESOPs). Second, the restriction falls if the interested stockholder's proposed business transaction is approved by the board of directors and is authorized by an affirmative vote of at least 66 ⅔% of the outstanding voting stock that is not owned by the interested stockholder.

The Delaware statute was quickly challenged on constitutional grounds in two separate actions.⁸⁶ In *BNS Inc. v. Koppers Co., Inc.*,⁸⁷

79. *Dynamics*, 481 U.S. at 91-92.

80. *See supra* note 2.

81. DEL. CODE ANN. tit. 8, § 203 (Supp. 1988).

82. WIS. STAT. ANN. § 180.726 *et seq.* (West 1989-1990).

83. *First City Financial Corp. Ltd. v. Armstrong World Indus., Inc.*, No. 89-4858 (E.D. Pa. 1990) (WESTLAW, DCT DATABASE).

84. DEL. CODE ANN. tit. 8, § 203 (Supp. 1988).

85. N.Y. BUS. CORP. LAW § 912(a)(5) (McKinney 1986).

86. The first action, *BNS Inc. v. Koppers Co.*, 683 F. Supp. 458 (D. Del. 1988) will provide the basis for the discussion which follows. The second action, *RP Acquisition Corp. v. Stanley Continental, Inc.*, 686 F. Supp. 476 (D. Del. 1988) was decided on similar grounds and will not, therefore, be discussed in the same degree of detail.

87. 683 F. Supp. 458 (D. Del. 1988).

the hostile raider, BNS, sought an order declaring the Delaware statute unconstitutional on federal preemption and Commerce Clause grounds. The United States District Court for the District of Delaware refused to enjoin enforcement of the statute, holding that even though the statute may have a substantial deterrent effect on tender offers, it did not circumvent the policy of the Williams Act as long as offers which are beneficial to target shareholders have a meaningful opportunity for success.⁸⁸ Finding further that the statute did not discriminate between offerors which were Delaware corporations and offerors which were not incorporated there, and finding that the statute promoted stable corporate relationships and protected shareholders, the court held that BNS was unlikely to prevail on the merits of its Commerce Clause challenge.⁸⁹

The *Koppers* court relied heavily on the Supreme Court's decision in *Dynamics*, which, the court said, "unmistakably teaches that states have a legitimate interest in regulating tender offers, despite the significant influence such regulation has over the transfer of securities and the so-called market for corporate control."⁹⁰

Following Justice Powell's preemption analysis in *Dynamics*, the court found that whether the Delaware statute frustrates the purposes of the Williams Act may be determined by asking four questions.⁹¹ First, does the statute protect independent shareholders from coercion? Second, does the statute give either management or the offeror an advantage in communicating with shareholders? Third, does the statute impose an indefinite or unreasonable delay on offers? Fourth, does the statute allow the state government to interpose its views of fairness between willing buyers and sellers?⁹²

First, the court found that the Delaware statute "offers protection to independent shareholders by preventing certain dealings between a successful offeror and the target corporation" which would be harmful to shareholders, such as freezeouts and leveraged buyouts.⁹³ Next, the court held that while the statute gives the target's management an advantage in fighting an unwanted takeovers, *Dynamics* suggests that incidentally pro-management measures undertaken to benefit sharehold-

88. *Id.* at 469.

89. *Id.* at 472.

90. *Id.* at 469 (citing *Dynamics*, 481 U.S. at 85-86, 93).

91. *Koppers*, 683 F. Supp. at 469.

92. *Id.*

93. *Id.*

ers do not offend Williams Act policies.⁹⁴ Third, the court found that although the Delaware statute delays the acquisition of full control following purchase for three years if no exception applies, the delay was "not troublesome for preemption purposes."⁹⁵ This is so, the court said, because under pre-existing and accepted corporation law in Delaware, a staggered board delays shifts of control for two years, and the additional one-year delay imposed by section 203 is minimal.⁹⁶ Finally, the court found that the Delaware statute does not interpose the state government's views of fairness between willing buyers and sellers,⁹⁷ a characteristic which proved fatal to the Illinois statute in *MITE*.

