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STATE TAKEOVER AND TENDER OFFER REGULATIONS POST-MITE: THE MARYLAND, OHIO AND PENNSYLVANIA ATTEMPTS

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ABSTRACT

Following the Supreme Court's decision in Edgar v. MITE Corp.,[1] striking down portions of Illinois' takeover laws, a number of commentators predicted that state efforts to regulate takeovers could no longer be successful. However, a number of states have adopted new laws in the wake of MITE, seeking to provide a continuing role for the states in the tender offer field.

This article examines three such attempts: Maryland, Ohio and Pennsylvania. These three statutes represent a variety of approaches to the problems of takeover regulation and provide a basis for a model of constitutionally permissible state regulation. The article examines the three statutes, and concludes with a suggested analytical model for constitutional adjudication in this context.

I. Introduction

During the past twenty-five years, the tender offer[2] has become the most common[3] and controversial[4] weapon in the market for corp-

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[1] 457 U.S. 624 (1982).

[2] In this article, tender offer, takeover and takeover bid are used interchangeably, except where the context indicates otherwise.

[3] Note, A Failed Experiment: State Takeover Regulation after Edgar v. MITE Corp., 1983 U. ILL. L. REV. 457.

[4] There has been an ongoing academic debate over the validity and desirability of tender offers and tender defense tactics. See, e.g., Bebchuk, The Case for Facilitating Competing Tender Offers, 35 STAN. L. REV. 23 (1982); Bebchuk, The Case for Facilitating Competing Tender Offers, 95 HARV. L. REV. 1028 (1982); Easterbrook & Fischel, Auctions and Sunk Costs in Tender Offers, 35 STAN. L. REV. 1 (1982); Easterbrook & Fischel, Takeover Bids, Defensive Tactics, and Shareholder's Welfare, 36 BUS. LAW 1733 (1981); Easterbrook & Fischel, The Proper Role of a Target's Management in Responding to a Tender Offer, 94 HARV. L. REV. 1161 (1981); Gelfond & Sebastian, Reevaluating the Duties of Target Management in a Hostile Tender Offer, 60 B.U.L. REV. 403 (1980); Gilson, Seeking Competitive Bids Versus Pure Passivity in Tender Offer Defense, 35 STAN. L. REV. 51 (1982); Gilson, The Case Against Shark Repellent Amendments, 34 STAN. L. REV. 775 (1982); Gilson, A Structural Approach to Corporations: The Case Against Defensive Tactics in Tender Offers, 33 STAN. L. REV. 819 (1981); Lipton, Takeover Bids in the Target's Boardroom: An Update After One Year, 36 BUS. LAW 1017 (1981); Lipton, Takeover Bids in Target's Boardroom: A Response to Professor Easterbrook & Fischel, 55 N.Y.U.L. REV. 1231 (1980); Lipton, Takeover Bids in the Target's Boardroom, 35 BUS. LAW 101 (1979).

orate control.[5] It has become the principal device whereby inefficient incumbent management may be displaced,[6] but also has come to be viewed as an instrument for "greenmailers" and other corporate despoilers to use against healthy well-managed firms.[7] As such it has generated great controversy in the law schools, the courts and the legislatures.

Federal regulation of tender offers began in 1968 with the passage of the Williams Act.[8] The "frenetic abandon" of the "conglomerate merger mania"[9] of the period led a number of states to also enact legislation governing tender offers. By 1982, some thirty-seven states had passed laws explicitly regulating tender offers.[10] Both the policies behind, and the procedures adopted by, the federal and state regulatory systems frequently conflicted. The Williams Act, as adopted, "was ostensibly designed to provide investors with full disclosure and other substantive protections within a statutory framework favoring neither the tender offeror nor the management of the target company."[11] In contrast, state statutes often seemed intended to protect in-state target companies from out-of-state takeover bids[12] and therefore their provisions generally tilted in favor of target management.[13] In many cases the conflict between the state and federal rules was so severe that a potential offeror was unable to comply with both regulatory schemes.

The conflict between the federal and state tender offer regulatory systems naturally produced a series of constitutional challenges

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[5] The market for corporate control is a term used to describe the ability of shareholders to trade their shares to someone who will then use them to gain control of the corporation and presumably remove incumbent management. See Fischel, Efficient Capital Market Theory, the Market for Corporate Control, and the Regulation of Cash Tender Offers, 57 TEX. L. REV. 1 (1978); Manne, Cash Tender Offers for Shares -- A Reply to Chairman Cohen, 1967 DUKE L.J. 231.

[6] Fischel, supra note 4, at 2-7.

[7] See Lowenstein, Pruning Deadwood in Hostile Takeovers, 83 COLUM. L. REV. 249, 311, 311 n.249 (1983) and authorities cited therein.

[8] 15 U.S.C. §§ 78m(d)-78m(e), 78n(d)-78n(f) (1976).

[9] E.R. ARANOW & H.A. EINHORN, TENDER OFFERS FOR CORPORATE CONTROL 64-65 (1973).

[10] Empirical Research Project, Blue Sky Laws and State Takeover Statutes: New Importance for an Old Battleground, 7 J. CORP. L. 689, 734 n.344 (1982) [hereinafter cited as Research Project].

[11] E.R. ARANOW & H.A. EINHORN, supra note 9, at 67. See H. R. REP. NO. 1711, 90th Cong., 2d Sess. (1968); S. REP. NO. 550, 90th Cong., 1st Sess. (1967).

[12] See Research Project, supra note 10, at 735.

[13] For a comparison of the provisions of the Williams Act with common state provisions, see Research Project, supra note 10, at 735-42.

to the state laws. The United States Supreme Court first agreed to hear a case addressing this issue in Leroy v. Great Western United Corp.[14] in 1978. In Great Western, the Fifth Circuit had struck down the Idaho takeover statute[15] on both preemption and commerce clause[16] grounds.[17] The Supreme Court declined to address the constitutional issue, but reversed on venue grounds. The Supreme Court's decision in Great Western thus left the lower federal courts with no guidance in the area, thereby generating considerable confusion and divergency in results. Although the majority of cases after Great Western found state takeover statutes to be unconstitutional, several courts either upheld the statutes or refused to address the constitutional issue.[18]

In 1982 the Supreme Court again addressed this issue in Edgar v. MITE Corp.[19] In striking down the Illinois Business Takeover Act,[20] the Court's badly fractured opinion[21] essentially rendered most, if not all, then existing state takeover statutes unconstitutional.[22]

Despite the set-back to state takeover regulation in MITE, a number of reasons have been advanced to justify a continued role for the states in regulating tender offers. Among the arguments that have been advanced are the states' traditional roles in governing the internal affairs of their corporations,[23] protection of in-state share

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[14] 443 U.S. 173 (1979), rev'ing sub nom. Great Western United Corp. v. Kidwell, 577 F.2d 1256 (5th Cir. 1978).

[15] Idaho Code § 30-1501(3),(5),(16); § 30-1503(1),(2),(3),(4); § 30- 1506(5),(6) (Supp. 1979).

[16] U.S. CONST. art. I, § 8, cl. 3, which provides that Congress has the power "To regulate commerce with foreign Nations, and among the several States, and with the Indian Tribes."

[17] Great Western, 577 F.2d at 1279-81, 1285-86.

[18] Sargent, On the Validity of State Takeover Regulation: State Responses to MITE and Kidwell, 42 OHIO L.J. 689, 692 (1981). See also infra notes 57-63 and accompanying text.

[19] 457 U.S. 624 (1982), aff'ing sub nom. MITE Corp. v. Dixon, 633 F.2d 486 (7th Cir. 1980). See infra notes 64-90 and accompanying text for a fuller discussion of the opinion.

[20] Ill. Rev. Stat. ch. 121 1/2, ¶137.52-.70 (1979) [hereinafter cited as IBTA].

[21] Six Justices filed opinions: White, Powell (concurring in part), Stevens (concurring in part and concurring in the judgment), O'Connor (concurring in part), Marshall (dissenting, joined by Justice Brennan), and Rehnquist (dissenting). Justice White's opinion, joined in its entirety by Chief Justice Burger, was joined in part by Justices Blackmun (parts I, II, III and IV), Powell (parts I and V-B), and Stevens and O'Connor (part I, II and V). Thus, only parts I, II and V-B of Justice White's opinion constituted the opinion of the court.

[22] See infra notes 88-91 and accompanying text.

