Maryland Law Review

Volume 43 | Issue 2 Article 5

Takeovers and the 1983 Maryland Fair Price Legislation

L. P. Scriggins

David Clarke Jr.

Follow this and additional works at: http://digitalcommons.law.umaryland.edu/mlr

Part of the Commercial Law Commons

Recommended Citation

L. P. Scriggins, & David Clarke Jr., *Takeovers and the 1983 Maryland Fair Price Legislation*, 43 Md. L. Rev. 266 (1984)
Available at: http://digitalcommons.law.umaryland.edu/mlr/vol43/iss2/5

This Article is brought to you for free and open access by the Academic Journals at DigitalCommons@UM Carey Law. It has been accepted for inclusion in Maryland Law Review by an authorized administrator of DigitalCommons@UM Carey Law. For more information, please contact smccarty@law.umaryland.edu.

TAKEOVERS AND THE 1983 MARYLAND FAIR PRICE LEGISLATION

L. P. SCRIGGINS*
and DAVID CLARKE, JR.**

On June 21, 1983, the Maryland General Assembly enacted and the Governor signed important legislation (the Act) providing fairness prerequisites or special voting requirements for business combinations of a Maryland corporation and certain persons that beneficially own ten percent or more of the corporation's outstanding voting stock.[1] This legislation was Maryland's response to two recent developments: the Supreme Court's holding in *Edgar v. MITE Corp.*[2] that the Illinois takeover statute was unconstitutional as an undue burden on interstate commerce, and the recent evolution of the takeover strategy known as the front-loaded or two-tiered takeover. During the widely-publicized Bendix-Martin Marietta takeover fight, the United States District Court for the District of Maryland had followed *MITE* and struck down the takeover statute which the Maryland General Assembly had enacted in 1976.[3]

In a front-loaded or two-tiered takeover, a corporation typically makes a cash tender offer for a stated amount of the target's shares, such as fifty-one percent, and gives notice that it intends to follow this acquisition with a merger or similar transaction in which the remaining shareholders will receive stock or debentures having a value substan-

---

* A.B., Middlebury College, 1958; J.D., University of Chicago, 1962. Mr. Scriggins is a partner in the Baltimore law firm of Piper & Marbury.

** A.B., Harvard University, 1978; J.D., Harvard University, 1981. Mr. Clarke is an associate with the Baltimore law firm of Piper & Marbury. The authors gratefully acknowledge the assistance of their colleague, George P. Stamas, in the preparation of this article.

1. The Act was passed during a brief special session of the Maryland General Assembly. Baltimore Sun, June 22, 1983, at A1, col. 2. The Maryland General Assembly had enacted an earlier version of the Act, H.B. 1030, during its regular session. *See* 1983 Md. Laws 2466-76. On May 31, 1983, the Governor had vetoed that bill, based on claims that certain exemptions and exemptive procedures were unclear or inadequate, and had stated that he would call a special session to consider a revised bill. 1983 Md. Laws 2464-66. The Act was designed to meet the objections which led to the veto.

The Act amended § 3-202 and added §§ 3-601 to -603 of the Corporations and Associations Article of the Annotated Code of Maryland, which are portions of the Maryland General Corporation Law.

2. 457 U.S. 624 (1982).

3. *See* Bendix Corp. v. Martin Marietta Corp., 547 F. Supp. 522 (D. Md. 1982) (striking down §§ 11-901 to -908 of the Corporations and Associations Article of the Annotated Code of Maryland).

tially less than the cash paid for the first fifty-one percent. The offeror typically limits the opportunity to obtain the earlier, higher price to the shortest period allowed by the rules of the Securities and Exchange Commission (the SEC),[4] and the remaining shareholders are forced to accept the lower price paid in the merger or similar transaction because the state general corporation law typically allows the transaction to occur upon approval by a bare majority of the shareholders.[5] The front-load or two-tiered takeover produces a stampeding effect which may well enable the offeror to acquire the assets of the target corporation for a combined price that is less than their real value.

After setting forth the historical background[6] and summarizing the provisions of the Act,[7] this Article will demonstrate that under the Supreme Court's analysis of the Illinois statute, which focused on the negative effect of the state's tender offer regulation and the lack of any substantial local interest justifying the regulation, the Act should withstand constitutional scrutiny.[8] The Act regulates only the new majority's use of the statutory voting provisions to force out the minority at a low price. Thus, the Act prevents acquiring stockholders from using the voting provisions of a modern general corporation statute in a context for which they were never intended. The Maryland legislature has applied old principles of conflict of interest and self dealing in a new context and provided a traditional legislative response to a new problem.

I. HISTORICAL BACKGROUND

A brief discussion of the historical changes that have occurred in corporation laws and the techniques for combining corporations will set the stage for consideration of the Act and its constitutional status. In the early days of corporations in the United States, mergers and similar transactions could not be accomplished without the consent of every shareholder.[9] Late in the nineteenth century, however, when the tradi-

---

4. *See* 17 C.F.R. § 240.14e-1(a) (1983) (prohibiting tender offers held open for less than twenty days after the offer is first published or sent or given to shareholders).

5. In many states, the general corporation law itself provides that such transactions may occur upon approval by a bare majority of the shareholders. *See* MODEL BUSINESS CORP. ACT ANN. § 73 (1971, Supp. 1973 & Supp. 1977). In Maryland, the general corporation law provided that such transactions could occur upon approval by two thirds of the stockholders, *see* MD. CORPS. & ASS'NS CODE ANN. § 3-105(d) (1975), but allowed corporations to elect in their articles of incorporation to be governed instead by the vote of a bare majority, *see id.* at § 2-104(b)(5).

6. *See infra* text accompanying notes 9-26.

7. *See infra* text accompanying notes 27-68.

8. *See infra* text accompanying notes 69-145.

9. *See* 13 R. EICKHOFF & M. MEIER, FLETCHER CYCLOPEDIA OF THE LAW OF CORPORATIONS § 5906.1, at 254 (1980 rev. ed.); Weiss, *The Law of Take Out Mergers: A Historical*

tional rule proved to be an undesirable restriction on economic growth, legislators enacted statutes allowing less than all of a corporation's shareholders to authorize a merger or similar transaction if it had been approved by the corporation's directors.[10] Many of these statutes now provide that such transactions can be approved by a bare majority of the shareholders.[11] The statutes typically granted dissenting shareholders an appraisal right—the right to relinquish their stock in return for its cash value.[12] Later, after World War II, the position of minority shareholders was eroded further. Legislators enacted statutes allowing cash, rather than stock in the new or surviving corporation, to be distributed to the shareholders of the corporations involved in the transaction.[13] The need for a vote of shareholders was eliminated altogether for mergers and similar transactions involving a parent corporation and a wholly-owned or almost wholly-owned subsidiary.[14] Many states elimi-

---

Perspective, 56 N.Y.U. L. REV. 624, 627 (1981). The corporate charter was seen as a contract among the shareholders, giving each shareholder vested rights, so that no fundamental corporate change could take place without his consent. *See id.*

10. *See* 13 R. EICKHOFF & M. MEIER, *supra* note 9, at 254; Weiss, *supra* note 9, at 629. Maryland's first true general corporation statute, enacted in 1868, included such a provision. *See* 1868 Md. Laws ch. 471, § 36. The current version of the provision is codified as § 3-105(d) of the Corporations and Associations Article of the Annotated Code of Maryland.

11. *See* MODEL BUSINESS CORP. ACT ANN. § 73 (1971, Supp. 1973 & Supp. 1977). Maryland's first merger and consolidation provision, enacted in 1868, required approval by just a bare majority of the stockholders. *See* 1868 Md. Laws ch. 471, § 36. During the extensive overhaul of the Maryland general corporation statute which occurred in 1908, the merger and consolidation provision was amended to require approval by two thirds of the stockholders. *See* 1908 Md. Laws ch. 240, § 29. That requirement still applies to negotiated transactions. *See* MD. CORPS. & ASS'NS CODE ANN. § 3-105(d) (Supp. 1983). The effect of the two-thirds rule is somewhat mitigated by the fact that a Maryland corporation may elect in its articles of incorporation to be governed instead by a bare majority. *See id.* at § 2-104(b)(5) (1975). *See also supra* note 5.

12. *See* 13 R. EICKHOFF & M. MEIER, *supra* note 9, at 254-55. The appraisal remedy was added to the Maryland general corporation statute in 1908. *See* 1908 Md. Laws ch. 240, § 31. The current version of the provision is codified as §§ 3-201 to -213 of the Corporations and Associations Article of the Annotated Code of Maryland.