The second prong of BNS's constitutional attack met with similar results. Here, the court applied the three-step Commerce Clause inquiry set out in *Dynamics*.⁹⁸ The three-part test inquires: (1) whether the effects of the statute are discriminatory; (2) whether the statute creates an impermissible risk of inconsistent regulation; and (3) whether the statute promotes stable corporate relationships and protects shareholders.⁹⁹

First, the court found that section 203 does not discriminate between offerors which are Delaware corporations and those which are not incorporated in Delaware.¹⁰⁰ Second, the court held that the mere fact that many Delaware corporations do not have their principal offices or many of their shareholders within Delaware does not inevitably create a risk of inconsistent regulation.¹⁰¹ Finally, the court found that the Delaware statute promotes stable corporate relationships and protects shareholders, and dismissed an argument that the law's real purpose was to protect state revenues.¹⁰² "The statute's furtherance of Delaware's pecuniary interest does not automatically render it unconstitutional . . .," the court held. "While the legislative history of section 203 is not free of protectionist sentiment, neither is it devoid of concern for the group putatively benefitted—the stockholders of Delaware corporations. It is manifestly not this Court's place to reject the legislature's offered justification for section 203 absent clear proof that

94. *Id.*

95. *Id.* at 470.

96. *Id.* at 469.

97. *Id.*

98. *Id.* at 472.

99. *Id.*

100. *Id.*

101. *Id.*

102. *Id.* at 473.

this justification is only a pretense. Such proof is missing."¹⁰³

Thus, in both *Koppers* and its companion case, *RP Acquisition Corp. v. Stanley Continental, Inc.*,¹⁰⁴ the district court upheld the constitutionality of the Delaware Business Combination statute. Similar challenges were soon mounted against the Wisconsin¹⁰⁵ and Pennsylvania statutes.¹⁰⁶

G. Amanda Acquisition Corp. v. Universal Foods Corp.

In May, 1989 the Seventh Circuit Court of Appeals upheld Wisconsin's third-generation anti-takeover statute.¹⁰⁷ Enacted after *Dynamics*, the Wisconsin law postpones the kinds of transactions which often follow, and are the reasons for, corporate takeovers. Unless the target's board agrees to the transaction in advance, the bidder must wait three years after buying the shares to merge with the target or acquire more than 5% of its assets.

Similar in many respects to the Pennsylvania legislation discussed below, Wisconsin's law provides that no firm incorporated in Wisconsin and having its headquarters, substantial operations, or 10% of its shares or shareholders there may "engage in a business combination with an interested stockholder . . . for three years after the interested stockholder's stock acquisition date unless the board of directors of the corporation has approved, before the interested stockholder's stock acquisition date, that business combination or the purchase of stock."¹⁰⁸ An "interested stockholder" is defined as one which owns 10% of the voting stock of the corporation either directly or in concert with any other party.¹⁰⁹ A "business combination" is a merger with the bidder or any of its affiliates, sale of more than 5% of the assets to the bidder or affiliate, liquidation of the target, or a transaction by which the target guarantees the bidder's or its affiliates' debts or passes tax benefits to the bidder or its affiliates.¹¹⁰ Unless the target's board agrees to the plan beforehand, the statute provides for an absolute three-year mora-

103. *Id.* at 473 n.31.

104. 686 F. Supp. 476 (D. Del. 1988).

105. *Amanda Acquisition Corp. v. Universal Foods Corp.*, 877 F.2d 496 (7th Cir. 1989), *cert. denied*, ___ U.S. ___, 107 L. Ed. 2d 353 (1989).

106. *First City Financial Corp. v. Armstrong World Indus., Inc.*, No. 89-4858 (E.D. Pa. 1989) (WESTLAW, DCT DATABASE).

107. WIS. STAT. ANN. § 180.726.

108. *Id.* § 180.726(2).

109. *Id.* § 180.726(1)(j).

110. *Id.* § 180.726(1)(e).

torium on business combinations between bidder and target. This requirement is even more restrictive than the Delaware law, where obtaining 85% of the shares owned by non-management shareholders provides an exception to the ban on business combinations.¹¹¹ In Wisconsin, even acquiring 100% of non-management held shares would not lift the bar.¹¹² In addition, Wisconsin corporations cannot opt out of the law's provisions, as corporations can do in most other states, including Delaware and Pennsylvania. As a practical matter, Wisconsin's statute eliminates hostile leveraged buyouts.¹¹³

On December 1, 1988, Amanda Acquisition Corporation, a shell corporation formed to acquire Universal Foods Corporation, commenced a tender offer for at least 75% of the shares of Universal. The deal was structured as a leveraged buyout. Chase Manhattan Bank had agreed to lend Amanda 50% of the cost of the acquisition, to be secured by Universal stock,¹¹⁴ contingent upon a prompt merger of Amanda and Universal. Amanda's offer to Universal's shareholders was conditioned on a judicial declaration that the Wisconsin law was invalid.¹¹⁵ Amanda promptly filed suit seeking a declaration that the law was preempted by the Williams Act and inconsistent with the Commerce Clause.¹¹⁶

The district court declined to issue a preliminary injunction,¹¹⁷ finding the statute constitutional and not preempted. The court found that under Wisconsin law directors are entitled to prevent investors from accepting tender offers of which the directors do not approve.