[23] See House Bill 822 § 1701.832, 1982 Ohio Legislative Service 5-401 (Baldwin) [hereinafter cited as Ohio H.B. 822]; Letter of Hon. Harry Hughes to Hon. Benjamin L. Cardin at 2 (May 31, 1983) (vetoing Maryland House Bill 1030, a state takeover statute) [hereinafter cited as Hughes Letter], reprinted in Maryland Department of Legislative Research, Staff Report to the General Assembly of Maryland on Corporations and Associations: Consideration of the Problem of Special Voting Requirements in Consolidations, Mergers, Takeovers, and Transfers of Assets at 49, 50 (1983) [hereinafter cited as Maryland Report].

holders,[24] protection of target shareholders following acquisition,[25] and the states' special interest in primarily local companies and in industries traditionally regulated by the state.[26] Using these arguments, several states[27] have passed legislation apparently intended to avoid the constitutional pitfalls pointed out by MITE, while a number of other states[28] have modified existing legislation for the same purpose.

This article will examine the constitutionality of the responses to MITE by three states: Maryland, Ohio and Pennsylvania. Part II will briefly explore the background leading up to the MITE decision and the decision itself. Part III will examine the various provisions of the state statutes adopted after MITE. In particular, the provisions examined in Part III are fair value redemption rights and special voting provisions. Part IV will examine these provisions from both preemption and commerce clause perspectives. Part V will explore issues of federalism raised by competing federal and state takeover regulations.

II. Background

Many of the great issues of federalism have arisen from the competing powers of Congress and the states to regulate commerce and commercial actors. Under modern constitutional doctrine, the combined effect of the supremacy and commerce clauses results in virtually unlimited and unchallenged congressional power over commerce.[29] However, traditional state interests and powers provide a basis for a continued state role in the regulation of commerce. A principal example of this is the primary role for the states in corporate governance.[30] The intrusion of federal regulatory power into corporate law, principally through the federal securities laws, has created an ongoing tension between the dual but not always parallel regulatory systems. In recent years this conflict has been particularly pronounced in the field of tender offer regulation.

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[24] Ohio H.B. 822, supra note 23, at § 1701.832.
[25] Maryland Report, supra note 23, at 14.
[26] See Profusek & Gompf, State Takeover Legislation After MITE: Standing Pat, Blue Sky, or Corporation Law Concepts?, 7 CORP. L. REV. 3, 22- 24 (1984).
[27] Among these states are Maryland, Ohio and Pennsylvania.
[28] Among these states are Hawaii, Indiana, Ohio and Wisconsin.
[29] See generally J. NOWAK, R. ROTUNDA & J. YOUNG, CONSTITUTIONAL LAW 266-96 (2d ed. 1983) [hereinafter cited as NOWAK]; L. TRIBE, AMERICAN CONSTITUTIONAL LAW 224-243, 300-318 (1978).
[30] Santa Fe Industries, Inc. v. Green, 430 U.S. 462, 478-79 (1977); Cort v. Ash, 422 U.S. 66, 84 (1975).

A. State versus Federal Regulation of Securities

Historically, the state had primary regulatory authority over corporations incorporated in the state.[31] This power was first extended to securities regulation by Kansas through the passage of a "blue sky law"[32] in 1911.[33] Business resisted the blue sky laws and subjected them to a series of constitutional challenges.[34] In the Blue Sky Cases of 1917,[35] the United States Supreme Court upheld three state merits review and securities registration statutes, holding that such requirements were constitutional under the commerce clause.

By the 1929 stock market crash almost all states had some sort of securities regulation.[36] However, the Depression provided a strong impetus to the movement for federal regulation, and in 1933 and 1934, the first major federal securities laws were enacted.[37] Despite the comprehensive nature of the 1933 and 1934 Acts, Congress specifically provided that they would not preempt existing state law.[38] By refusing to prohibit or limit state authority over corporations and securities, Congress created the present dual regulatory scheme and laid the groundwork for future conflict.

Prior to the 1960's, neither federal nor state law regulated tender offers. This lack of regulation was one of a number of intrinsic advantages which led to an enormous growth in the volume of tender offers during the early and middle part of that decade.[39] In

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[31] See supra note 30 and accompanying text.

[32] The term "blue sky law" or "blue sky statute" is used "to describe [[state securities] legislation aimed at promoters who 'would sell building lots in the blue sky in fee simple."' L. LOSS, FUNDAMENTALS OF SECURITIES REGULATION 8 (1983). The blue sky laws were enacted to protect investors from the many real and perceived dangers of speculative or fraudulent securities sales in the early part of the twentieth century. Research Project, supra note 10, at 695-96.

[33] 1911 Kan. Sess. Laws 133.

[34] See generally, L. LOSS & E. COWETT, BLUE SKY LAW (1958).

[35] Hall v. Geiger-Jones Co., 242 U.S. 539 (1917); Caldwell v. Sioux Falls Stock Yards Co., 242 U.S. 559 (1917); Merrick v. N.E. Halsey & Co., 242 U.S. 568 (1917).

[36] Research Project, supra note 10, at 697. Today, "blue sky laws of one kind or another are found in every state, the District of Columbia, Puerto Rico, and all the Canadian provinces." L. LOSS, supra note 32, at 8.

[37] Securities Act of 1933, ch. 38, 48 Stat. 74 (1933) (codified as amended at 15 U.S.C. §§ 77a-77aa (1976)); Securities Exchange Act of 1934, 48 Stat. 881 (1934) (codified as amended at 15 U.S.C. §§ 78a-78jj (1976)).

[38] See 15 U.S.C. § 77r (1976) (Section 18 of the 1933 Act); Id. at § 78bb (Section 28 of the 1934 Act).

[39] Between 1960 and 1966 the number of tender offers per year increased from eight to 107. E.R. ARANOW & H.A. EINHORN, supra note 9, at 65 n.3.

The following have been suggested as some of the underlying reasons for the rapid growth of the tender offer phenomenon in this country:

1. Increased corporate liquidity and readily available credit;

2. Comparatively depressed price/earnings ratios, book values, and cash or quick assets ratios, making acquisition via the tender offer more attractive;

3. Greater recognition, sophistication, and knowledge with respect to the takeover via tender technique;

4. Lack of extensive federal or state regulation of tender offers;

late 1965, the "'industrial sabotage' resulting from what were deemed to be reckless corporate raids on 'proud old companies"'[40] prompted Senator Harrison Williams to propose federal legislation to protect target companies.[41] Although the 1965 legislation was not adopted, a second bill was introduced in 1967.[42] The bill, influenced by a growing perception that tender offers had both beneficial and detrimental economic effects, was considerably more balanced. In primarily focusing on disclosure and anti-fraud provisions, the bill attempted to favor neither the target nor the offeror. As such, it "advanced not only investor protection but investor confidence as well, within a statutory framework which preserves the required flexibility of private enterprise in our market economy."[43]

The Williams Act, however, did not amend the provisions of the 1933 and 1934 Acts that exempted state securities statutes from preemption.[44] Interests similar to those that spurred federal legislation also created a demand for state tender offer regulation. Indeed, Virginia had passed tender offer legislation several months prior to passage of the Williams Act.[45] In the latter part of the 1970's, there was a virtual flood of state legislation, with thirty-seven states adopting tender offer statutes by 1982.[46]

The state tender offer statutes differed considerably from the earlier blue sky laws. In particular, the tender offer statutes had

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5. Quicker and more successful results when compared with a full-dress proxy contest;
6. Greater flexibility -- the ability to hedge by reserving certain options against a final and irrevocable commitment;
7. Psychology -- the appeal to shareholders in straight dollars and cents language, eliminating the need, as in a proxy contest, to convince the shareholder that the insurgent can do a more efficient job;
8. Notwithstanding the actual capital investment, the reduced costs of effecting a tender offer when compared with a proxy contest;
9. A new "respectability" for cash tender offers.

Id. at 65-66.

[40] Id. at 64 (quoting the remarks of Senator Williams, 111 CONG. REC. 28256-60 (daily ed. Oct. 22, 1965), on S. 2731, the original Williams Bill).

[41] Id.

[42] 113 CONG. REC. 854-56 (daily ed. Jan. 18, 1967) (remarks of Senator Williams).

[43] E.R. ARANOW & H.A. EINHORN, supra note 9, at 69.

[44] MITE, 457 U.S. at 630-31 (White, J.). "Thus Congress did not explicitly prohibit states from regulating takeovers; it left the determination whether [such regulation] conflicts with the Williams Act to the Courts." Id. at 631.

[45] Va. Code § 13.1-528-1-541 (1978) (effective March 5, 1968). The Williams Act was enacted on July 19, 1968. See MITE, 457 U.S. at 631 n.6 (White, J.).