13. *See* Weiss, *supra* note 9, at 632-33, 648. Such authority was not directly granted to Maryland corporations until 1975, when the Corporations and Associations Article of the Annotated Code of Maryland was enacted. *See* MD. CORPS. & ASS'NS CODE ANN. § 3-103 (1975). Prior to 1975, such authority had been indirectly granted to Maryland corporations in the provisions which specified what had to be included in the articles of consolidation or merger. *See, e.g.*, MD. ANN. CODE art. 23, §§ 68(6), 69(6) (1957). These provisions required the articles of consolidation or merger to specify the amount of stock in the new or surviving business entity or "other consideration" that was to be distributed to the stockholders of the business entities involved in the consolidation or merger. *See, e.g.*, *id.* The "other consideration" language was first added in 1951. *See* 1951 Md. Laws ch. 1354, §§ 64(6), 65(6). Earlier versions of these provisions implied that the stockholders of the business entities involved in the consolidation or merger were required to receive stock in the new or surviving business entity. *See, e.g.*, 1949 Md. Laws ch. 452, §§ 33(2)(d), 34(2)(c).

14. *See* Weiss, *supra* note 9, at 648. Maryland first adopted such a "short form" merger

nated appraisal right provisions, which had been accused of giving minority shareholders an excessive ability to hinder beneficial transactions,[15] if the shares of the corporation were listed on a national securities exchange.[16]

Those statutory changes greatly increased the ability of the majority to effectuate a merger or similar transaction over the objections of the minority and, if it so desired, to force the minority out of the new or surviving corporation. But the changes had been enacted against a background of mergers and similar transactions that were generally negotiated at arm's length by the directors of the two corporations.[17] Since the 1960s, the statutory provisions have increasingly been used in the wake of tender offers in which one of the corporations has gone over the heads of the directors of the other corporation and dealt directly with its shareholders.[18] In the first step, the corporation desiring to accomplish a merger or similar transaction uses a tender offer to obtain a majority of the target corporation's stock. In the second step, a new board of directors is installed and the statutory provisions are used to bring about the desired transaction.

Viewed separately, the two steps of this process might seem unob-

---

provision in 1951, applicable only to wholly-owned subsidiaries. *See* 1951 Md. Laws ch. 135, § 63. In 1970, Maryland expanded its "short form" merger provision to cover subsidiaries in which the parent owned ninety percent or more of the stock. *See* 1970 Md. Laws ch. 689, § 1. The "short form" merger provision is currently codified as § 3-106 of the Corporations and Associations Article of the Annotated Code of Maryland.

15. *See Changes in the Model Business Corporation Act Affecting Dissenters' Rights*, 32 BUS. LAW. 1855, 1856-57 (1977).

16. *See* 13 R. EICKHOFF & M. MEIER, *supra* note 9, at 255. This limitation on the remedy available to a dissenting shareholder was premised on the theory that the national securities market provides a fair and efficient alternative to appraisal. *See id.* It is interesting to note that, in 1978, the national securities exchange exemption was removed from the appraisal right provisions contained in the Model Business Corporation Act on the ground that the market does not, in fact, always provide fair value. *See* Conard, *Amendments of Model Business Corporation Act Affecting Dissenters' Rights (Sections 73, 74, 80 and 81)*, 33 BUS. LAW. 2587, 2595-96 (1978). This judgment, which was made by the Committee on Corporate Laws of the Section on Corporation, Banking and Business Law of the American Bar Association, stands in sharp contrast to the single-minded devotion of certain writers to the "efficient market" hypothesis. *See, e.g.*, Easterbrook & Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161, 1165 (1981) [hereinafter cited as Easterbrook & Fischel, *The Proper Role*].

Maryland adopted the national securites exchange exemption in 1970, *see* 1970 Md. Laws ch. 689, § 1, and continues to apply it in the case of negotiated consolidations and mergers, *see* MD. CORPS. & ASS'NS CODE ANN. § 3-202(c)(1) (Supp. 1983).

17. *See* Carney, *Shareholder Coordination Costs, Shark Repellents, and Takeout Mergers: The Case Against Fiduciary Duties*, 1983 A.B.F. RES. J. 341, 347 n.31.

18. *See* E. ARANOW & H. EINHORN, TENDER OFFERS FOR CORPORATE CONTROL v (1973); Brundney & Chirelstein, *Fair Shares in Corporate Mergers and Takeovers*, 88 HARV. L. REV. 297, 330 (1974); Lowenstein, *Pruning Deadwood in Hostile Takeovers: A Proposal for Legislation*, 83 COLUM. L. REV. 249, 257-59 (1983).

jectionable. It could be argued that, in the first step, individual shareholders are merely taking advantage of the free market for their shares and that, in the second step, the new board of directors and the shareholder majority required by the statutory provisions are merely exercising their well established right to bring about a fundamental corporate change. Viewed together, however, the two steps surely amount to more than this. First, at variance with the bulk of our historical experience, a merger or similar transaction involving two previously independent corporations has been accomplished without the approval of one of the original boards of directors. Some commentators find this development itself undesirable.[19] Second, because the usual statutory scheme does not guarantee that the remaining shareholders will receive as much as the majority received in the tender offer,[20] its use in conjunction with a tender offer may be expected to harm the shareholders as a group.[21] Specifically, because the usual statutory scheme does not guarantee that the remaining shareholders will receive as much as the majority received in the tender offer, the tender offer confronts shareholders with a "prisoner's dilemma" that can stampede them into accepting a tender offer which represents less than the real value of the corporation's assets.[22]

---

19. *See, e.g.*, Lowenstein, *supra* note 18, at 257-68.

20. Where the stock of the target corporation is publicly traded and the target corporation is incorporated in a state which recognizes the national securities exchange exemption, the problem is that the market price for a target corporation's shares generally falls below the tender offer price as soon as the tender offeror executes its purchase. *See* Carney, *supra* note 17, at 351 n.47. This can result from many factors, including the tremendous decrease in liquidity and investor concerns about the new parent's ability to manipulate the stock price. If the national securities exchange exemption is not applicable, the problem is in the appraisal mechanism itself. Most importantly, the typical appraisal right provision excludes value flowing from the proposed merger or similar transaction. *See* Brudney & Chirelstein, *supra* note 18, at 304-05; *accord* MD. CORPS. & ASS'NS CODE ANN. § 3-202(b)(2) (Supp. 1983) ("fair value may not include any appreciation . . . which directly or indirectly results from the transaction objected to or from its proposal"). In any event, typical appraisal right provisions are loaded with procedural pitfalls for the unwary shareholder, and enforcement of one's appraisal right is prohibitively expensive for most shareholders. *See* Eisenberg, *The Legal Roles of Shareholders and Management in Modern Corporate Decision Making*, 57 CALIF. L. REV. 1, 85 (1969); *Changes in the Model Business Corporation Act Affecting Dissenters' Rights*, *supra* note 15, at 1856; *accord* MD. CORPS. & ASS'NS CODE ANN. § 3-203 (Supp. 1983). If the stock market and the appraisal right statute have failed him, a shareholder can turn to common law fiduciary principles for relief, but to date these have also failed to guarantee that the remaining shareholders will receive as much as the majority received in the tender offer. *See* Brudney & Chirelstein, *supra* note 18, at 309-13; Carney, *supra* note 17, at 363-64 (discussing the recent decision of the Supreme Court of Delaware in Weinberger v. UOP, Inc., 457 A.2d 701 (Del. 1983)); Weiss, *supra* note 9, at 661-80.

21. *See, e.g.*, Brudney & Chirelstein, *supra* note 18, at 336-40; Carney, *supra* note 17, at 347-53.

22. *See, e.g.*, sources cited *supra* note 21. Professors Brudney and Chirelstein, writing in 1974, appear to have been the first explicitly to identify this problem. *See* Carney, *supra* note 17, at 348-49. A front-loaded or two-tiered takeover creates several other problems as well. It

This danger has become more serious in recent years as tender offerors have recognized the coercion inherent in front-loaded or two-tiered takeovers and have increasingly bid for a bare majority of the target's stock rather than for "any and all."

Thus, during the last twenty years, the statutory scheme which developed over the course of a century or more has been put to use in a new context, and the ramifications have been disturbing.[23] The takeover statute that the General Assembly passed in 1976 represented

---

is likely that the shareholders of the target corporation who fund the bulk of the transfer of wealth will be the small individual shareholders. Theoretically, the shareholders of the target corporation should suffer equally, because the offeror is required to purchase shares on a pro rata basis from all shareholders who have tendered within at least twenty days of the announcement of the offer. *See* 15 U.S.C. § 78n(d)(6) (1976) (requiring a ten-day proration period); 17 C.F.R. § 240.14d-8 (1983) (rule adopted by the SEC in December 1982, requiring that the proration pool be left open for the full life of the tender offer); 17 C.F.R. § 240.14e-1(a) (1983) (requiring tender offers to remain open for at least twenty days). In practice, however, it does not always work out that way. Professional and institutional investors who have ready access to market information and the capability to tender securities rapidly have a tremendous advantage over small individual stockholders, many of whom would not hear of the proposal through the financial center news media. Many individual stockholders do not receive any notice at all until the rather formidable formal documents come in the mail, perhaps a week after the announcement of the tender offer. The size and complexity of these documents is somewhat bewildering, and such a stockholder would have to act with great alacrity in order to go to his safe deposit box, to get his stock certificates, and to send them to a New York bank under cover of a complicated tender form with a signature guarantee in time to meet the deadline. Worse yet, many of the individual stockholders may sell on the market after seeing a dramatic rise in the price of their shares in newspaper quotations but before receiving information enabling them to understand that an even higher price may be available through the complex tender offer mechanics. It is also possible that an offeror who values the target corporation's assets less than the target corporation does may nonetheless be able to take advantage of the stampeding effect and acquire those assets for a combined price that leaves it with a profit. *See* Carney, *supra* note 17, at 352 & n.48.