The Seventh Circuit Court of Appeals affirmed,¹¹⁸ finding that the Wisconsin law was neither preempted by the Williams Act, nor in violation of the Commerce Clause. As an initial matter, however, the court attacked the economic wisdom of anti-takeover legislation. "If our views of the wisdom of state law mattered, Wisconsin's takeover statute would not survive," because in the court's view "anti-takeover legislation injures shareholders."¹¹⁹ Drawing on law and economics literature, the court observed that a statute which prevents sharehold-

111. *Amanda*, 877 F.2d at 498.

112. *Id.*

113. *Id.* at 499.

114. *Id.* at 498.

115. *Id.*

116. *Id.* at 499.

117. 708 F. Supp. 984 (E.D. Wis. 1989).

118. 877 F.2d 496 (7th Cir. 1989).

119. *Id.* at 500.

ers from receiving the benefit of premium offers for their shares makes them worse off.¹²⁰ "It makes the economy worse off too, because the higher bid reflects the better use to which the bidder can put the target's assets."¹²¹ Citing studies of anti-takeover legislation similar to Wisconsin's,¹²² the court concluded that "share prices of firms incorporated in the state drop when the legislation is enacted."¹²³

Despite reservations about the economic wisdom of Wisconsin's legislation, the court recognized that "[s]kepticism about the wisdom of a state's law does not lead to the conclusion that the law is beyond the state's power."¹²⁴ Noting that unless the Constitution or some federal law bars the way, the court observed that "Wisconsin's choice must be respected."¹²⁵

Amanda first challenged the statute on federal preemption grounds, claiming that in the Williams Act Congress had created an entitlement for investors to receive the benefit of tender offers, and that since Wisconsin's law makes tender offers unattractive to potential bidders, it is in conflict with the federal policy. The Seventh Circuit Court of Appeals disagreed. The Williams Act regulates only the process of tender offers and provides for disclosure requirements, the court observed. The Wisconsin law makes a takeover bid for a Wisconsin corporation unattractive, but since the statute leaves the process alone once a bidder appears, the court held that the Wisconsin law could coexist with the Williams Act.¹²⁶

Next, Amanda argued that the Wisconsin statute violated the Commerce Clause.¹²⁷ Once again, the Seventh Circuit Court of Appeals disagreed. Applying the rationale developed in *Dynamics*, the court held that "[b]ecause nothing in the [Wisconsin] law imposes a greater burden on out-of-state offerors than it does on similarly situated [Wisconsin] offerors, we reject the contention that the Act discriminates against interstate commerce." What is noteworthy about the court's Commerce Clause discussion is that it expressly rejected the "meaningful opportunity for success" test applied in the Delaware

120. *Id.* at 500-502.

121. *Id.* at 500.

122. *Id.* at 501.

123. *Id.*

124. *Id.* at 502.

125. *Id.* In the final paragraph of its opinion the Seventh Circuit, quoting language from Justice Scalia's concurring opinion in *Dynamics*, observed that "[a] law can be both economic folly and constitutional." *CTS Corp. v. Dynamics Corp.*, 481 U.S. 69, 96-97 (1987).

126. *Amanda*, 877 F.2d at 502-503.

127. *Id.* at 505.

cases.¹²⁸

In those cases, the district judges sustained the Delaware anti-takeover statute, at least in part, because under the law obtaining 85% of the shares owned by non-management shareholders provides an exception to the ban on business combinations. In Wisconsin, however, even acquiring 100% of non-management held shares would not lift the bar. Unless the target's board has previously agreed to the plan, the statute provides for an absolute three-year moratorium on business combinations between bidder and target. Nevertheless, the Seventh Circuit Court of Appeals observed that "the Commerce Clause does not demand that states leave bidders a 'meaningful opportunity for success'."¹²⁹ Despite the court's unfavorable opinion about the economic wisdom of the statute, Wisconsin's third generation anti-takeover statute survived attack.

III. PENNSYLVANIA'S THIRD GENERATION ANTI-TAKEOVER LEGISLATION

A. *Provisions of the Law*

Pennsylvania elected to codify its anti-takeover statute as part of its newly enacted Business Corporation Law in 1988.¹³⁰ The provisions took effect on March 30, 1989.¹³¹ Pennsylvania's statute is modeled after the Delaware and New York approach to preventing certain "business combinations"¹³² between target corporations and "interested shareholders"¹³³ from taking place, absent board approval. In addition, the Pennsylvania law includes provisions which take effect whenever a "control transaction"¹³⁴ occurs.