[46] State statutes in effect as of mid-1982 are collected in Research Project, supra note 10, at 734 n.344. Pre-MITE takeover statutes are discussed in detail in Langevoort, State Tender-Offer Legislation, 62 CORNELL L. REV. 213, 219-40 (1977); Sargent, supra note 18, at 695-700; Wilner -& Landry, The Tender Trap: State Takeover Statutes and their Constitutionality, 45 FORD. L. REV. 1, 5-9, (1976); Note, State Regulation of Tender Offers, 7 J. CORP. L. 603, 604-12 (1982); Note, The Constitutionality of State Takeovers Statutes: A Response to Great Western, 53 N.Y.U.L. REV. 872, 880-87 (1978); Research Project, supra note 10, at 734-54.

a considerably greater extraterritorial effect. Most blue sky statutes did not prohibit or regulate extraterritorial issues of stock,[47] while most tender offer statutes did regulate out-of-state transactions.[48] Indeed, such extraterritorial effect was an essential part of the state regulatory regime. If a state regulated only in-state shareholder-offeror transactions, the offeror could simply ignore the state and so avoid inhibitory regulations. The statutes' extraterritorial effect was compounded by the fact that many statutes regulated not only corporations incorporated in the state, but also corporations with either their principal place of business or substantial assets in the state.[49] Thus, a potential offeror could be faced with the prospect of having to comply with not only the Williams Act but also several state regulatory schemes. Because of this extraterritorial effect of the state statutes, failure to comply with any applicable statute could in theory create a nationwide bar to the offer.[50] As Professor Sargent has observed:

> The state statutes have always varied in their particular terms, and the recent changes have created even more disparity. They do, however, share the common feature of extraterritorial impact. If a corporation targeted for a takeover bid meets the state's jurisdictional criteria, the statute will apply to transactions with both resident and nonresident shareholders. Each state takeover statute, therefore, may have a virtually global impact.[51]

The state statutes went far beyond the requirements of the Williams Act to create substantial difficulties for potential offerors. Requirements such as advance filings and administrative hearings on the "fairness" or other aspects of the offer could significantly delay an offer.[52] Such delay could be deadly to the success of the offer. During the delay, target management was free to pursue potential "white knights,"[53] arbitraguers could buy up large blocks of stock, thus driving the target's market price towards the offeror's tender

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[47] MITE, 457 U.S. at 641 (White, J.).
[48] Profusek & Gompf, supra note 26, at 7.
[49] Id.
[50] The court in Kennecott Corp. v. Smith, 507 F. Supp. 1206, 1224 (D.N.J. 1981), observed that "[s]ince, is it [sic] not uncommon for major companies to have plants, employees, offices and shareholders in many states, each state could impose varying hurdles over which the tenderor would have to leap." See also MITE, 633 F.2d at 502 ("[w]here a number of states on various bases claim authority over a tender offer, any single state would have effective veto power over the offer even if it received the enthusiastic endorsement of all other states."). A few statutes contained comity provisions, permitting deference to a more closely related state. See, e.g., Ill. Rev. Stat. ch. 121 1/2 ¶137.53 (1979).
[51] Sargent, supra note 18, at 690 n.7.
[52] Langevoort, supra note 46, at 227-28; Research Project, supra note 10, at 744-47, 752-53.
[53] Note, Securities Law and the Constitution, 88 YALE L.J. 510, 524 (1978).

bid,[54] and other potential offerors could make competing bids without expending the search costs incurred by the initial offeror.[55]

The greater potential for delay, disclosure requirements and uncertainty[56] generated by state tender offer statutes apparently had at least some of the desired deterrent effect. The relative frequency of offers for regulated corporations significantly declined following adoption of a state statute governing those corporations, while the cost of those tender offers that did occur substantially increased.[57] These difficulties ultimately led to a series of constitutional challenges, culminating in Edgar v. MITE Corp. and its progeny.

B. MITE

1. History.--Prior to the Supreme Court's decision in MITE, the majority of constitutional challenges to state takeover statutes were successful. In at least thirteen cases such statutes were found either to be preempted by the Williams Act, to be an unconstitutional burden on interstate commerce, or both.[58] However, in at least six cases, courts upheld the state statute,[59] while a number of other courts managed to avoid reaching the constitutional issue.[60]

The philosophical and procedural conflicts between the Williams Act and the state statutes formed the basis in several cases for a finding of preemption. The potential for delay inherent in the advance filing and the administrative review requirements of many state statutes were found to excessively tilt the balance sought by the Williams Act to the side of target management.[61] The administra-

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[54] Langevoort, supra note 46, at 227.
[55] MITE, 633 F.2d at 497.
[56] See Research Project, supra note 10, at 744-54.
[57] Id. at 745.
[58] MITE, 633 F.2d at 486; Kennecott Corp. v. Smith, 637 F.2d 181 (3d Cir. 1980), on remand 507 F. Supp. 1206 (D.N.J. 1981); Natomas Co. v. Bryan, 512 F. Supp. (D. Nev. 1981); Crane Co. v. Lam, FED. SEC. L. REP. (CCH) (P97, 8)96 (E.D. Pa. 1981); Canadian Pac. Enter. (U.S.), Inc. v. Krouse, 506 F. Supp. 1192 (S.D. Ohio 1981); Hi-Shear Indus., Inc. v. Campbell, [FED. SEC. L. REP. (CCH) ¶97,804 (D.S.C. 1980); Branscan Ltd., v. Lassiter, [Current] FED. SEC. L. REP. (CCH) ¶98,247 (E.D. La. 1979); Dart Indus., Inc. v. Conrad, 426 F. Supp. 1 (S.D. Ind., 1978); Kelly v. Beta-X Corp., 302 N.W.2d 596 (Mich. Ct. App. 1981); Eure v. Grand Metropolitan Ltd., [FED. SEC. L. REP. (CCH) ¶ 97,694 (N.C. Super. Ct. 1980); Empire, Inc. v. Ashcroft, FED. SEC. L. REP. (CCH) ¶98,310 (W.D. Mo. 1981); Joseph E. Seagram & Sons, Inc. v. Marley, FED. SEC. L. REP. (CCH) ¶ 98,246 (W.D. Okla. 1981).
[59] AMCA Int'l Corp. v. Krouse, 482 F. Supp. 929 (S.D. Ohio 1979); City Investing Co. v. Simcox, 476 F. Supp. 112 (S.D. Ind. 1979), aff'd, 633 F.2d 56 (7th Cir. 1980); Strode v. Esmark, Inc., FED. SEC. L. REP. (CCH) ¶ 97,538 (Ky. Cir. Ct. 1980); Wylain, Inc. v. TRE Corp., 412 A.2d 338 (Del. Ch. 1980). See also Hi-Shear Indus., Inc. v. Neiditz, FED. SEC. L. REP. (CCH) ¶97,805 (D. Conn. 1980) (provisionally upholding Connecticut statute); Sun Life Group, Inc. v. Standard Life Ins. Co. of Indiana, FED. SEC. L. REP. (CCH) ¶97,314 (S.D. Ind. 1980).
[60] See cases cited in Sargent, supra note 18, at 692 n.19.
[61] See, e.g., MITE, 633 F.2d at 495; Kennecott, 507 F. Supp. at 1218; Hi-Shear, FED. SEC. L. REP. at 90,032. But see Wylain, 412 A.2d at 348. See also Sargent, supra note 18, at 692-98.

tive review process, which could result in the state barring the tender offer on "fairness" or other grounds, was also found to conflict with the congressional intent that shareholders make the decision as to whether to tender or not.[62]

In 1979, when the SEC promulgated Rule 14d-2(b), which requires that a bidder meet the SEC's dissemination and Schedule 14D-1 disclosure requirements within five days of the announcement of the offer, a direct conflict between the federal and state systems was created. Since most state statutes required a substantial delay between the announcement and dissemination of the offer, it was no longer possible to time an offer to comply with both federal and state law. The SEC recognized and apparently intended to create such a conflict:

> [T]he conflict between Rule 14d-2(b) and such state statutes is so direct and substantial as to make it impossible to comply with both sets of requirements as they presently exist. While recognizing its long and beneficial partnership with the states in the regulation of securities transactions, the Commission nevertheless believes that the state takeover statutes presently in effect frustrate the operation and purposes of the Williams Act and that, based upon the abuses in current tender offer practice discussed above, Rule 14d-2(b) is necessary for the protection of investors and to achieve the purposes of the Williams Act.[63]

The effect of Rule 14d-2(b) was to preempt numerous state statutes and to force several states to eliminate their pre-commencement delays. After Rule 14d-2(b) was promulgated, the clear trend was towards finding state takeover statutes unconstitutional.[64]

2. The MITE Decision.--On January 19, 1979, MITE Corporation ("MITE") filed a Schedule 14D-1 with the SEC, indicating its intent to make a $28 per share cash tender offer for Chicago Rivet & Machine Company ("Chicago Rivet").[65] The same day, MITE filed an action for a declaratory judgment in the United States District Court for the Northern District of Illinois against Alan J. Dixon, the Illinois Secretary of State. MITE sought to have the Illinois Business Takeover Act (IBTA) declared unconstitutional

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[62] Sargent, supra note 18, at 694-95. See also Hi-Shear, FED. SEC. L. REP. at 90,031; Kennecott, 507 F. Supp. at 1219-20.