23. The changes which have taken place during the last twenty years have triggered an outpouring of secondary literature which threatens to overwhelm the individual reader. *See, e.g.,* articles cited in Carney, *supra* note 17, at 344 nn.17 & 19, 346 n. 26; articles cited in Lowenstein, *supra* note 18, at 250 n.5, 251 n.10. Professors Easterbrook and Fischel have emerged as the leading spokesmen for the position that contested takeovers are almost uniformly beneficial, that such takeovers have already been regulated more than enough, and that the power of incumbent management to resist such takeovers should be sharply curtailed. *See, e.g.*, Easterbrook & Fischel, *Auctions and Sunk Costs in Tender Offers*, 35 STAN. L. REV. 1 (1982); Easterbrook & Fischel, *Corporate Control Transactions*, 91 YALE L.J. 698 (1982); Easterbrook & Fischel, *The Proper Role*, *supra* note 16; Easterbrook & Fischel, *Takeover Bids, Defensive Tactics and Shareholders' Welfare*, 36 BUS. LAW. 1733 (1981); Fischel, *Efficient Capital Market Theory, the Market for Corporate Control, and the Regulation of Cash Tender Offers*, 57 TEX. L. REV. 1 (1978). Obviously, the authors of this article take a contrary view. *See* Brudney & Chirelstein, *supra* note 18; Carney, *supra* note 17; Lowenstein, *supra* note 18.

Professors Brudney and Chirelstein deal with front-loaded or two-tiered takeovers in the course of discussing the larger class of all parent-subsidiary mergers. They apparently view the "prisoner's dilemma" as the most serious problem presented by front-loaded or two-tiered takeovers over and above the problems presented by all parent-subsidiary mergers. *See* Brudney & Chirelstein, *supra* note 18, at 337. Their proposed solution is "a rule which obli-

Maryland's first response to this historical development.[24] The 1976 statute regulated the initial, tender offer stage of a takeover[25] and thus, for reasons that will be discussed below, ran afoul of the Constitution.[26] The new Act represents a more fundamental, and thus a more durable, change in the statutory scheme governing Maryland corporations.

II. THE PROVISIONS OF THE ACT

The primary goal of the Act is to remedy the inequities resulting from the front-loaded or two-tiered takeover. The Act provides that when the second step of a takeover involves a forcing transaction using state law voting provisions (i.e., when there is a merger or similar transaction with an interested stockholder), the second transaction is subject

---

gates [the offeror] to pay the *same* price per share on merger as it offered on tender." *Id.* (emphasis in original).

Professor Carney agrees with Professors Brudney and Chirelstein that the "prisoner's dilemma" needs to be corrected, but agrees with Professors Easterbrook and Fischel that more regulation is not the solution. *See* Carney, *supra* note 17, at 342-44. Rather, he concludes that the problem is one that the shareholders can solve for themselves in advance of any takeover attempt by passing so-called "shark repellent" amendments to the corporation's charter and bylaws. *See id.* at 343-44. He argues that market forces, operating along this avenue, are more likely to reach the appropriate solution than is a legislature or administrative agency. *See id.* However, there is reason to doubt the efficacy of adopting Professor Carney's proposal and leaving the solution to market forces. While the shareholders of a significant number of companies have adopted minority protection provisions similar to those found in the Act, it is widely believed that many publicly owned companies have decided not to put forward such amendments because of the expectation that institutional investors will not vote for them. *See Proxy Season Update: Voting on Fair-Pricing and Staggered-Board Amendments*, Georgeson Report, July 1983, at 3. Because the current federal scheme tends to favor professional investors who are close to the market, as opposed to small individual shareholders, *see supra* note 22, a corporation whose shareholder population is heavily weighted toward institutional investors may expect an unfavorable vote on such provisions. The Act represents a judgment by the Maryland General Assembly that small stockholders should obtain the protections afforded by such provisions.

Professor Lowenstein is more concerned with a perceived inconsistency between takeovers and the fundamental nature of corporations than he is with the problem of the "prisoner's dilemma." *See* Lowenstein, *supra* note 18, at 257-68. As a solution, Professor Lowenstein proposes amendments to the Williams Act, 15 U.S.C. §§ 78m(d)-(e), 78n(d)-(f) (1976), the federal statute regulating tender offers. *See* Lowenstein, *supra* note 18, at 317-34. Among other things, Professor Lowenstein believes that the minimum life for a tender offer should be increased to six months. *See id.* The authors of this article believe that, although that proposal has merit, it is politically unrealistic and may go too far.

24. *See* MD. CORPS. & ASSN'S CODE ANN. §§ 11-901 to -908 (Supp. 1983).

25. Among other things, the 1976 statute required a tender offeror to file a disclosure statement at least twenty days before the commencement of the offer and allowed the Maryland Securities Commissioner to suspend a tender offer indefinitely while conducting an investigation or hearing relating to its fairness. For a summary of the 1976 statute, see Bendix Corp. v. Martin Marietta Corp., 547 F. Supp. 522, 523-24 (D. Md. 1982) (declaring the 1976 statute unconstitutional).

26. *See infra* text accompanying notes 69-145.

to a higher vote than is usually required unless the price paid in the second transaction is as high as the price paid in the first step of the takeover bid. The Act also requires the higher vote for certain other transactions with interested stockholders. The Act applies only to transactions that state law has traditionally required to be approved by stockholder vote and transactions that involve a conflict of interest. It does not apply to tender or other offers to buy stock in which the stockholder has the freedom to make his own decision to sell or not to sell—that is, in which the shareholder will not be bound by a majority vote.[27]

The Act defines a "business combination" to include various transactions.[28] A business combination with a person who meets the Act's definition of an "interested stockholder" (i.e., a stockholder controlling at least ten percent of the corporation's stock[29]) must be recommended by the board of directors and approved by eighty percent of the total votes entitled to be cast on the matter *and* two-thirds of the votes entitled to be cast by holders of voting stock other than voting stock held by the interested stockholder or an affiliate thereof.[30] A corporation that already has a charter provision that requires a lesser proportion of votes than otherwise required by the statute (as is now permitted[31]) is nevertheless subject to the Act.[32] The voting requirements are suspended if

---

27. In this respect, the Maryland Act is strikingly different from the takeover statute passed by Ohio in the wake of *MITE*. In the fall of 1983, the Ohio legislature amended the Ohio general corporation law to subject certain acquisitions of stock to shareholder approval. Specifically, whenever a purchaser moves into one of several ownership ranges (one fifth to one third, one third to one half, or over one half), the transaction must be approved by a majority of all shareholders *and* a majority of all shareholders other than the acquiring person. OHIO REV. CODE ANN. § 1701.831(E)(1) (Page Supp. 1983). The statute applies to all Ohio corporations having at least fifty shareholders and a principal place of business, principal executive offices or substantial assets in Ohio. *Id.* at § 1701.01(Y) (Page Supp. 1983). For a general discussion of this statute, concluding that it is probably unconstitutional, see Kreider, *Fortress Without Foundation? Ohio Takeover Act II*, 52 CINN. L. REV. 108 (1983).

Pennsylvania has taken an interesting intermediate approach. In December 1983, the Pennsylvania legislature amended the Pennsylvania general corporation law so that certain acquisitions of stock trigger an enhanced appraisal right. Specifically, whenever a purchaser obtains at least thirty percent of a corporation's stock, the remaining shareholders may demand the fair value of their stock in cash. PA. BUS. CORP. L. § 910D (1983). Fair value is to be computed as of the date when the purchaser acquired a thirty percent interest, and is required to reflect the increment which the purchaser paid for control. *Id.* § 910E.

In addition to Maryland, Ohio, and Pennsylvania, at least three states—Michigan, Kentucky and Wisconsin—are considering or have enacted takeover statutes designed to withstand invalidation under the *MITE* analysis. This article will not consider how any approaches other than Maryland's can be expected to fare in the courts.

28. MD. CORPS. & ASS'NS CODE ANN. § 3-601(e) (Supp. 1983)

29. *Id.* at § 3-601(j).

30. *Id.* at § 3-602.

31. *Id.* at § 2-104(b)(5) (1975).