128. *Id.* at 508.

129. *Id.*

130. The legislation is substantially a reenactment of former section 910 of the 1933 Business Corporation Law, 15 PA. CONS. STAT. § 1910 (1983) (repealed 1988).

131. The anti-takeover provisions referred to are sections 2541 to 2548 (relating to Control Transactions), 2551 to 2556 (relating to Business Combinations), 2513 (relating to Disparate Treatment of Certain Persons) and 2502 (relating to Registered Corporation Status), Act of Dec. 21, 1988, No. 107, 1988 Pa. Laws 103, 15 PA. CONS. STAT. §§ 2541-2548, 2551-2556, 2513, 2502 (Supp. 1990).

132. The term "business combination" is defined in 15 PA. CONS. STAT. § 2554.

133. The term "interested shareholder" is defined in 15 PA. CONS. STAT. § 2553.

134. The term "control transaction" is defined in 15 PA. CONS. STAT. § 2542 as "[t]he acquisition by a person or group of the status of a controlling person or group." *Id.* It is perhaps significant that the definition is status driven rather than transaction driven. Taken together with the definition of a "Controlling Person or Group" in § 2543, some interesting results could conceivably occur. A "Controlling Person or Group" means a person or group of persons *acting in concert* that

1. *Business Combination Provisions*

Under Pennsylvania's law, a "registered corporation"¹³⁵ may not engage in any "business combination" with an "interested shareholder" for five years from the "interested shareholder's share acquisition date"¹³⁶ unless certain exceptions apply. A "registered corporation" is generally defined as a domestic business corporation, or a wholly owned subsidiary of a domestic business corporation, which has a class or series of shares entitled to vote generally in the election of directors of the corporation registered under the Securities Exchange Act of 1934.

A "business combination" is defined broadly under the statute to include any merger or consolidation of the corporation with the interested shareholder. Included within the definition are subsidiaries, affiliates or associates of the corporation and the interested shareholder. In addition, the definition encompasses any sale, lease, mortgage, pledge, transfer or other disposition of 10% or more of the assets, earning power or net income of the corporation to the interested shareholder. Moreover, if the corporation issues or transfers 5% or more of the market value of its shares to the interested shareholder, or if it extends any loans, advances, guarantees, pledges, financial assistance, tax credits or tax advantages to the interested shareholder its actions will fall within the definition of a "business combination." Finally, if the corporation adopts any plan for its dissolution or liquidation, or reclassification of securities or recapitalization in conjunction with an interested shareholder, such action would be encompassed by the statute's definition of a "business combination."

The term "interested shareholder" is defined to mean any person (other than the corporation or its subsidiaries) that is the beneficial owner of 20% or more of the voting shares of the corporation.

Pennsylvania's law provides for a five-year moratorium on business combinations between a target corporation and an interested shareholder, absent board approval or certain exceptions.¹³⁷ The first excep-

has voting power over voting shares that *would entitle* the holders to cast at least 20% of the votes. *Id.* Under this definition it would be possible for a group of persons, without transacting to buy or sell a single share in the corporation, to trigger the provisions of this subchapter simply by "acting in concert." One must wonder whether a business lunch between two persons, each of whom owns 10% of the voting stock of a Pennsylvania corporation, for the purpose of discussing corporate affairs, would rise to the level of an act "in concert" so as to trigger a control transaction and thereby subject these two to demand for fair value by the remaining shareholders.

135. The term "registered corporation" is defined in 15 PA. CONS. STAT. § 2502.

136. The term "Share Acquisition Date" is defined in 15 PA. CONS. STAT. § 2552.

137. 15 PA. CONS. STAT. § 2555.

tion is made for an interested shareholder who has acquired 80% or more of the voting shares.¹³⁸ In that event, if a majority of the disinterested shareholders approve of the business combination at a meeting called no earlier than three months after the interested shareholder passes the 80% threshold, then the five-year ban is waived. Second, the restriction is lifted if 100% of the outstanding shares vote in favor of the business combination.¹³⁹ If neither of these exceptions apply, and in the absence of board approval, the interested shareholder must wait for five years before any business combination can be consummated.

2. Control Transaction Provisions

Subchapter E of the statute¹⁴⁰ provides that in the event of a "control transaction,"¹⁴¹ shareholders of the corporation are entitled to demand "fair value"¹⁴² for their shares from the "controlling person or group."¹⁴³ A "control transaction" is defined as the acquisition by a person or group of the status of a controlling person or group. A "controlling person or group" means a person, or a group of persons "acting in concert," having voting power over 20% or more of the voting shares of the corporation.