[63] SEC Release No. 34-16384 (Nov. 29, 1979) (quoted in Profusek & Gompf, supra note 26, at 14).

[64] On the effect of Rule 14d-2(b), see generally Profusek & Gompf, supra note 26, at 14-15; Sargent, supra note 18, at 696-97; Research Project, supra note 10, at 762.

[65] The facts are drawn from the opinions of Justice White in MITE, 457 U.S. at 626-30, and Circuit Judge Cudahy in MITE, 633 F.2d at 488-90.

so as to avoid being required to comply with its provisions.

On February 1, 1980, Dixon notified MITE that the proposed offer violated the IBTA and issued a cease and desist order and a notice of an administrative hearing. The next day Chicago Rivet notified MITE that it would file suit under the IBTA to restrain the tender offer. MITE thereupon renewed its own action in the district court. On February 2, the district court enjoined the state action, and on February 5, the offer was disseminated. On February 9, the district court issued an order finding the IBTA to be unconstitutional under both preemption and commerce clause analyses.[66] The Seventh Circuit affirmed on both grounds.

Although the circuit court recognized that "the federal scheme of regulating tender offers [is not] so pervasive that an implicit congressional intent to preempt parallel state legislation may fairly be inferred" from the Williams Act,[67] it found that the IBTA "empowers the [Illinois] Secretary of State to pass upon the substantive fairness of a tender offer [in administrative review] and to prohibit it from going forward, if, in his sole opinion, he judges the offer 'inequitable.'"[68] Thus, the circuit court stated that "Illinois' substitution of the judgment of its Secretary of State for an investor's own assessment of the equitability of a tender offer is patently inconsistent with the Williams Act, . . . which contemplates unfettered choice by well-informed investors."[69] Therefore the IBTA was preempted by the Williams Act.

The circuit court also found that the IBTA unconstitutionally burdened interstate commerce. The test used by the court to make "the 'delicate adjustment' of state and federal claims [was that] set forth in Pike v. Bruce Church, Inc.,"[70] which states that "[w]here the statute regulates evenhandedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits."[71] Illinois argued that its interests were the protection of resident share-

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[66] Subsequent to the district court's decision, MITE and Chicago Rivet came to a settlement. MITE subsequently decided not to make an offer for Chicago Rivet. MITE, 457 U.S. at 629-30. MITE's decision was part of the basis for Justice Rehnquist's dissent on grounds of mootness. See id. at 664-67.

[67] MITE, 633 F.2d at 491.

[68] Id. at 493.

[69] Id. at 494. The court further found that potential for target management to request administrative review and potential delays inherent in the review process and advance filing requirements gave management a suspect advantage. Such advantage conflicted with the Williams Act's neutrality and thus required a finding of preemption. Id. at 494-99.

[70] Id. at 500.

[71] Pike v. Bruce Church, Inc. 397 U.S. 137, 142 (1970) (citation omitted). Pike is further discussed infra at notes 185-88 and accompanying text.

holders and the regulation of the internal affairs of Illinois corporations. However, the circuit court rejected these arguments. It found that the protections of the IBTA were "marginal" in view of the Williams Act's protections, and that the extraterritorial effect and broad jurisdictional base of the IBTA[72] further undercut Illinois' arguments. Illinois' "tenuous interest" was counterbalanced by the statute's "global impact" and its "significant potential to cause commercial disruption" by blocking an offer "even if it received the enthusiastic endorsement of all other States."[73] "Thus, because it substantially obstructs interstate commerce, without countervailing local benefit, the Illinois Act violates the commerce clause, and is therefore unconstitutional."[74]

The Supreme Court, as has been noted,[75] affirmed in a badly divided opinion. Rejecting an argument that the preliminary injunction rendered the case moot, the plurality reached the constitutional issues.[76] However, among the substantive portions of Justice White's opinion only the Pike commerce clause analysis, part V-B,[77] commanded a majority.

In part V-B, the Court found that Illinois had "no legitimate interest in protecting non-resident shareholders," and offered only "speculative" protection for resident shareholders.[78] The Court agreed with the circuit court "that the possible benefits of the potential delays as required by the Act may be outweighed by the increased risk that the tender offer will fail due to defensive tactics employed by incumbent management."[79] The Court also rejected Illinois'"internal affairs" argument, noting that

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[72] The IBTA applied to companies of which Illinois residents owned 10% of the equity securities effected by the offer, or for which two of the following conditions were met: company's principal executive office located in Illinois, company organized under Illinois law, or company having at least 10% of its stated capital and surplus in Illinois. IBTA, supra note 20, at ¶137.52- 10.

[73] MITE, 633 F.2d at 502.

[74] Id.

[75] See supra notes 18-20 and accompanying text. The concurrences, dissents and those portions of Justice White's opinion that constituted the plurality will be indicated by parenthetical. Parts I, II and V-B of Justice White's opinion, which constitute the opinion of the Court, shall be indicated by the absence of the parenthetical.

On the MITE decision, see generally Profusek & Gompf, supra note 25, at 16-20; Note, The Unsung Death of State Takeover Statutes, 24 B.C.L. REV. 1017 (1983); Note, A Failed Experiment: State Takeover Regulation After Edgar v. MITE Corp., 1983 U. ILL. L. REV. 457.

[76] Justices Marshall, Brennan and Rehnquist dissented on grounds of mootness. See MITE, 457 U.S. at 655-67 (opinions of Marshall and Rehnquist, JJ.).

Justice Powell agreed that the case was moot, but also joined the Court in the fact and commerce clause portions of the opinion. Id. at 646-47 (Powell, J.). Justices White, Stevens and O'Connor's opinions rejected the mootness arguments. Id. at 630, 647-54, 655.

[77] Id. at 643-46.

[78] Id. at 644-45.

[79] Id. at 645.

> [t]ender offers contemplate transfers of stock by stockholders to a third party and do not themselves implicate the internal affairs of the target company. Furthermore, the proposed justification is somewhat incredible since the Illinois Act applies . . . to corporations that are not incorporated in Illinois and have their principal place of business in other States. Illinois has no interest in regulating the internal affairs of foreign corporations.[80]

The Court therefore concluded "that the Illinois Act impose[d] a substantial burden on interstate commerce which outweigh[ed] its putative local benefits. It [was] accordingly invalid under the Commerce Clause."[81] The plurality also found that the IBTA's extraterritorial effect constituted an unconstitutional direct regulation of interstate commerce.[82]

Justice White also held that the IBTA was preempted by the Williams Act. As in the circuit court opinion, the basis for his finding was the potential for delay and the interference in the shareholder decision-making process inherent in the administrative review and advance filing requirements. He noted that Congress had rejected an advance filing requirement for fear that it would favor target management by giving them an unfettered opportunity to undertake defensive measures that might thwart the offer.[83] The Justice's reading of the legislative history led him to conclude that "Congress itself 'recognized that delay can seriously impede a tender offer' and sought to avoid it."[84] Thus, the delay forced by the IBTA rendered it inconsistent with the Williams Act, and compelled a finding of pre-emption. Similarly, he found that the administrative veto granted the Secretary of State conflicted with Congress' intent that it be the shareholders who make the final decision as to whether to accept the offer.[85]

The MITE decision's immediate impact was unclear. Only those statutes with similarly "global" ability to block tender offers were directly rendered unconstitutional by the opinion of the Court. Since Justice White's preemption analysis commanded the votes of only two other Justices, it seemed possible that state statutes with a more narrow jurisdictional basis but still having a pro-target bias were constitutional.[86] Indeed, Justice Stevens, in refusing to join the preemption analysis, stated that he was "not persuaded . . . that Congress' decision to follow a policy of neutrality in its own legis-

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[80] Id. at 645-46 (citations omitted).
[81] Id. at 646.
[82] Id. at 641-43.
[83] Id. at 634-36 (White, J.).
[84] Id. at 637 (White, J.) (quoting Great Western, 577 F.2d at 1277).
[85] Id. at 639-40 (White, J.).
[86] See Profusek & Gompf, supra note 26, at 19-20.

lation is tantamount to a federal prohibition against state legislation designed to provide special protection for incumbent management."[87] Similarly, Justice Powell declined to join the preemption analysis, observing that the Court's "Commerce Clause reasoning leaves some room for state regulation" and that "the Williams Act's neutrality policy does not necessarily imply a congressional intent to prohibit state legislation [[protecting] interests that include but are often broader than those of incumbent management."[88]

Those who support state regulation of tender offers initially found encouragement from the majority's focus on the ability of the Illinois regime to block offers, as opposed to a simple review of the adequacy of disclosure. However, the relatively narrow majority holding of the MITE decision was soon broadened in the lower courts. At least seven state tender offer statutes have been invalidated by lower federal courts since MITE[89] "in a series of opinions marked by their lack of analysis of facts which might distinguish the subject statutes from the Illinois statute and permit guidelines for permissible state regulation to develop . . . ."[90] Moreover, several courts have gone beyond the MITE commerce clause majority to also invoke Justice White's preemption analysis in invalidating state tender offer statutes.[91]

Despite the virtually uniform post-MITE rejection of state tender offer regulation by the courts and commentators, several states have responded with new legislation designed to meet the objections raised by MITE, including Maryland, Ohio and Pennsylvania.