32. *Id.* at § 3-603(f) (Supp. 1983).

an exemption is available[33] or if certain fairness prerequisites are satisfied.[34]

The Act exempts investment companies registered under the Investment Company Act of 1940, close corporations (organized under special statutory provisions), corporations having fewer than 100 stockholders, and corporations that elect to be exempt in their original articles of incorporation.[35] Any exempted corporation may elect to be covered by the statute by the vote normally required to amend its articles of incorporation.[36] Any corporation whose stockholders adopt a charter amendment after June 30, 1983, by the same vote required for business combinations (i.e., eighty percent and two thirds) may elect to be exempt.[37]

A Maryland corporation that on July 1, 1983, had an existing interested stockholder is entirely exempt from the statute unless, by a resolution of its board of directors, it elects to become subject to the statute.[38] That election may be in whole or in part, for a particular transaction or type of transaction, or with respect to an identified interested stockholder.[39] A corporation subject to this provision must inform the State Department of Assessments and Taxation of Maryland if it elects to be subject to the statute without qualification.[40] If no election is made, or if the election is partial, no state filing is required.[41] Until September 1, 1983, a Maryland corporation that did not have an interested stockholder on July 1, 1983, could have elected, by a resolution of its board of directors, to be exempt in whole or in part, or in a flexible manner with respect to particular types of business combinations or other classes of transactions or persons.[42] This election would be revocable unless the terms of the resolution provided that it was irrevocable.[43]

The Act also exempts any transaction that is negotiated prior to the

---

33. *Id.* at § 3-603 (e).
34. *Id.* at § 3-603 (b).
35. *Id.* at § 3-603(e)(1).
36. *Id.* at § 3-603(e)(1).
37. *Id.* at § 3-603(e)(1)(iii).
38. *Id.* at § 3-603(d)(1).
39. *Id.*
40. *Id.* at § 3-603(d)(4).
41. *See id.*
42. *Id.* at § 3-603(c)(1)(i).
43. *Id.* at § 3-603(c)(2). In addition, the board of directors of a corporation that had no interested stockholder on July 1, 1983, could have irrevocably accelerated the September 1, 1983, deadline for taking exemptive action. *Id.* at § 3-603(c)(1)(i). Thus, for example, if a front-loaded or two-tiered tender had been mounted for a Maryland corporation on July 1, 1983, with the prospect of a change in control and a change in the board of directors on August 15, 1983, the current board of directors could have taken irrevocable action to accelerate the deadline for taking exemptive action to August 1, 1983.

interested stockholder's acquisition of ten percent of the corporation's stock. Specifically, the higher voting requirements and fair price provisions of the Act do not apply to a transaction with a particular interested stockholder or its affiliates if the transaction is approved by the board of directors of the corporation prior to the date when the interested stockholder becomes an interested stockholder.[44] Thus, the law does not affect friendly transactions if worked out prior to the date when the acquiring company owns as much as ten percent of the stock of the Maryland corporation.

As indicated above, a key definition in the Act is the definition of "business combination."[45] The term is defined to include five different types of transactions. Any merger, consolidation or share exchange of a Maryland corporation with any interested stockholder or any corporation which is, or after the transaction would be, an affiliate of a person or entity that was an interested stockholder before the transaction is a business combination.[46] This aspect of the definition includes the second step in the typical front-loaded or two-tiered tender offer. If the merger, consolidation, or share exchange does not alter the contract rights of the stock or convert any outstanding shares of stock of the corporation, then it is not considered to be a business combination.[47]

The definition of "business combination" also includes any sale, lease, or other disposition of a corporation's assets having an aggregate book value of ten percent or more of the total market value of the outstanding stock of the corporation or of its net worth measured as of the end of its most recently ended fiscal quarter.[48] This aspect of the definition prohibits an acquiring corporation from forcing the target corporation to dispose of its assets without complying with the statute, and thus prevents the majority from squeezing out the minority in a roundabout fashion. Coverage is limited to transactions that are out of the ordinary course of business and to transactions with an interested stockholder or an interested stockholder's affiliate.[49] Furthermore, any series of transactions which occurs within a twelve month period is to be aggregated for the purpose of determining whether the ten percent threshold has been satisfied.[50]

A third aspect of the definition of "business combination" prevents

---

44. *Id.* at § 3-603(c)(1)(ii).
45. *Id.* at § 3-601(e).
46. *Id.* at § 3-601(e)(1).
47. *Id.*
48. *Id.* at § 3-601(e)(2).
49. *Id.*
50. *Id.*

those in control of a target corporation from issuing or transfering five percent or more of the corporation's equity to any interested stockholder or his affiliate.[51] This aspect of the definition is also designed to preclude an acquiring corporation from squeezing out minority shareholders. Without this prohibition, the acquiring group, after gaining control, might try to sell authorized but unissued stock or treasury stock to itself or a potential ally until it could satisfy at least the first of the supermajority voting requirements—the eighty percent requirement. Once again, any series of transactions is to be aggregated for the purpose of determining whether the threshold has been satisfied.[52] In this instance, however, the aggregation is not limited to a twelve-month period.[53]

The definition of "business combination" also includes the liquidation or dissolution of a corporation if an interested shareholder or his affiliate is to receive anything other than cash.[54] Finally, the Act defines "business combination" to include certain securities transactions (reclassifications, recapitalizations and mergers, consolidations or share exchanges with subsidiaries) which increase the percentage of the corporation controlled by an interested shareholder or its affiliate.[55]

The Act defines "interested stockholder" to be any person that (i) beneficially owns ten percent or more of the outstanding voting stock of the corporation, or (ii) is an affiliate of the corporation and at any time during the preceding two years beneficially owned ten percent or more of the outstanding voting stock of the corporation.[56] Beneficial ownership is broadly defined along the lines of similar rules of the SEC and includes ownership by affiliates, associates, and certain relatives and ownership through arrangements giving a person the right to acquire or the right to vote stock.[57]

In addition to the general exemptions outlined above, the Act exempts mergers, consolidations, and share exchanges that would otherwise be considered business combinations if certain fairness requirements are met.[58] These requirements are designed to protect mi-

---

51. *Id.* at § 3-601(e)(3).

52. *Id.*

53. The twelve-month limitation in § 3-601(e)(2) was added to the statute after the Governor's veto of H.B. 1030. *See* 1983 Md. Laws 2469 (§ 3-601(e)(2) as it appeared in H.B. 1030).

54. MD. CORPS. & ASS'NS CODE ANN. § 3-601(e)(4) (Supp. 1983).

55. *Id.* at § 3-601(e)(5).

56. *Id.* at § 3-601(j).

57. *Id.* at § 3-601(d); *see, e.g.*, 17 C.F.R. § 240.13d-3 (1983).

58. MD. CORPS. & ASS'NS CODE ANN. §§ 3-603(b)(1)-(4) (Supp. 1983).

nority shareholders by guaranteeing that they will receive the same consideration for their stock in the second step of the two-tiered takeover that the majority received in the tender offer. Some of the fairness prerequisites relate to price, and others relate to non-price aspects of the transaction.

The nature of the price conditions depends upon the type of stock involved in the transaction.[59] The amount of cash and the value of other consideration to be received by holders of common stock must be at least equal to the highest price resulting from the application of three tests which relate to the price paid by the interested stockholder and the market value of the stock. Specifically, the amount of consideration to be received by holders of common stock must be at least equal to the highest value determined by any of the following three methods: (a) the highest price per share paid by the interested stockholder for any share of the corporation's common stock during the two years prior to the first public announcement of the proposed business combination (the "announcement date") or in the transaction in which it became an interested stockholder (the date of such transaction is the "determination date"), whichever is higher; (b) the market value per share of common stock on the announcement date or on the determination date, whichever is higher; and (c) a price equal to the value per share determined under (b) multiplied by the ratio of (i) the highest price per share paid by the interested stockholder for any share of common stock during the two-year period prior to the announcement date, and (ii) the market value per share of the common stock on the first date during the two-year period that the interested stockholder acquired any shares of common stock.[60] An illustration of the foregoing is as follows:

> (i) highest price paid during the two-year period prior to the announcement date ($22.00) or in the transaction on the determination date ($21.00), whichever is higher: *$22.00*
>
> (ii) the market value on the announcement date ($24.00) or on the determination date ($21.00), whichever is higher: *$24.00*
>
> (iii) higher value in (ii) multiplied by the ratio of the highest price paid during the two-year period prior to the announcement date and the first price paid during such period ($24.00 x $22.00/$20.00): *$26.40*

The interested stockholder would be required to pay at least $26.40 per share to holders of common stock in the business combination if he

---

59. *Id.* at § 3-603(b)(1), (2).

60. *Id.* at § 3-603(b)(1).

purchased any stock during the two years prior to the transaction in which he became an interested stockholder. If the interested stockholder did not purchase any shares of common stock during the two years prior to becoming an interested stockholder, the minimum price under the statute would be the price paid in the transaction on the determination date, the market value on the announcement date, or the market value on the determination date, whichever is higher, or, in the example above, $24 per share.