The statute provides that in the event of a control transaction, the controlling person or group must give prompt notice of that fact to each shareholder of record and to the court.¹⁴⁴ The notice to the shareholders must state that all shareholders are entitled to demand that they be paid fair value for their shares. Upon written demand by a shareholder, the controlling person or group must pay the fair value of the shares to the shareholder.¹⁴⁵ The statute provides a procedure for determining the "fair value" of the shares,¹⁴⁶ but generally, the minimum value the shareholder can receive is the highest price paid per share by the controlling person or group within the 90-day period ending on and including the date of the control transaction.

138. *Id.* § 2555(2)(i).

139. *Id.* § 2555(2)(ii).

140. *Id.* §§ 2541-2548.

141. *See supra* note 133.

142. The term "Fair Value" is defined at 15 PA. CONS. STAT. § 2542.

143. The term "Controlling Person or Group" is defined at 15 PA. CONS. STAT. § 2543. *See also supra* note 133.

144. 15 PA. CONS. STAT. § 2545 (1988).

145. *Id.* § 2546.

146. *Id.* § 2547.

3. *Additional Provisions*

In addition to the provisions restricting business combinations and control transactions, two other sections of the Pennsylvania law are noteworthy. First, as a further deterrent to hostile takeovers, the legislation expressly validates as a matter of state corporation law the adoption of shareholder rights plans, or "poison pills," including the provisions of such plans commonly referred to as "flip-ins" and "flip-overs."¹⁴⁷ Second, the law provides that the board of directors may, in determining the best interests of the corporation, consider the effects of any action upon employees, customers, suppliers and the local communities in which the corporation's offices or other establishments are located.¹⁴⁸ Thus, in evaluating a tender offer, the board may look beyond the shareholders' best interests and consider the interests of local constituencies.

B. *The First City Challenge*

Beginning in April, 1989, First City Financial Corporation ("First City"), individually and through its subsidiaries and affiliates, acquired shares in Armstrong World Industries, Inc. ("Armstrong"), a Pennsylvania corporation, and indicated to Armstrong's officers and directors its interest in acquiring the corporation in a negotiated merger or other business combination.¹⁴⁹ In response, Armstrong's board authorized an Employee Stock Ownership Plan (ESOP) to purchase a newly issued

147. Section 2513 read in conjunction with 15 PA. CONS. STAT. § 1525 (1988). See Committee Comment to 15 PA. CONS. STAT. ANN. § 2513 (Purdon's 1990 Pamphlet). A "poison pill" is "[a]n anti-takeover tactic in which warrants are issued to a firm's stockholders, giving them the right to purchase shares of the firm's stock at a bargain price in the event that a suitor hostile to management acquires a stipulated percentage of the firm's stock. The poison pill is intended to make the takeover so unpalatably expensive that any attempt to take control will be abandoned." D. SCOTT, *supra* note 39, at 262. A "flip-in" or "flip-over pill" is "[a]n entitlement granted by a firm's management to its stockholders giving them the right to purchase shares of an acquiring company's stock at a bargain price in the event of a merger. The flip-over pill is a variation of the poison pill. The difference between the two is that a poison pill allows stockholders to purchase additional shares of the target firm's stock rather than shares of the acquiring firm's stock." *Id.* at 140. In an extreme case, the company may adopt a "suicide pill," defined as "[a] poison pill provision so devastating to the target of a takeover attempt that the target company may have to be liquidated to satisfy its creditors. For example, the company's directors may institute a suicide pill giving stockholders the right to exchange their stock for debt if a raider acquires more than a specified percentage of the company's outstanding shares. The tremendous increase in debt will effectively doom the target company if the takeover attempt is successful." *Id.* at 343.

148. 15 PA. CONS. STAT. ANN. § 1721(c) (Purdon 1990); *id.* § 511(b).

149. Plaintiff's Complaint at pp. 19-20; First City Financial Corp. v. Armstrong World Indus., No. 89-4858 (E.D. Pa. 1989) (WESTLAW, DCT DATABASE).

series of convertible preferred stock convertible into 12% of Armstrong's outstanding common stock.¹⁵⁰ The board also authorized a common stock repurchase program designed to repurchase up to 8,000,000 of the outstanding shares of Armstrong at market prices in unsolicited open-market or private transactions.¹⁵¹

In March of 1989, Armstrong's board authorized a "poison pill" shareholder rights plan, which would dilute the common stock upon the happening of a "triggering event," such as a tender offer not approved by the board.¹⁵² Faced with these defensive tactics, First City engaged in discussions with commercial banks and other financial institutions regarding the financing of a tender offer to Armstrong's shareholders.¹⁵³ Pennsylvania's new statute, however, stood in their way.