III. The State Response to MITE

Post-MITE commentators generally agreed that the decision, particularly as interpreted in the lower courts, left no room for meaningful state regulation of tender offers.[92] However, several

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[87] MITE, 457 U.S. at 655 (Stevens, J.).

[88] Id. at 646-47 (Powell, J.). Justice O'Connor found that "it is not necessary to reach the preemption issue," id. at 655, and therefore expressed no opinion on it.

[89] See, e.g., Martin Marietta Corp. v. Bendix Corp., 690 F.2d 558 (6th Cir. 1982); Nat'l City Lines, Inc. v. LLC Corp., 687 F.2d 1122 (8th Cir. 1982); Mesa Petroleum Co. v. Cities Serv. Co., 715 F.2d 1425 (10th Cir. 1983); Televest, Inc. v. Bradshaw, FED. SEC. L. REP. (CCH) ¶99,104 (4th Cir. 1982); Occidental Petroleum Corp. v. Cities Serv. Co., FED. SEC. L. REP. (CCH) ¶99,0623 (W.D. Okla. 1982); Bendix Corp. v. Martin Marietta Corp., 547 F. Supp. 523 (D. Md. 1982); Esmark, Inc. v. Strode, 639 S.W.2d 768 (Ky. 1982).

[90] Profusek & Gompf, supra note 26, at 21.

[91] See, e.g., National City Lines, 687 F.2d at 1131; Bendix, 547 F. Supp. at 532.

[92] See, e.g., Note, supra note 75, 24 B.C.L. REV. at 1052 ("with the possible exception of non-Williams Act transactions, the states are powerless to enact meaningful, yet constitutionally permissible, tender offer legislation."); Note, supra note 3, 1983 U. ILL. L. REV. at 476 ("Because of the doubtful constitutional basis of State takeover statutes that fail to serve a legitimate state purpose, state legislatures should repeal their takeover statutes and leave the regulation of tender offers to the federal government."). But see Profusek & Gompf, supra note 26, at 20-41.

states have responded to MITE by passing new legislation designed to avoid the constitutional obstacles thrown up by the decision. These statutes are analyzed structurally here, focusing on fair value redemption rights and special voting requirements.[93]

A. Fair Value Redemption Rights

Maryland and Pennsylvania have adopted fair value redemption rights as part of their post-MITE tender offer regulatory schemes. These statutes are novel in that they are aimed at the period following a partial tender offer or the first step of a two-step merger, and thus do not directly regulate the initial tender offer. Further, these statutes are modeled on corporate shark repellent amendments that would almost certainly be lawful if adopted by a corporation in its by-laws.[94]

1. Maryland.--In 1976, Maryland adopted a Corporate Takeover Law[95] that provided for various disclosures by potential offerors and for an administrative review of proposed offers. In Bendix Corp. v. Martin Marietta Corp.,[96] Judge Joseph Young of the United States District Court of Maryland struck down the Takeover Law on both preemption and commerce clause grounds. In response to that decision, a new statute, House Bill 1030, was passed by the Maryland General Assembly in 1983 to regulate two-tier tender offers. Since the bill's provisions would have adversely affected friendly mergers, as well as hostile takeovers, it was strongly resisted by Maryland corporations and was vetoed by Governor Harry Hughes.[97] Subsequently, House Bill 1[98] was prepared for a special session of

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[93] Other provisions that have been adopted include rules prohibiting fraudulent or manipulative conduct or statements in connection with an offer (Ohio), restrictions on share transfers (Ohio), modification of the Business Judgment Rule (Pennsylvania), and modifications of the jurisdictional basis of pre-MITE statutes to reduce their extraterritorial effect (Hawaii, Indiana, and Wisconsin). These provisions are not examined herein, but would be analyzed similarly.

[94] See infra notes 101 and 108 and accompanying text. See generally Smith, Fair Price and Redemption Rights: New Dimensions in Defense Charter Provisions, 4 DEL. J. CORP. L. 1 (1978).

Ronald Gilson, in his critical study of shark repellent amendments, The Case Against Shark Repellent Amendments: Structural Limitations on the Enabling Concept, 34 STAN. L. REV. 775 (1982), argues that such "provisions serve no justifiable role in the public corporation," id. at 832, but admits that under traditional technical legal analysis, shark repellent amendments would be held valid. See id. at 804-18.

[95] Md. Corps. & Ass'ns Code Ann. § 11-901-908 (1976).

[96] 547 F. Supp. 522 (D. Md. 1982).

[97] See Hughes Letter, supra note 23.

[98] Codified at Md. Corps. & Ass'ns Code Ann. §§ 3-202, 3-601- 603, 8-301 (1983 Supp.).

the General Assembly and revised so as to make it acceptable to Governor Hughes. House Bill 1 was passed and signed in late 1983.

Under the Maryland Act a shareholder has the right to demand the fair value of his shares in the event of a "business combination," whether such combination is governed by the special voting provisions of the Act or not.[99] Five different transactions may constitute a "business combination"[100] such that the fair value redemption right is triggered. The first of these is a merger or consolidation with an "interested stockholder,"[101] unless such merger "does not alter the contract rights of the stock . . . or change or convert in whole or in part the outstanding shares of stock of the corporation . . . ."[102] The second transaction is the "sale, lease, transfer, or other disposition" of ten percent or more of the corporation's or subsidiaries' assets to the "interested stockholder."[103] Third is the issuance of stock to the "interested stockholder" having an aggregate market value equal to five percent or more of the outstanding shares of the corporation, unless the issue is made available to all voting shareholders on a pro rata basis.[104] Fourth is a liquidation or dissolution giving the "interested stockholder" anything other than cash.[105] Last is a reclassification or recapitalization of the corporation or a

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[99] Md. Corps. & Ass'ns Code Ann. § 3-202(a)(5). The special voting requirements are codified at id. at §§ 3-602-603.

[100] Id. at § 3-601(e). The definition of business combination is substantially identical or similar to a number of definitions used in corporate shark repellent amendments. Compare § 3-601(e) with the definitions used by Central Bancshares of the South, Inc., Amerada Hess Corp., Bendix Corp., Control Data Corp., Burlington Industries, and Dart & Kraft, Inc., reprinted in SHARK REPELLENTS AND GOLDEN PARACHUTES: A HANDBOOK FOR THE PRACTITIONER 35-37, 65-66, 85-86, 107-08 (R. Winter, M. Stumpf & G. Hawkins eds. 1983) [hereinafter cited as SHARK REPELLENTS]. Many of the other definitions used by the Maryland Act also appear to be modeled on such shark repellents. Compare Md. Corps. & Ass'ns Code Ann. § 3-601 (1983 Supp.) with Shark Repellents, supra at 25-42.

[101] The term is defined in Md. Corps. & Ass'ns Code Ann. § 3- 601(j) (1983 Supp.) as follows:

Interested stockholder.--"Interested stockholder" means any person (other than the corporation or any subsidiary) that:

(1)(i) Is the beneficial owner, directly or indirectly, of 10 percent or more of the voting power of the outstanding voting stock of the corporation; or

(ii) Is an affiliate of the corporation and at any time within the 2 year period immediately prior to the date in question was the beneficial owner, directly or indirectly, of 10 percent or more of the voting power of the then outstanding voting stock of the corporation.

(2) For the purpose of determining whether a person is an interested stockholder, the number of shares of voting stock deemed to be outstanding shall include shares deemed owned by the person through application of subsection (d) of this section but may not include any other shares of voting stock which may be issuable pursuant to any agreement, arrangement, or understanding, or upon exercise of conversion rights, warrants or options, or otherwise.