The amount of cash and the value of other consideration to be received by holders of any class or series of stock other than common stock must be equal to the highest price resulting from the application of four tests which are based on the market value of the stock, the price paid for any of the stock by the interested stockholder, and the price stockholders would be paid for the stock in the event of liquidation, dissolution, or winding up of the corporation. Specifically, the amount of consideration to be received by holders of stock other than common stock must be at least equal to the higher of (i) the highest per share price determined with respect to such class of stock in the same manner as described above for common stock, or (ii) the highest preferential amount per share to which the holders of such class of stock would be entitled in the event of a voluntary or involuntary liquidation, dissolution, or winding up of the corporation.[61] Finally, the consideration to be received by holders of any class of outstanding stock must be in cash or in the same form as the interested stockholder paid for the largest number of the shares of stock of the same class that he acquired.[62]

The basic non-price conditions are as follows (with certain exceptions relating to acts not controlled by or acquiesced in by the interested stockholder): between the time of acquisition of stock by the interested stockholder and consummation of the business combination, (a) dividends on any preferred stock must have been declared and paid on the regular dates; (b) there shall not have been a reduction in the annual rate of dividends paid on any class of stock that is not preferred stock, and there must have been an increase in the annual rate of dividends if necessary to reflect any reclassification, recapitalization or reorganization; (c) the interested stockholder shall not have acquired any additional shares of stock except by virtue of pro rata stock splits or stock dividends; and (d) the interested stockholder shall not have received the benefit of any loans, advances, guarantees, pledges, or other financial

61. *Id.* at § 3-603(b)(2).
62. *Id.* at § 3-603(b)(3).

assistance, or any tax credits or other tax advantages provided by the corporation or one of its subsidiaries.[63]

The Act also amended the appraisal right provisions of the existing law. A stockholder of a corporation who objects to a "business combination," as defined in the Act, may demand cash payment of the fair value of his stock through an appraisal proceeding.[64] The Act eliminates the national securities exchange exemption for business combinations.[65] The appraisal remedy is available even if the transaction is exempt from the supermajority voting requirements under the fairness prerequisites of the Act.[66] If the business combination is exempted by any other statutory provision, then the appraisal remedy is not available.[67] Whenever the appraisal remedy is available, fair value will be determined pursuant to the same price standards that are used to determine whether a business combination is exempt from the higher voting requirements imposed by the Act.[68]

III. CONSTITUTIONALITY OF THE MARYLAND ACT

The recent experience of state takeover statutes in the courts inevitably raises the question of the constitutionality of the Act. A wave of lower court decisions, set in motion in 1977 by *Great Western United Corp. v. Kidwell*[69] and given full impetus by the Supreme Court's decision in *Edgar v. MITE Corp.*,[70] eventually washed away virtually all of the thirty-seven state takeover statutes which had been enacted between

---

63. *Id.* at § 3-603(b)(4), (5).

64. *Id.* at § 3-202(a)(5).

65. *Id.* at § 3-202(c).

66. *Id.* at § 3-202(a)(5). Thus, in the rare situation where the initial tender offer is for securities rather than for cash, so that the Act's fairness requirements can be satisfied without paying the minority stockholders cash, the appraisal remedy will be available for the traditional purpose of letting minority stockholders cash in their investment.

67. The statute states that the stockholder may demand fair value if the "[t]ransaction is governed by § 3-602 of this title or exempted by 3-603(b) of this title." *Id.* at § 3-202(a)(5). By negative implication, the appraisal remedy is not available when the transaction is exempted under any provision other than § 3-603(b).

68. *Id.* at § 3-202(b)(3).

69. 439 F. Supp. 420 (N.D. Tex. 1977), *aff'd*, 577 F.2d 1256 (5th Cir. 1978), *rev'd on grounds of improper venue sub nom.* Leroy v. Great W. United Corp., 443 U.S. 173 (1973). The Supreme Court's refusal to reach the merits in *Kidwell* started a trend, which lasted until *MITE* was decided, in which lower courts struggled to avoid the merits if they could. *See* cases cited in Sargent, *On the Validity of State Takeover Regulation: State Responses to* MITE *and* Kidwell, 42 OHIO ST. L.J. 689, 692 n.17 (1981).

70. 457 U.S. 624 (1982).

1968 and late 1981.[71] Maryland's 1976 takeover statute,[72] which narrowly avoided being one of the first casualities in *Kidwell*,[73] was struck down a few months after *MITE* during the much-publicized Bendix-Martin Marietta takeover fight.[74]

A. Edgar v. MITE Corp.

The state takeover statutes that were enacted between 1968 and 1981 were identical in several crucial respects.[75] The statutes regulated the initial, tender offer stage of a takeover.[76] They imposed procedural requirements, substantive requirements, or both directly on the tender offeror.[77] As a practical matter, a state cannot effectively regulate tender offers for large corporations by regulating only offers made to its own residents.[78] Therefore, all of the state takeover statutes that were enacted between 1968 and 1981 imposed requirements on tender offers even to the extent that the offer involved communications between out-of-state offerors and out-of-state offerees.[79]

In *MITE*, the Supreme Court addressed two distinct constitutional challenges to the Illinois takeover statute:[80] the tender offeror argued

---

71. The case law as it stood shortly before the Supreme Court's decision in *MITE* is summarized in some detail in Sargent, *supra* note 69, at 692-702. Some of the more important of the post-*MITE* decisions are Mesa Petroleum Co. v. Cities Servs. Co., 715 F.2d 1425 (10th Cir. 1983), Telvest, Inc. v. Bradshaw, 697 F.2d 576 (4th Cir. 1983), Martin Marietta Corp. v. Bendix Corp., 690 F.2d 558 (6th Cir. 1982), National City Lines v. LLC Corp., 687 F.2d 1122 (8th Cir. 1982), and Bendix Corp. v. Martin Marietta Corp., 547 F. Supp. 522 (D. Md. 1982). Citations to the thirty-seven state takeover statutes which were on the books in late 1981 are provided in Sargent, *supra* note 69, at 690 n.7. All but one of these statutes was passed after Congress' 1968 adoption of the Williams Act, 15 U.S.C. §§ 78m(d)-(e) & 78n(d)-(f) (1976), the federal statute regulating tender offers. *See MITE*, 457 U.S. at 631 n.6. Virginia's statute predated the Williams Act by less than five months. *See id.*

72. MD. CORPS. & ASS'NS CODE ANN. §§ 11-901 to -908 (Supp. 1982).

73. *See* 439 F. Supp. at 428 (holding that the plaintiff had failed to demonstrate that it had "a concrete case or controversy against the Maryland statute").

74. *See* Bendix Corp. v. Martin Marietta Corp., 547 F. Supp. 522 (D. Md. 1982).

75. For a discussion of the common characteristics of state takeover statutes see Wilner & Landy, *The Tender Trap: State Takeover Statutes and Their Constitutionality*, 45 FORDHAM L. REV. 1, 5-9 (1976).

76. Indeed, until very recently, it simply went without saying that takeover regulation involved tender offer regulation. For several examples of discussions that assume that takeover regulation means tender offer regulation, see Sargent, *supra* note 64; *The Supreme Court—1981 Term*, 96 HARV. L. REV. 62, 62-71 (1982) (comment on the *MITE* case); Note, *Securities Law and the Constitution: State Tender Offer Statutes Reconsidered*, 88 YALE L.J. 510 (1979).

77. The specific provisions of the state takeover statutes enacted between 1968 and 1981 are discussed in some detail in Sargent, *supra* note 69, *passim*; Note, *supra* note 76, at 514-16.

78. *See* E. ARANOW & H. EINHORN, *supra* note 18, at 157; Note, *supra* note 76, at 515 & n.34.

79. *See* Sargent, *supra* note 69, at 690 n.7; *The Supreme Court—1981 Term*, *supra* note 76, at 65 n.29; Note, *supra* note 76, at 515.

80. *See* 457 U.S. at 626.

that the statute violated both the supremacy clause[81] and the commerce clause of the United States Constitution.[82] The tender offeror argued that the state statute was unconstitutional under the supremacy clause because it conflicted with the federal statute regulating tender offers, the Williams Act.[83] Finding that the Williams Act does not explicitly preempt the field of tender offer regulation,[84] the Court noted that state legislation is nonetheless invalid under the supremacy clause if it is impossible to comply with both the state and the federal requirements or if the state legislation "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress."[85]

On the facts before the Court,[86] it was not impossible to comply

---

81. U.S. CONST. art. VI, cl. 2 ("This Constitution, and the Laws of the United States . . . shall be the supreme Law of the Land . . . .").

82. *Id.* art. I, § 8, cl. 3. ("The Congress shall have Power . . . [t]o regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes . . . .").