On July 3, 1989, First City brought an action against Armstrong in the United States District Court for the Eastern District of Pennsylvania asking that the Pennsylvania Anti-Takeover Statute be declared unconstitutional, and requesting an injunction against its enforcement by the state.¹⁵⁴ First City challenged the law on two grounds. First, it alleged that the statute violated the Supremacy Clause of the Constitution of the United States and was preempted by the Williams Act. Second, the law was attacked as an impermissible burden on interstate commerce in violation of the Commerce Clause of the Constitution.

First City withdrew its suit against Armstrong in 1990, but a consideration of the constitutional questions raised in its complaint remains a timely and important issue.

IV. CONSTITUTIONAL ANALYSIS

A. *The Preemption Argument*

1. *The Williams Act and the Supremacy Clause*

The starting point for the preemption argument is the Supremacy Clause of the Constitution of the United States¹⁵⁵ and the Williams Act of 1968.¹⁵⁶ Since the Williams Act regulates the conduct of tender offers, an argument can be articulated that Congress intended through the Williams Act to preempt the field. State legislation which conflicts

150. Plaintiff's Complaint at ¶ 21.

151. *Id.*

152. *Id.* at ¶¶ 71-75.

153. *Id.* at ¶ 23.

154. *First City*, No. 89-4858.

155. U.S. CONST. art. VI.

156. 15 U.S.C. §§ 78m(d)-78m(e), 78n(d)-78n(f) (1981).

with the express provisions of the federal legislation is therefore unconstitutional under the Supremacy Clause. Since the provisions of Pennsylvania's Anti-Takeover Statute practically eliminate the possibility of a successful tender offer in the absence of board approval, the state law conflicts with the Williams Act and should therefore be found unconstitutional.

Preemption has not won easy acceptance in the courts for a number of reasons. First, there is section 28(a) of the 1934 Securities Act, which provides that "[n]othing in this chapter shall affect the jurisdiction of the securities commission . . . of any State over any security or any person insofar as it does not conflict with the provisions of this chapter"¹⁵⁷ Since the S.E.C. has not passed regulations concerning mergers and control transactions, the States have traditionally used the language of section 28(a) to carry out "merit regulation" of securities, or "blue sky" laws which allow securities commissioners to forbid sales altogether, in contrast with the federal statute which emphasizes disclosure.¹⁵⁸ Since section 28(a) allows states to stop these transactions, which federal law would permit, there is no reason to believe that a different result would obtain with respect to Pennsylvania's business combination or control transaction provisions, which merely restrict, but do not forbid sales of securities.

Next, there is the traditional reluctance of federal courts to infer preemption of "state laws in areas traditionally regulated by the States."¹⁵⁹ Corporation laws are in the category of areas traditionally regulated by the states, and since Pennsylvania's statute is written as a corporation, rather than a securities, law the courts should be reluctant to infer federal preemption in this area.

The best argument for preemption is that the practical effect of the Pennsylvania statute violates the Williams Act's policy of neutrality between bidder and management. But to say that Congress wanted to be neutral between bidder and management is not to say that it also forbids states to express a different policy in their laws. "Of course it is a big leap from saying that the Williams Act does not itself exhibit much hostility to tender offers to saying that it implicitly forbids states to adopt more hostile regulations"¹⁶⁰

157. *Amanda Acquisition Corp. v. Universal Foods Corp.*, 877 F.2d 496, 502 (7th Cir. 1989), *cert. denied*, ___ U.S. ___, 107 L. Ed. 2d 353 (1989).

158. *Id.*

159. *Id.*

160. *Id.*

The Williams Act regulates the *process* of tender offers, slowing things down to allow shareholders time to evaluate the offer and management's response. Nothing in the Pennsylvania statute, however, runs afoul of the federal process requirements. Rather, the Pennsylvania law addresses itself more to the *substance* and *effect* of proposed business combinations. This being the case, it is "entirely possible"¹⁶¹ to meet both the requirements of the Pennsylvania law and the Williams Act. Viewed from this perspective, the Pennsylvania statute is entirely consistent with federal legislation, and is therefore not unconstitutional under the Supremacy Clause.