Most of the provisions discussed in the text are also applicable to affiliates, as defined in § 3-601(b), of an interested shareholder.

[102] Id. at § 3-601(e)(1).

[103] Id. at § 3-601(e)(2).

[104] Id. at § 3-601(e)(3).

[105] Id. at § 3-601(e)(4).

parent-subsidiary merger increasing the proportionate amount of stock held by the "interested stockholder" by five percent or more.[106]

Once a transaction constituting a "business combination" occurs, the fair price redemption right is triggered. Under it, common shareholders may demand the highest of the following:

> (i) The highest per share price (including any brokerage commissions, transfer taxes and soliciting dealers' fees) paid by the interested stockholder for any shares of common stock of the same class or series acquired by it:
>
> 1. Within the 2 year period immediately prior to the announcement date of the proposal of the business combination; or
>
> 2. In the transaction in which it became an interested stockholder, whichever is higher; or
>
> (ii) The market value per share of common stock of the same class or series on the announcement date or on the determination date, whichever is higher; or
>
> (iii) The price per share equal to the market value per share of common stock of the same class or series determined pursuant to subparagraph (ii) of this paragraph, multiplied by the fraction of:
>
> 1. The highest per share price (including any brokerage commissions, transfer taxes and soliciting dealers' fees) paid by the interested stockholder for any shares of common stock of the same class or series acquired by it within the 2 year period immediately prior to the announcement date, over
>
> 2. The market value per share of common stock of the same class or series on the first day in such 2 year period on which the interested stockholder acquired any shares of common stock.[107]

Similarly, a non-common shareholder may demand the highest of:

> (i) The highest per share price (including any brokerage commissions, transfer taxes and soliciting dealers' fees) paid by the interested stockholder for any shares of such class of stock acquired by it:
>
> 1. Within the 2 year period immediately prior to the announcement date of the proposal of the business combination: or

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[106] Id. at § 3-601(e)(5).

[107] Id. at § 3-603(b)(1). Section 3-202(b)(3) provides that "fair value" shall be determined according to the provisions of section 3-603(b). Section 3-603 is essentially a codification of shark repellent fair price -- supermajority voting requirements. Under both the statute and the shark repellents any "business combination" must be approved by a supermajority vote unless the fair price requirement is met. See SHARK REPELLENTS, supra note 100, at 43-47. The voting aspects of the Maryland fair price requirements are considered infra notes 117-27 and accompanying text.

> 2. In the transaction in which it became an interested stockholder, whichever is higher; or
>
> (ii) The highest preferential amount per share to which the holders of shares of such class of stock are entitled in the event of any voluntary or involuntary liquidation, dissolution or winding up of the corporation; or
>
> (iii) The market value per share of such class of stock on the announcement date or on the determination date, whichever is higher; or
>
> (iv) The price per share equal to the market value per share of such class of stock determined pursuant to subparagraph (iii) of this paragraph, multiplied by the fraction of:
>
> 1. The highest per share price (including any brokerage commissions, transfer taxes and soliciting dealers' fees) paid by the interested stockholder for any shares of any class of voting stock acquired by it within the 2 year period immediately prior to the announcement date, over
>
> 2. The market value per share of the same class of voting stock on the first day in such 2 year period on which the interested stockholder acquired any shares of the same class of voting stock.[108]

This calculation of fair price is substantially identical to that adopted in the fair price -- voting requirements of several corporate shark repellents.[109]

2. Pennsylvania.--Like Maryland, Pennsylvania has adopted new legislation aimed at takeovers.[110] The bill is slightly different from Maryland's in that under the Pennsylvania statute, the redemption right is available immediately upon a control transaction, while the Maryland law requires some further transaction to trigger the right. Under the Pennsylvania Act, unless the corporation opts out of the statute by by-law or article amendment,[111] a shareholder may demand the "fair value" of his stock in the event of "control transaction." A "control transaction" is defined as the acquisition by a person, or group of persons acting in concert, of voting control over at least thirty percent of the outstanding voting shares of the corporation.[112]

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[108] Md. Corps. & Ass'ns Code Ann. § 3-603(b)(2) (1983 Supp.).

[109] See infra note 120.

[110] Act No. 1983-92, 1983 Pa. Laws 773.

[111] 15 PA. CONS. STAT. § 1910(A) (1985 Supp.).

[112] Id. at § 1910(B), (D). The "controlling person" retains the right to offer to buy the shares at a price other than the "fair value." Id. at § 1910(D).

"Fair value" must take "into account all relevant factors, including an increment representing the proportion of any value payable for acquisition of control of the corporation."[113] Fair value is determined in the same manner as in the appraisal rights section, section 1515, of the general Pennsylvania Business Corporations Law.[114] Thus, the minority shareholder following a takeover gets the appraisal rights he would have were he dissenting to any other corporation action. Under section 1515, the dissenting shareholder may demand that a court determine the fair value of his shares. The court may appoint appraisers at its discretion. Once fair value is determined, the controlling person must buy the shares at that price.

B. Special Voting Requirements

Maryland, Ohio and Pennsylvania have adopted special voting provisions as a part of their post-MITE takeover regulations. The Maryland and Pennsylvania bills require shareholder approval of the second step of a two-tier or front- end loaded merger. The Ohio statute requires shareholder approval of virtually all tender offers, including the first step of a two-tier transaction.

A number of corporations have adopted shark repellent by-law amendments which require majority or supermajority approval of the second step of a two-tier offer unless the offeror pays a "fair price" in the second step. Such a fair price is typically defined so as to at least equal the price paid in the first step, and is justified on the ground that most offerors pay a substantially lower price in the second step.[115] Because courts have been generally unreceptive to fairness arguments in this context,[116] it is argued that by-law or statutory remedies are necessary to protect minority shareholders. The Maryland and Pennsylvania acts essentially codify these corporate shark repellents.

1. Maryland.--Under section 3-602 of the Maryland Corporate Code, a "business combination"[117] must be recommended by the corporation's Board of Directors. Next, it must be approved by the votes of at least eighty percent of the outstanding voting shares of

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[113] Id. at § 1910(E).
[114] Id. at §§ 1910(E), 1515.
[115] SHARK REPELLENTS, supra note 100, at 44-45. An SEC study of tender offers in 1981-83 found that the average premium for one step offers was 63.4 percent, compared with an average "blended," i.e., the net premium for both steps, of 55.1 percent for two-step offers. In two-step offers the average premium in the first step was 63.5 percent, while for the second step it was only 47.1 percent. SEC Exchange Act Release No. 21079 (June 21, 1984).
[116] SHARK REPELLENTS, supra note 100, at 45-46.
[117] A "business combination" is defined in Md Corps. & Ass'ns Code Ann. § 3-601(e). See supra notes 101-07.

the corporation and two-thirds of those shares not held by the interested stockholder[118] or an affiliate of his if they are a party to the combination.[119] Section 3-603(b) provides that section 3-602 will not apply if each of five conditions is met with regard to the combination.[120] First, the price paid the common shareholders must meet the formula of Section 3-603(b)(1).[121] Second, the price paid non-common shareholders must meet the formula of Section 3-603(b)(2).[122] Third, the consideration given in the second step must be in the same form as that given in the first step.[123] Fourth, various dividend restrictions must have been met.[124] Last, the interested stockholder must not have received any corporate benefits, except those given all shareholders.[125]

The Board of Directors may by resolution exempt particular interested stockholders from the voting rules,[126] and the shareholders may vote to exclude the corporation entirely from coverage. Further, the act does not apply to corporations with a pre-existing interested shareholder, unless the Board resolves otherwise, to close corporations, to corporations with fewer than 100 shareholders or to investment companies registered under the 1940 Investment Company Act.[127]

2. Ohio.--Ohio House Bill 822 sets up, inter alia, a procedure for shareholder review of a proposed tender offer.[128] Unless the corporation's articles or regulations provide that the statute will not apply to it, any "control share acquisition"[129] must be approved by a shareholder vote prior to the purchase. Thus, in contrast to the other two statutes, the Ohio bill regulates all tender offers, including the first step of a two-tier acquisition. The bill applies only to Ohio corporations with their principal place of business, executive office or substantial assets in the state.[130]

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[118] This term is defined in Md Corps. & Ass'ns Code Ann. § 3-601(j). See supra note 102.
[119] Md Corps. & Ass'ns Code Ann. § 3-602.
[120] The statute bears a striking resemblance to a number of corporate shark repellents, as noted earlier. Compare SHARK REPELLENTS, supra note 100, at 43-113.
[121] See supra text accompanying note 107.
[122] See supra text accompanying note 108.
[123] Md Corps. & Ass'ns Code Ann. § 3-603(b)(3).
[124] Id. at § 3-603(b)(4).
[125] Id. at § 3-603(b)(5).
[126] Id. at § 3-603(c)(1).
[127] Id. at § 3-603(d-e).
[128] Ohio Rev. Code Ann. § 1701.831 (Baldwin 1983).
[129] The term is defined in id. at § 1701.01(Z)(1) as the acquisition of shares sufficient to elect more than 20% of the Board of Directors. The definition excludes several types of transactions, most significantly, a merger or consolidation to which the target is a party, i.e., a friendly acquisition. Id. at § 1701.01(Z)(2).
[130] Id. at § 1701.01(Y).