83. *See* 457 U.S. at 630-40. The Williams Act is codified as 15 U.S.C. §§ 78m(d)-(e), 78n(d)-(f). The Williams Act was passed in 1968, when the tender offer phenomena was relatively new and still appeared fragile. *See* Lowenstein, *supra* note 18, at 252. If the Williams Act did indeed represent a final judgment as to the appropriate level of regulation, *see infra* text accompanying note 89, it stands in sharp contrast with the much more restrictive approach previously taken in England, *see* COUNCIL FOR THE SECURITIES INDUSTRY, THE CITY CODE ON TAKE-OVERS AND MERGERS (5th ed. 1981), where the tender offer phenomena had appeared years earlier, *see* E. ARANOW & H. EINHORN, *supra* note 18, at v. The first fifteen years of experience with the Williams Act apparently has convinced the agency responsible for its enforcement that some significant changes are necessary. In a report published on July 8, 1983, the SEC Advisory Committee on Tender Offers proposed a series of changes which would sharply depart from current practice and, despite statements to the contrary, interject federal regulation into certain corporate transactions traditionally governed by state law. On March 13, 1984, the SEC endorsed many of the proposed changes, but disapproved of those which it deemed most intrusive into the traditional area of state regulation. Wall St. J., March 14, 1984, at 4, col. 1.

84. *See* 457 U.S. at 631. There is no indication in the legislative history of the Williams Act that Congress was aware of state takeover statutes. *Id.* at 631 n.6. The Williams Act constituted an amendment to the Securities Exchange Act of 1934, 15 U.S.C. §§ 78a-78kk (1983), which already contained the following provision:

> Nothing in this chapter shall affect the jurisdiction of the securities commission (or any agency or officer performing like functions) of any State over any security or any person insofar as it does not conflict with the provisions of this chapter or the rules and regulations thereunder.

15 U.S.C. § 78bb(a). It has been argued that this provision creates a presumption against preemption which extends even to the Williams Act. *See* Sargent, *supra* note 69, at 704-06 (discussing both sides of the debate).

85. Hines v. Davidowitz, 312 U.S. 52, 67 (1941), *quoted in* Ray v. Atlantic Richfield Co., 435 U.S. 151, 158 (1978), and *MITE*, 457 U.S. at 631.

86. The tender offer at issue in *MITE* was made in February 1979 and abandoned in March 1979. The tender offeror obtained a preliminary injunction blocking enforcement of the Illinois statute and did not comply with the statute. The only reason why a majority of the Supreme Court concluded that the case was not moot was because Illinois' Secretary of State had indicated that he would bring an action for civil penalties against the tender offeror if the statute were upheld. *See* 457 U.S. at 630. Thus, even though *MITE* was decided in June 1982, the Supreme Court was limited to considering the statute's validity as of February and March 1979.

Meanwhile, on January 7, 1980, shortly after the set of facts in *MITE* had crystalized,

with both the state and federal requirements.[87] As for the final prong of the test, of the six Justices who reached the merits in *MITE*, three Justices concluded that the state legislation was invalid, two concluded that it was not invalid, and one refused to say.[88] The three Justices who concluded that the state legislation was invalid argued that Congress sought to "strike a balance between the investor, management, and the takeover bidder" in the Williams Act, and that any state regulation which altered the balance frustrated the objectives of the Act.[89] These Justices found that the Illinois statute altered the balance struck by Congress not only because it provided stockholders with additional time to decide and additional information,[90] but also because it allowed the Secretary of State to veto tender offers that he considered unfair.[91] These Justices concluded that the veto was inconsistent with what they deemed to be a basic feature of the Williams Act—full stockholder free-

---

the first prong of the supremacy clause analysis—impossibility of simultaneous compliance—was brought into play by the SEC. *See* Sargent, *supra* note 69, at 695-97; *The Supreme Court—1981 Term*, *supra* note 76, at 67-68. Acting pursuant to the rule-making authority conferred on it by the Williams Act, the SEC promulgated new rule 14d-2(b), 17 C.F.R. § 240.14d-2(b) (1983), for the express purpose of making it impossible for a tender offeror to comply with both the Williams Act and the major features of the state takeover statutes then in effect. *See* SEC Release No. 34-16,384, 44 Fed. Reg. 70,326 (1979), *reprinted in* [1979-80] FED. SEC. L. REP. (CCH) ¶ 82,373. Most importantly, the new rule required a tender offeror to commence its tender offer within five days of announcing the material terms of the offer, and defined the announcement that triggered the five-day requirement so that it included the filings that many states required a tender offeror to make anywhere between twenty and sixty days before the commencement of a tender offer. The new rule also made it impossible to comply with both the Williams Act and the state statutes to the extent that they provided pro rata, withdrawal or certain other rights different from those provided by the Williams Act. *See The Supreme Court—1981 Term*, *supra* note 76, at 68 n.40. As was soon borne out by a series of lower court decisions, *see, e.g.*, cases cited in Sargent, *supra* note 69, at 697 nn.47-48, the SEC's action virtually guaranteed a finding of preemption. *But cf.* Agency Rent-A-Car, Inc. v. Connolly, 686 F.2d 1029 (1st Cir. 1982) (provision of Massachusetts Act, which barred corporations from making a tender offer for twelve months as a sanction for failures to make disclosure, was *not* preempted; plaintiff conceded the validity of the disclosure requirement and challenged only the sanction).

87. *See* 457 U.S. at 631-32.

88. *See id.* at 632-40 (opinion of White, J., in which Burger, C.J. and Blackmun, J., joined) (statute invalid); *id.* at 646-47 (Powell, J., concurring in part) (statute valid); *id.* at 655 (Stevens, J., concurring in part and concurring in judgment) (same); *id.* at 655 (O'Connor, J., concurring in part) (not necessary to reach preemption issue). The Supreme Court's 3-2 vote on this issue left the lower courts free to do as they see fit. *See The Supreme Court—1981 Term*, *supra* note 76, at 63 n.15.

89. *See* 457 U.S. at 634-39.

90. *See id.* In so doing, these Justices adopted the view that the benefits of allowing stockholders additional time to decide were outweighed by the additional opportunity afforded to incumbent management to fend off the tender offer through the use of improper defensive tactics. *See id.* at 635. This view later played an important role in the majority's commerce clause analysis. *See infra* notes 108 & 116 and accompanying text.

91. *See* 457 U.S. at 639-40.

dom to accept or reject the offer.[92] The two Justices who concluded that the state legislation was not invalid accepted their opponents' reading of the Williams Act's legislative history, but stated that they were "not persuaded . . . that Congress' decision to follow a policy of neutrality in its own legislation is tantamount to a federal prohibition against state legislation designed to provide special protection for incumbent management."[93]

The tender offeror argued that the state takeover statute was unconstitutional under the commerce clause because it impermissibly interfered with interstate commerce.[94] There are two parts to the commerce clause test, or at least there were two parts to the test articulated by Justice White in the lead opinion in *MITE*.[95] According to Justice White, state legislation is invalid if it regulates interstate commerce directly, as opposed to indirectly, or if the burden of an indirect regulation on interstate commerce outweighs the legitimate local benefits.[96] Justice White concluded that the Illinois takeover statute was invalid under both prongs of this test.[97] Three other Justices agreed with him on the first prong of the test.[98] Four other Justices agreed with him on the second prong of the test, making this balancing test the *only* basis for striking down the Illinois statute that was endorsed by a majority of the Court.[99]

Arguably, the first half of Justice White's test, founded on a distinction between direct and indirect regulation, was jettisoned by the Court

---

92. *See id.*

93. *Id.* at 655 (Stevens, J., concurring in part and concurring in judgment); *accord id.* at 646-47 (Powell, J., concurring in part).

94. *See id.* at 640-46.

95. As for the possibility that Justice White departed from the prevailing standard, see *infra* note 100 and accompanying text.

96. *See* 457 U.S. at 640.

97. *See id.* at 641-46.

98. In addition to Chief Justice Burger, who joined in Justice White's entire opinion, Justices Stevens and O'Connor joined in this portion of Justice White's opinion. *See id.* at 654-55 (Stevens, J., concurring in part and concurring in judgment); *id.* at 655 (O'Connor, J., concurring in part).

99. In addition to Chief Justice Burger, Justices Powell, Stevens, and O'Connor joined in this portion of Justice White's opinion. *See id.* at 646 (Powell, J., concurring in part); *id.* at 654-55 (Stevens, J., concurring in part and concurring in judgement); *id.* at 655 (O'Connor, J., concurring in part). It is worth noting that Justice Powell joined this portion of Justice White's opinion even though he was one of the three Justices who had concluded that the case was moot. *See id.* at 646 (Powell, J., concurring in part). Among the six Justices who concluded that the case was justiciable, no more than four could agree on any one ground for striking down the Illinois Act. *See supra* note 81 and accompanying text (describing 3-2-1 split on preemption issue). For a criticism of the Supreme Court's increasing inability to reach a concensus, see Note, *Plurality Decisions and Judicial Decisionmaking*, 94 HARV. L. REV. 1127 (1981).

during the judicial revolution of the 1930s and had not since reappeared.[100] Regardless of the usefulness of the distinction as a general matter, Justice White's actual application of the first part of his test was perplexing because it seems inconsistent with the Court's prior treatment of state blue sky legislation. Justice White himself pointed out that "this Court has upheld the authority of States to enact 'blue sky' laws against Commerce Clause challenges on several occasions."[101] Although all of the cases which he cited were decided in 1917,[102] the Justice did not indicate that there was any reason to question the applicability of their holdings to today's blue sky laws. However, Justice White distinguished state blue sky laws from the state takeover statute at issue in *MITE* on the ground that blue sky laws deal solely with intrastate transactions.[103] That argument may distinguish the blue sky laws at issue in the 1917 decisions which he had cited, but it cannot distinguish the blue sky laws on the books today. Generally modeled on the Uniform Securities Act, modern blue sky laws regulate offers made by telephone or mail from another state to someone in the regulating state—quintessential interstate commerce.[104] State blue sky laws can be distinguished from the Illinois statute on a ground not mentioned by White—at least one end of the transaction regulated by the blue sky laws occurs in the regulating state.[105] Thus, Justice White's brief discussion of blue sky laws would not merit attention were it not for the fact that he indicated that Illinois' takeover statute would have been invalid

---

100. *See Supreme Court—1981 Term*, *supra* note 76, at 64 n.16 (citing L. TRIBE, AMERICAN CONSTITUTIONAL LAW § 6-5, at 326 (1978)).