2. *The Dynamics Analysis*

Any serious analysis of the preemption argument must consider the Supreme Court's holding and reasoning in *Dynamics*. There the Court found that whether the Delaware statute frustrates the purposes of the Williams Act may be determined by asking four questions. First, does the statute protect independent shareholders from coercion? Second, does the statute give either management or the offeror an advantage in communicating with shareholders? Third, does the statute impose an indefinite or unreasonable delay on offers? Fourth, does the statute allow the state government to interpose its views of fairness between willing buyers and sellers?¹⁶²

a. *The First Inquiry*

Turning to the first inquiry, the Pennsylvania statute offers protection to independent shareholders by preventing certain dealings between a successful offeror and the target corporation which would be potentially harmful to shareholders, such as freezeouts and leveraged buyouts. Two-tier tender offers, which have been criticized as being coercive of shareholders, are effectively eliminated by the Fair Value provisions of the law.¹⁶³ The requirements for either board approval or a supermajority vote on proposals for business combinations effectively insulates independent shareholders from the coercive effects of a tender offer. Thus, the statute passes the first test.

161. *CTS Corp. v. Dynamics Corp.*, 481 U.S. 69, 79 (1987).

162. *BNS Inc. v. Koppers Co.*, 683 F. Supp. 458, 469 (D. Del. 1988) (citing *Dynamics*, 481 U.S. at 82-84).

163. 15 PA. CONS. STAT. ANN. §§ 2541-2548 (Purdon 1990).

b. The Second Inquiry

While the statute gives the target management an advantage in fighting an unwanted takeover, *Dynamics* suggests that incidentally pro-management measures undertaken to benefit shareholders do not offend Williams Act policies. The underlying purpose of the Williams Act is to ensure that shareholders have sufficient information and time in which to make an informed decision on whether to tender their shares.¹⁶⁴ Pennsylvania's statute does nothing to shorten the time or reduce the amount of information which the shareholders are given by the Williams Act. Under *Dynamics*, the mere fact that the Pennsylvania law gives target management an advantage in fighting a hostile tender offer is not fatal, as long as the incidentally pro-management measures are undertaken to benefit the shareholders.

What is unclear after *Dynamics* is specifically what types of measures will be considered as "undertaken to benefit the shareholders," and which measures will be seen as entrenching management.

Pennsylvania's statute specifically authorizes corporate boards to adopt shareholder rights plans, or "poison pills," including plans with provisions for "flip-in" and "flip-over" rights.¹⁶⁵ Such plans dilute the common stock when the rights are exercised, and have the practical effect of making a corporate takeover much more costly to the raider. Since this makes the corporation less attractive to any potential bidder, shareholders in corporations which have adopted "poison pill" plans are less likely to receive a premium offer for their shares than they would be had their corporation not adopted such a plan. "Poison pills," and the statute which authorizes them can therefore be seen as depriving shareholders of the premium value of their shares. Since the premium value of a share of common stock is a property interest in that share, adoption of a statutorily authorized "poison pill" plan might be seen as a "taking" of property without due process. At a minimum, one might question whether such plans are legitimately in the best interest of the shareholders, or whether they actually serve management's interest in entrenching itself.

The Pennsylvania statute also authorizes corporate boards to consider the effects of any action upon its employees and the community.¹⁶⁶ Measures adopted by a corporate board pursuant to this section

164. 13 CONG. REC. 854-55 (1967) (statement of Sen. Williams).

165. 15 PA. CONS. STAT. ANN. § 2513 (Purdon 1990) read in conjunction with 15 PA. CONS. STAT. ANN. § 1525 (Purdon 1990).

166. 15 PA. CONS. STAT. ANN. § 1721(c) (Purdon 1990); *id.* § 511(b).

of the statute would be contrary to the second preemption inquiry in *Dynamics* which requires that incidentally pro-management measures be undertaken for the benefit of the *shareholders*, not local constituencies. After *Dynamics*, it seems that measures adopted by corporate boards are subject to a case-by-case determination of whether they were undertaken to benefit shareholders, local constituencies or management.

c. *The Third Inquiry*

The third prong of the *Dynamics* inquiry is best examined by considering the *Koppers* application of the test to the Delaware law. The court there found that although the Delaware statute delays the acquisition of full control following purchase for three years if no exception applies, the delay was "not troublesome for preemption purposes."¹⁶⁷ This is so, the court said, because under pre-existing and accepted corporation law in Delaware, a staggered board delays shifts of control for two years, and the additional one-year delay imposed by section 203 is minimal.¹⁶⁸ The Pennsylvania law delays acquisition of full control for five years, absent board approval or certain exceptions. Since Pennsylvania allows staggered terms of directors which would delay acquisition of full control for up to three years, the five-year provision of the anti-takeover statute would add an additional two-year delay. If a one-year delay is not "troublesome" in Delaware, is a two-year delay "troublesome" in Pennsylvania, so as to impose an indefinite or unreasonable delay on offers? Given that legislatures are to be afforded deference in matters of state law, it would be difficult for a court to substitute its own judgment on this issue for that of the Pennsylvania legislature. Hence, the statute should pass the third test.

d. *The Fourth Inquiry*

The final preemption inquiry is whether the Pennsylvania statute interposes the state government's views of fairness between willing buyers and sellers. In *Koppers*, the court found that the Delaware statute did not. The Pennsylvania statute contains no provision for administrative review, as in *MITE*, which could be found to be offensive to a free market for shares. The statute may make it much less attractive for a bidder to make a hostile tender offer, but bidders may still make bids

167. *Koppers*, 683 F. Supp. at 470.