The statute requires that the would-be offeror file an "acquiring person statement" with the target. The statement must include the offeror's identity, the number of shares currently held, the number of shares to be acquired (which is defined by the number of directors the offeror will be able to elect), the offer's terms in "reasonable detail," and a representation that the acquisition is not "contrary to law" and that the offeror has adequate finances to complete the bid.[131]

Within ten days after the statement is filed, the target's Board must call a special stockholders' meeting to consider the offer. Unless the offeror makes a written request, the meeting must be held within fifty days after it is called. If the request is made, the meeting must be held within thirty days.[132] The record shareholders must be promptly notified of the meeting by the target. The notice must contain a copy of the offeror's statement and a statement of position or recommendation by target management.[133]

For the acquisition to proceed a majority of all voting shares represented at the meeting must vote affirmatively, as must a majority of shares other than those held by the offeror. A quorum for the meeting consists of a majority of the corporation's voting shares, and a majority of the shares other than those held by the offeror. Further, the acquisition must be completed within one year.[134]

3. Pennsylvania.--Under the new Pennsylvania statute, the shareholders are given a right to approve the second step of a two-step merger. The provision also applies to other mergers, consolidations and sales of substantially all corporate assets to an interested shareholder.[135] The bill requires that a majority of shares, other than those held by the offeror, vote to approve the transaction. The vote is not required if the price paid in the second step at least equals the highest previously paid price by the offeror for shares of the same class. In addition, the vote is also not required if the transaction is approved by a majority of directors, other than those who were nominated by or who have an interest in the offeror.[136]

IV. Constitutionality

State regulations of commerce may be found unconstitutional under either the supremacy or the commerce clause or both. The

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[131] Id. at § 1701.831(B).
[132] Id. at § 1701.831(C).
[133] Id. at § 1701.831(D).
[134] Id. at § 1701.831(E).
[135] Pa. Stat. Ann. tit. 15, § 1409.1(c) (Purdon Supp. 1985).
[136] See generally 1983 Pa. Legis. J. Sen. 1434 (Dec. 6, 1983) (analysis of the bill by Sen. Fisher).

supremacy clause invalidates state regulations preempted by federal law, while the commerce clause prohibits both direct state regulation of interstate commerce and indirect burdens on commerce created by state law. Thus, the constitutionality of state takeover statutes will turn on three issues: whether the state statute impermissibly conflicts with federal law; whether the statute directly regulates interstate commerce; and whether the statute places an indirect burden on interstate commerce that outweighs the local benefits and interests promoted by it.

A. Preemption

Despite the savings clause of section 28(a) of the 1934 Securities Exchange Act, of which the Williams Act is an amendment which permits state securities regulation "insofar as it does not conflict with [federal statutes] or the rules and regulations thereunder," Justice White held in MITE that "Congress . . . left the determination whether [a state takeover] statute conflicts with the Williams Act to the courts."[137] Therefore, one must look to judicial precedents on preemption in analyzing such statutes, rather than the savings clause alone.

In MITE, Justices White, Burger and Blackmun adopted the preemption analysis of Ray v. Atlantic Richfield:

> a state statute is void to the extent that it actually conflicts with a valid federal statute. A conflict will be found "where compliance with both federal and state regulations is a physical impossibility . . . ," or where the state "law stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress."[138]

Further, under other Supreme Court precedents, preemption may occur when federal legislation occupies the entire field of regulation.[139] Thus, in evaluating post-MITE tender offer statutes one must look to three issues: is the federal scheme of regulation so pervasive that one may reasonably infer that Congress has left no room for statute regulation; is compliance with both state and federal law "a physical impossibility"; and is the state statute so philosophically incompatible with the federal rule that it stands "as an obstacle" to accomplishment of Congress' intent.[140]

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[137] MITE, 457 U.S. at 631 (White, J.). See also Great Western, 577 F.2d at 1281.

[138] 435 U.S. 151, 158 (1978) (citations omitted). Accord Hines v. Davidowitz, 312 U.S. 52 (1941). See generally NOWAK, supra note 29, at 292-96.

[139] See, e.g., Pennsylvania v. Nelson, 350 U.S. 497 (1956). Congress can also explicitly prohibit state regulation, see City of Burbank v. Lockheed Air Terminal, Inc., 411 U.S. 624, 633 (1973), but has not done so in the field of tender offer regulation.

[140] Cf. Profusek & Gompf, supra note 26, at 31-32.

Clearly, the Williams Act is not so pervasive a regulatory regime as to make reasonable the inference that Congress left no room for state regulation. As the United States' brief in MITE observed:

> *We do not, of course, contend that the federal government has occupied the entire field of securities regulation or that the states have no role to play.* Congress has approved concurrent regulation of some types of securities transactions by state governments. Congress has forbidden, however, attempts by the states to regulate securities transactions in a manner that would undermine or conflict with the operation of federal law. See Section 28(a) of the Securities Exchange Act which bars any state from enacting a law that conflicts with either the Securities Exchange Act or any rules or regulations issued by the Commission thereunder. Thus, the Illinois statute is not invalid simply because it regulates tender offers, but rather because it regulates them in a way that conflicts with the Williams Act and frustrates the accomplishment of its objectives.[141]

Moreover, Justices Stevens and Powell rejected Justice White's pre- emption holding on the grounds that the Williams Act left some room for state regulation of tender offers.[142] Therefore, the issue is not whether the Williams Act occupies the field of tender offer regulation, but whether otherwise valid state regulations are procedurally or philosophically incompatible with the federal scheme.

The Maryland redemption right statute governs the second step of a front end loaded takeover merger. Maryland asserts that its

> proposal in H.B./S.B. 1 and in former House Bill 1030 of the 1983 Session is novel because it is aimed at the second stage of a takeover. At this stage, a raiding corporation has already acquired the necessary 10% of outstanding voting stock of a Maryland target corporation through its tender offer. The raiding corporation is now seeking, as an interested shareholder, to influence the internal affairs of the target corporation, specifically by forcing a merger, a sale or some other act significantly affecting the corporation's existence. These are extraordinary acts and are regulated by Maryland corporate law, a traditional state function.[143]

The bill was justified as a way of protecting investors:

> One objectionable feature of a hostile takeover is that the raiding corporation offers a premium price to purchase a certain percentage of stock to gain its controlling interest. Once that

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[141] Brief for the United States as Amicus Curiae. Edgar v. MITE Corp., 457 U.S. 624 (1981) (citations omitted) (emphasis added) [hereinafter cited as U.S. Brief].

[142] See supra notes 87-88 and accompanying text.

[143] Maryland Report, supra note 23, at 4-5.

> controlling interest is gained, the stockholders of the target corporation who did not sell their stock for the premium price are given a much less desirable offer (squeeze- out) in the transaction that finalizes the merger. The nature of the process is such that professional investors (arbitraguers) reap the benefit of the premium price, while small investors are left to take what is given in the final transaction.
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> In Maryland, the first step of this process is illustrated by Bendix Corporation's attempted takeover of Martin Marietta Corporation. Bendix made a tender offer at $43 a share for 44.5% of Martin Marietta's outstanding stock. Two weeks later, Bendix increased its offer to $48 a share. In three more days, Bendix further extended its tender offer to 55% of Martin Marietta's stock. Had Bendix been successful with its first-stage tender offer, it could have taken the second step of acquiring all of Martin Marietta's remaining shares in squeeze-out-merger . . . .
>
> Maryland's proposal is unique in that it is aimed at the second stage of a takeover, and amends that portion of state corporate law which governs the voting requirements for mergers and other extraordinary corporate actions. By law, corporations may alter these voting requirements by a charter amendment. In fact, at least 40 companies nationwide have independently amended their corporate charters to require supermajority voting approval. Maryland will accomplish this by statewide law with the proposed bill.
>
> It is generally agreed that a company-by-company approach does not solve the problem. It is unlikely that those companies having a large proportion of institutional investors would be unable [sic] to get a charter amendment, because it is the institutional investors who stand to profit most in a takeover.[144]

The bill gives the dissenting shareholder the right to demand the redemption of his shares at fair value in the event of such a transaction.