101. 457 U.S. at 641.

102. *See id.* (citing Hall v. Geiger-Jones Co., 242 U.S. 539 (1917), Caldwell v. Sioux Falls Stock Yards Co., 242 U.S. 559 (1917), and Merrick v. N.W. Halsey & Co., 242 U.S. 568 (1917)).

103. *See* 457 U.S. at 641.

104. *See* UNIFORM SECURITIES ACT § 414. This is not to say that the courts of the regulating state have personal jurisdiction over the offeror. Indeed, the draftor of the Uniform Securities Act has explicitly recognized that the Act will prohibit conduct by many offerors over whom the regulating state cannot obtain personal jurisdiction. Lecture by Louis A. Loss, September 9, 1980. Thus, Justice White's comment that the "limits on a state's power to enact substantive legislation are similar to the limits on the jurisdiction of state courts," 457 U.S. at 643, is extremely perplexing if one assumes that modern blue sky laws are constitutionally valid.

105. In contrast, in its takeover statute Illinois purported to regulate even that portion of a tender offer which involved communications made, for example, from New York to Florida. Consistent with its past decisions, the Court might have struck down the Illinois statute—or any of the takeover statutes enacted between 1968 and 1981—solely because of this extraterritorial effect. *Compare* Nebbia v. New York, 291 U.S. 502 (1934) (it is constitutional for New York to regulate the price paid to New York farmers for milk), *with* Baldwin v. G.A.F. Seelig, Inc., 294 U.S. 511 (1935) (it is not constitutional for New York to regulate the price paid by a buyer in Vermont for milk even if he is going to transport it to New York and sell it in New York).

as a "direct" regulation of interstate commerce even if it regulated nothing other than offers communicated from out-of-state *to Illinois residents*.[106] Taken at face value, Justice White's argument implies that all modern blue sky laws are unconstitutional.[107]

As for the second part of his commerce clause test, Justice White described the burdens imposed on interstate commerce by the Illinois takeover statute as follows:

> Shareholders are deprived of the opportunity to sell their shares at a premium. The reallocation of economic resources to their highest valued use, a process which can improve efficiency and competition, is hindered. The incentive the tender offer mechanism provides incumbent management to perform well so that stock prices remain high is reduced.[108]

On the other side of the equation, Illinois suggested that its statute protected resident stockholders and regulated the internal affairs of corporations incorporated in Illinois.[109]

The Court held that the legitimate local benefits served by the Illinois takeover statute did not outweigh the burdens that it imposed on interstate commerce.[110] To begin with, the Court noted that much of Illinois' regulatory scheme did not further Illinois' claimed goals at all, because the statute regulated tender offers that involved communications to nonresident stockholders,[111] and tender offers for corporations which had a "presence" in Illinois but which were not incorporated there.[112] The Court stated flatly that "the State has no legitimate interest in protecting nonresident shareholders"[113] and that "Illinois has no interest in regulating the internal affairs of foreign corporations."[114] The Court also pointed out that the state's purported concern for stockholders was belied by the fact that its statute did not apply to a corpora-

---

106. *See* 457 U.S. at 641-42.

107. In all fairness, despite the unfortunate indications to the contrary, there is language in Justice White's opinion which suggests that the argument given here for distinguishing state blue sky laws is what he actually had in mind. *See, e.g.*, *id.* at 641 ("The Illinois Act differs substantially from state blue-sky laws in that it directly regulates transactions which take place across state lines, even if *wholly* outside the State of Illinois") (emphasis added).

108. *Id.* at 643-44 (citing Easterbrook & Fischel, *The Proper Role*, *supra* note 16, at 1173-74; Fischel, *supra* note 23, at 5, 27-28, 45; H.R. REP. NO. 1373, 94th Cong., 2d Sess. 12 (1976) (legislative history of the Hart-Scott-Rodino Antitrust Improvements Act of 1976)).

109. *See* 457 U.S. at 644.

110. *See id.* at 644-46.

111. *See id.* at 644.

112. *See id.* at 645-46.

113. *Id.* at 644.

114. *Id.* at 645-46.

tion's offer to buy its own stock.[115] In the Court's view, the net benefits conferred on stockholders by the Illinois statute were insubstantial and speculative.[116] Finally, as for the state's interest in regulating the internal affairs of a corporation incorporated under its laws, the Court denied that the regulation of tender offers constituted any such thing:

> The internal affairs doctrine is a conflict of laws principle which recognizes that only one State should have the authority to regulate a corporation's internal affairs—*matters peculiar to the relationships among or between the corporation and its current officers, directors, and shareholders*—because otherwise a corporation could be faced with conflicting demands. That doctrine is of little use to the State in this context. *Tender offers contemplate transfers of stock by stockholders to a third party and do not themselves implicate the internal affairs of the target company*.[117]

This passage provides the key to understanding why the Maryland Act is constitutional. The Act does not regulate the initial, tender offer stage of a takeover at all. Rather, it regulates the second, forced transaction stage of a takeover and directly concerns the target corporation's "internal affairs."

B. *Theory of the Act*

As was pointed out earlier, some commentators argue that takeovers are undesirable because the tender offer allows shareholders—rather than the directors—to decide whether the corporation should enter into a merger or similar transaction and because that power is inconsistent with the fundamental attributes of a corporation.[118] In enacting the Williams Act, Congress did nothing to solve this purported problem.[119] Rather, Congress left stockholders with full freedom to ac-

---

115. *See id.* at 644.

116. *See id.* at 644-45. The Court apparently endorsed the view that the benefit gained by giving stockholders more time to consider a tender offer is outweighed by the danger that incumbent management will defeat a desirable tender offer through the use of improper defensive tactics. This is very much the view of the authorities which the Court had cited earlier when describing the burdens imposed on interstate commerce by the Illinois Act. *See generally* sources cited *supra* note 108. The Court also apparently endorsed the view that the additional disclosure required by the states, over and above what the Williams Act required, might well confuse stockholders rather than enlighten them.

117. 457 U.S. at 645 (citations omitted) (emphasis added).

118. *See, e.g.*, Lowenstein, *supra* note 18, at 257-68.

119. *See generally* H.R. REP. NO. 1711, 90th Cong., 2d Sess. 3 (1968) (House Report on the Williams Act); S. REP. NO. 550, 90th Cong., 1st Sess. 3 (1967) (Senate Report on the Williams Act); *Hearings on H. R. 14475, S. 510 Before the Subcomm. on Commerce and Finance*, 90th Cong., 2d Sess. 4, 47-48 (1968) (House hearings on the Williams Act); *Hearings on S. 510 Before the Subcomm. on Banking and Commerce*, 90th Cong., 1st Sess. 17, 19, 25, 182 (1967) (Senate Hearings on the Williams Act).

cept or reject a tender offer.[120] Many of the courts that struck down state takeover statutes on preemption grounds concluded that Congress' failure to restrict stockholder freedom represented a positive judgment that this freedom should not be restricted.[121] Those federal court decisions cast serious doubt on the constitutionality of further attempts by the states to restrict a shareholder's freedom to accept or reject a tender offer. The Maryland Act recognizes this and does not attempt to restrict this freedom. Indeed, the new Maryland statute makes no effort to regulate tender offers at all.[122]

Those who argue that takeovers are desirable presume that stockholders deciding whether or not to tender are making a rational economic judgment.[123] It is widely recognized, however, that there are at least two features of takeovers, as they generally take place today, that threaten that essential assumption. The first flaw, which is often inherent in the tender offer which is the first step in the takeover, is that a tender offer does not produce rational economic judgments if it gives stockholders too little time or too little information.[124] Most authorities recognize that, in this regard, more is not necessarily better. Beyond a certain point, additional time serves little purpose except to afford incumbent management further opportunity to fend off the tender offer through the use of tactics that are not in the corporation's or the shareholders' best interests.[125] Similarly, beyond a certain point, additional information simply overwhelms the shareholders.[126]

The question, obviously, is how much is enough? Many of the

---

120. *See generally* sources cited *supra* note 119.