168. *Id.*

and shareholders are still free to accept or reject those bids in Pennsylvania, free from state interference.

As reiterated by the *Koppers* court, the decision in *Dynamics* "unmistakably teaches that states have a legitimate interest in regulating tender offers, despite the significant influence such regulation has over the transfer of securities and the so-called market for corporate control."¹⁶⁹ Pennsylvania's anti-takeover statute should pass muster on the preemption challenge.

B. *The Commerce Clause Argument*

The second argument made against Pennsylvania's Anti-Takeover legislation is that its provisions impermissibly burden interstate commerce in contravention of the Commerce Clause of the United States Constitution. Similar arguments made against the Indiana, Delaware and Wisconsin statutes have failed to persuade the courts that such a burden exists.

Under the Court's decision in *Dynamics*, a three-step inquiry is made to evaluate whether the statute in question violates the Commerce Clause. The three-part test inquires: (1) whether the effects of the statute are discriminatory; (2) whether the statute creates an impermissible risk of inconsistent regulation; and (3) whether the statute promotes stable corporate relationships and protects shareholders.¹⁷⁰

First, Pennsylvania's legislation does not discriminate between offerors which are Pennsylvania corporations and those which are not incorporated in Pennsylvania. The mere fact that most bidders *may* be foreign is unpersuasive. The plain fact of the matter is that domestic bidders and foreign bidders are treated identically under the law. Therefore, the effects of Pennsylvania's statute are not discriminatory.

Second, the mere fact that many Pennsylvania corporations do not have their principal offices or many of their shareholders within the state of Pennsylvania does not inevitably create a risk of inconsistent regulation. Even if a conflict would arise between the laws of Pennsylvania and the laws of another jurisdiction, conflict of laws principles could be used to resolve these differences. Moreover, the anti-takeover provision has no greater potential for inconsistency with the laws of sister states than do other provisions of Pennsylvania's corporation law. Therefore, the Pennsylvania statute does not create an impermissible

169. *Id.* at 468-69 (citing *Dynamics*, 481 U.S. at 85-86).

170. 481 U.S. at 85-94.

risk of inconsistent regulation.

Finally, the Pennsylvania statute promotes stable corporate relationships and protects shareholders. Those that attack the law as a management entrenchment statute as much as concede the first point. Theirs is the argument favoring change over stability. The second point is the more oblique, since it begs the question: "protect shareholders from what?" The history of federal and state legislation on the subject is persuasive that such laws are designed to protect shareholders from the coercive aspects of tender offers. Those that argue against the law have conceded this point as well, since the thrust of their contention is that Pennsylvania's law affords shareholders too much protection from tender offers by practically eliminating any offer which does not have the board's seal of approval.

Like the Indiana, Delaware and Wisconsin statutes before it, Pennsylvania's third generation anti-takeover legislation should survive scrutiny under the Commerce Clause.

V. CONCLUSION

Pennsylvania's third generation anti-takeover legislation, codified as part of the 1988 Business Corporation Law, is clearly a pro-management statute. Under its provisions, a bidder for corporate control will be forced to deal with incumbent management. The alternative to obtaining board approval of a tender offer will be to wait the statutory five-year period before a second step merger or other business combination can be completed. The Act also effectively prevents shareholders from organizing to oust existing management even where no shares are being purchased or sold by the group, and no corporate takeover is contemplated. The statute may ultimately prove beneficial to shareholders, provided that incumbent management acts in the shareholders' best interests. Alternatively, the law and economics commentators may prove to be correct, and the statute may have the effect of entrenching incumbent management, ossifying scarce resources which could be put to better use, and depressing share prices to the disadvantage of shareholders. This question may take years to answer. One result is almost certain: hostile takeovers of Pennsylvania corporations will be effec-

tively eliminated. Given the Supreme Court's decision in *CTS Corp. v. Dynamics Corp. of America*, the Delaware cases and the Seventh Circuit's opinion in *Amanda Acquisition v. Universal Foods*, the Pennsylvania statute will almost certainly be upheld.

Richard C. Gaffney