121. *See, e.g.*, MITE Corp. v. Dixon, 633 F.2d 486, 493-94 (7th Cir. 1980), *aff'd on other grounds sub nom.* Edgar v. MITE Corp., 457 U.S. 624 (1982); Great W. United Corp. v. Kidwell, 577 F.2d 1256, 1279-80 (5th Cir. 1978), *rev'd on ground of improper venue sub nom.* Leroy v. Great W. United Corp., 443 U.S. 173 (1979).

122. The lawsuits challenging the validity of the state takeover statutes enacted between 1968 and 1981 were typically filed by tender offerors at the same time that they announced their tender offers. One major consequence of Maryland's shift from tender offer regulation would appear to be that a lawsuit challenging the validity of the Act could not be filed until a tender offer had been completed and a concrete plan for a merger or similar transaction had been recommended by the target's board of directors. Prior to the completion of the tender offer, the tender offeror apparently would be without standing to challenge the Act because it comes into play only when a ten percent shareholder seeks to deal with the corporation. Prior to the recommendation of a concrete plan for a merger or similar transaction, the application of the Act apparently would be too speculative to give rise to a justiciable case or controversy.

123. *See, e.g.*, Easterbrook & Fischel, *The Proper Role*, *supra* note 16, at 1165-68.

124. *Cf.* Note, *supra* note 76, at 523-24 (delay and disclosure benefit the investor).

125. *See, e.g.*, H.R. REP. NO. 1373, 94th Cong., 2d Sess. 12 (1976) (legislative history of the Hart-Scott-Rodino Antitrust Improvement Act of 1976).

126. *See, e.g.*, E. ARANOW, H. EINHORN & G. BERLSTEIN, DEVELOPMENTS IN TENDER OFFERS FOR CORPORATE CONTROL 219-20 (1977).

courts that struck down state takeover statutes on preemption grounds concluded that Congress meant the time and information provisions of the Williams Act to be the final judgment on what the balance should be, rather than just a set of minimum standards.[127] Those federal court decisions cast serious doubt on the constitutionality of further attempts by the states to strike a different time and information balance, even if states manage to do so without running afoul of a rule which the SEC promulgated in 1980 to make it extremely difficult for one to comply simultaneously with both the Williams Act and any other scheme of tender offer regulation.[128] The Maryland Act recognizes this and does not attempt to alter the time and information balance struck by the Williams Act.

The second feature of takeovers that threatens the assumption that shareholders deciding whether or not to tender are making a rational economic judgment is the coercion implicit in many tender offers. Although this second flaw affects a shareholder's decision whether to tender, it does not result from the nature of the tender offer itself. Rather, it results from the nature of the forced transaction that generally follows the tender offer.[129] Until recently, a stockholder considering a tender offer just worried that such a transaction might be the next step.[130] In the era of front-loaded or two-tiered tender offers, however, a stockholder considering a tender offer *knows* what is coming next, because he has already been informed of the details of the coming "cramdown."[131]

An elementary principle of both political and economic theory is that an "election," whether it be an election in the strict political sense or the process by which stockholders "vote" to accept or reject a tender offer, is not an accurate barometer of the group's sentiments if one but only one of the competing candidates will be in a position, if he wins, to reward those who voted for him and to punish those who voted against him.[132] When that occurs, the vote is skewed toward the candidate who possesses the advantage.[133] Prior to the passage of the Act, tender offer-

127. *See, e.g.*, MITE Corp v. Dixon, 633 F.2d 486, 495-98 (7th Cir. 1980) (time), *aff'd on other grounds sub nom.* Edgar v. MITE Corp., 457 U.S. 624 (1982); Great W. United Corp. v. Kidwell, 577 F.2d 1256, 1280-81 (5th Cir. 1978) (information), *rev'd on grounds of improper venue sub nom*. Leroy v. Great W. United Corp., 443 U.S. 179 (1979).

128. *See supra* note 86.

129. *See* Brudney & Chirelstein, *supra* note 18, at 337; Carney, *supra* note 17, at 347-53; Lowenstein, *supra* note 18, at 307-09.

130. *See* Carney, *supra* note 17, at 350.

131. *See id.*

132. *See id.* at 351-53 & nn.46-50.

133. *See id.*

ors bidding for Maryland corporations possessed that advantage. The appraisal rights, fiduciary duties, and other mechanisms of traditional state corporation law had not guaranteed stockholders who failed to tender that, if they lost the "election," they would receive as much in the forced transaction as the tendering stockholders received when they sold their stock.[134] This is precisely what the Act *does* guarantee.

Quite simply, the Act concerns the rights of minority stockholders in a transaction between the corporation and the majority stockholder. Thus, the Act directly concerns the corporation's "internal affairs" as that term was defined in the portion of Justice White's opinion that was joined by a majority of the *MITE* Court. The new Maryland statute directly concerns "matters peculiar to the relationships among or between the corporation and its current officers, directors, and shareholders."[135]

C. *Application of Justice White's Analysis*

The first half of the analysis employed by Justice White was designed to determine whether the statute there at issue was preempted by the Williams Act.[136] In stark contrast with the statute at issue in *MITE* and all of the other state takeover statutes enacted between 1968 and 1981, the Act does not even attempt to regulate the field occupied by the Williams Act. Because the two statutes regulate entirely different transactions, there is no difficulty in complying with the requirements of both the Williams Act and the Maryland Act. Similarly, because the Maryland Act does not address the time and information aspects of a tender offer, the new statute clearly does not frustrate the time and information objectives of the Williams Act. Furthermore, the Act does not jeopardize the Williams Act's purported attempt to insure that stockholders are left free to accept or reject a tender offer.[137] To the extent that the Maryland Act can be said to affect this aspect of the tender offer at all, the new statute is entirely consistent with Congress' purported objective, because it guarantees that a stockholder will be able to make a rational judgment, free from the coercive influences that are now often present.

The last half of the analysis employed by Justice White was designed to determine whether the Illinois statute unduly interfered with interstate commerce.[138] Because the new Maryland statute regu-

---

134. *See supra* note 20.
135. 457 U.S. at 645.
136. *See id.* at 630-32.
137. *See supra* note 83; *supra* text accompanying notes 92-93 & 119-21.
138. *See* 457 U.S. at 640.

lates the forced transaction stage of a takeover rather than the tender offer stage, its effect on the tender offer, and thus on interstate commerce, is patently indirect. Therefore, even if the direct-indirect distinction continues to have significance in commerce clause jurisprudence,[139] the Act is safe from invalidation on that score.

That brings us, finally, to the one aspect of Justice White's analysis that commanded a majority vote in *MITE*—the commerce clause balancing test.[140] The Court's description of the burdens imposed upon interstate commerce by the Illinois Act indicates that the Court has endorsed the view that takeovers generally are economically desirable.[141] Unlike the Illinois Act, however, which was aimed at all tender offers, the Maryland Act is aimed only at those in which the tender offeror truly intends to provide less compensation to the stockholders who do not tender than to the stockholders who do. Even assuming that takeovers in general are economically desirable, there are few who would argue in favor of the practice of differential compensation.[142] Thus, even if one gives full rein to the economic philosophy that apparently captured majority endorsement in *MITE*, the burden imposed on interstate commerce by the Maryland Act is insignificant.

As for the other side of the equation, the Maryland Act, unlike the statute at issue in *MITE*, qualifies as regulation of the "internal affairs" of corporations incorporated in the regulating state. Indeed, the Maryland Act is a paradigmatic example of such regulation. The interest served by the Act—protection of minority shareholders—is legitimate and substantial.[143] The interest outweighs the insignificant burden which the Act imposes on interstate commerce.

Given that the Act is a clear example of "internal affairs" regulation, subjecting it to the balancing test gives undue credit to those who might challenge the statute's validity. The task of regulating a corporation's "internal affairs" has traditionally been left to the state of incorporation, and that allocation of authority is so clearly established that it would not be questioned in other contexts.[144] Indeed, the law governing the "internal affairs" of corporations has been positively protected from

139. *See supra* notes 95-96 & 100 and accompanying text.
140. *See* 457 U.S. at 643-46.
141. *See supra* text accompanying note 108.
142. *But see* Easterbrook & Fischel, *Corporate Control Transactions, supra* note 23, at 698.
143. *See* Sargent, *supra* note 69, at 724-27.
144. *See id.*

"federalization."[145] All in all, the constitutionality of the Act should be beyond doubt.

---

145. *See, e.g.*, Burks v. Lasker, 441 U.S. 471 (1979) (federal courts should refer to state law to determine whether independent directors have power to terminate derivative suits brought under the federal securities laws); Santa Fe Indus. v. Green, 430 U.S. 461 (1977) (absent allegations that the defendants were guilty of misrepresentations or omissions of material fact, the plaintiff had no cause of action under the federal securities laws; the plaintiff's sole remedy for an "unfair" transaction was under state corporate law); Cort v. Ash, 422 U.S. 66 (1975) (in deference to state corporate law, a cause of action to be asserted by shareholders against management will not be implied from a federal statute in the absence of an express command from Congress).