The Pennsylvania statute gives the dissenting shareholder such a right as soon as the first step of the merger is completed. The Pennsylvania bill has been defended as being simply an extension of state law governing the duties of controlling shareholders and minority appraisal rights. Under existing Pennsylvania law, shareholders were granted an appraisal right in the event of a merger or other consolidation. The new bill extends that right to a change of control, giving shareholders unhappy with the change an opportunity to opt

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[144] Id. at 9-10, 18. These arguments are primarily directed at the voting provisions of the Act, but are equally applicable to the redemption rules.

out at a price similar to that paid tendering shareholders.[145]

Neither the Maryland nor Pennsylvania statutes procedurally conflict with current federal regulation. Both state statutes are directed at the fairness of the transaction,[146] while neither applicable federal rule regulates fairness. Rule 13e-3[147] requires various disclosures, similar to those required under other tender offer disclosures, with regard to the going private transaction. Rule 14d-8[148] extends the proration rules in the first step of such transactions to give shareholders additional time to consider the offer. Neither directly regulates the price to be paid, nor the shareholder appraisal rights in the event of such a transaction. An offeror seeking to complete a two-step merger would therefore be able to comply with both the federal disclosure and proration rules, and the state price rules, without conflict. Since compliance with both regimes is not "a physical impossibility," the only possible ground of preemption would be a finding of philosophical incompatibility.

In adopting the Williams Act, Congress intended to protect investors by letting them reach their own decision on the offer, while favoring neither target nor offeror.[149] While the disclosure requirements of the Williams Act and rules thereunder apply to more transactions than just tender offers,[150] Congress' principal focus was on the regulation of takeovers.[151] Unlike pre-MITE state statutes, whose timing and review provisions directly regulated tender offers and thus substantially interfered with Congress' intent,[152] the Maryland and Pennsylvania redemption provisions are directed at a stage in the takeover subsequent to the tender offer.

While the redemption right provisions of the state laws may slightly deter tender offers, they do not frustrate the congressional purpose by introducing extended delay into the tender offer process, nor do they interfere with the congressional intent that "investors be free to make their own decisions."[153] Moreover, since the statutes do not

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[145] 1983 Pa. Legis. J. Sen. 1434 (Dec. 6, 1983) (analysis of the bill).

[146] Although some states, especially Delaware, have required "entire fairness" in the second step of the merger, see generally Mirvis, Two-Tier Pricing: Some Appraisal and "Entire Fairness" Valuation Issues, 38 BUS. LAW 485 (1983), most courts have been hostile to claims that a lower price in the second step violates federal or state law. See, e.g. Radol v. Thomas, 534 F. Supp. 1302 (S.D. Ohio 1982); Martin Marietta Corp. v. Bendix Corp., 549 F. Supp. 623 (D. Md. 1982).

[147] Securities Exchange Act Rule 13e-3, 17 C.F.R. § 240-13e-3 (1984).

[148] Securities Exchange Act Rule 14d-8, 17 C.F.R. § 240.14d-8 (1984). See generally SEC Exchange Act Release No. 18761 (May 25, 1982) [[hereinafter cited as 14d-8 Release].

[149] MITE, 457 U.S. at 633 (White, J.). See also Piper v. Chris-Craft Indus., Inc., 430 U.S. 1 (1977); Rondeau v. Mosinee Paper Corp., 422 U.S. 49 (1975).

[150] See, e.g. Schedule 13D, 17 C.F.R. § 240.13d-101 (1984) (requiring disclosure by persons acquiring or holding more than 5 percent of a class of securities).

[151] E.R. ARANOW & H.A. EINHORN, supra note 9, at 67.

[152] See supra notes 52-57, 61-62, 68-69, 83-86 and accompanying text.

[153] Cf. MITE, 457 U.S. at 637, 639 (White, J.).

regulate the offer stage of the takeover, they cannot be said to excessively "upset the balance struck by Congress by favoring management at the expense of stockholders."[154] Rather, the statutes simply protect minority shareholders in the post-offer firm.[155] Of course, the mere possibility of deterrence may so tilt the balance toward management that Congress' intent would be frustrated. However, if Justices Stevens' and Powell's view that some room for state regulation must be found is taken seriously, some deterrent effect must be tolerated.

The SEC has recognized that the Williams Act leaves room for state fairness regulations. The original version of Rule 13e-3, promulgated under the Act, required that the going private transaction be both substantively and procedurally fair. Commentators opposed the fairness aspects of the proposed rule, arguing, inter alia, that fairness "was a subject for state and not federal cognizance."[156] In adopting Rule 13e-3, the SEC withdrew the fairness requirements of the proposed rule, focusing instead on greater disclosure provisions:

> The Commission believes that the question of regulation of the fairness of going private transactions should be deferred until there is an opportunity to determine the efficacy of the provisions of Rule 13e-3. *Further developments in the remedies provided by state law for unfairness in going private transactions will also be important in this regard.* In the interim, the commission believes that the protection of investors will be enhanced substantially by the more meaningful disclosure, particularly with respect to the fairness of going private transactions, and the other protections afforded by Rule 13e-3 . . . .
>
> The most significant change in the items of the Schedule is with respect to disclosure of the fairness of the transaction. Item 8 requires the issuer or affiliate to state whether it reasonably believes the Rule 13e-3 transaction is fair or unfair to unaffiliated security holders. The issuer or affiliate is also required to provide a detailed discussion of the material factors upon which that belief is based . . . .
>
> These factors are based to a large extent on the considerations set forth in the Note to proposed Rule 13e-3(b) which rule would have required that the transaction be fair to unaffiliated security holders. The commentators were concerned that the factors chosen would conflict with the standards under state law for determining fairness. Since a substantive fairness requirement

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[154] Id. at 639 (White, J.).

[155] See MARYLAND REPORT, supra note 23, at 14.

[156] Going Private Transactions by Public Companies or Their Affiliates, SEC Securities Exchange Act Release No. 16075 (Aug. 2, 1979) [hereinafter cited as 13e-3 Release].

> is not being adopted at this time, this concern is now inapplicable. Moreover, Instruction 1 to Item 8(b) of Schedule 13E-3 indicates that the factors which are important in determining the fairness of a transaction to unaffiliated security holders, and the weight which should be given to them, in a particular context, will vary. The context in which this determination is made, of course, includes the applicable state law. Accordingly, accommodation with those requirements is assured.[157]

Thus, the SEC has recognized the validity of state fairness requirements in this area.

The SEC Advisory Committee on Tender Offers has taken a confusing position on this issue. First, it generally opposed state regulation of tender offers.[158] Second, it opposed federal fairness rules or appraisal rights.[159] Last, however, the Committee felt that "[a]ll shareholders whose shares are purchased in a tender offer should be entitled to the highest per share price paid in the offer."[160] Whether this admonition extends to the second step of a two-tier offer is unclear. In general, the Committee felt there should be "a regulatory disincentive" with regard to two-tier offers.[161] Until directly reversed by congressional legislation or by further SEC rule-making, the SEC's position in the 13e-3 Release seems to be dispositive. Therefore, the fair value redemption rights should survive any Supremacy Clause challenge.[162]

It would be difficult to argue that the Maryland or Pennsylvania special voting requirement statutes procedurally conflict with federal law. First, since they do not regulate the initial offer, they introduce no statutory delay into the tender offer. This significantly contrasts with the substantial delay introduced by the advance filing and administrative review requirements of the IBTA.[163] Second, since the bills do not contain any disclosure or proration procedures, they do not conflict with Rules 13e-3 or 14d-8, the federal rules governing

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[157] Id. (Emphasis added). In Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 478-79 (1977), the Supreme Court observed that "once full and fair disclosure has occurred, the fairness of the terms of the transaction is at most a tangential concern of [federal securities law] . . . . Absent a clear indication of congressional intent, we are reluctant to federalize the substantial portion of the law of corporations that deals with transactions in securities, particularly where established state policies of corporate regulation would be overriden." Fairness is thus a state concern, and in the absence of new Congressional action, should remain so.

[158] SEC Advisory Committee on Tender Offers, Report of Recommendations (1983), reprinted in [Special Report] FED. SEC. L. REP. 1, 34-36 (July 15, 1983) [hereinafter cited as Advisory Report].

[159] Id. at 32.

[160] Id.

[161] Id. at 25.

[162] Cf. Profusek & Gompf, supra note 26, at 34 ("Since the Williams Act only regulates tender offers, state regulation of second-step, squeeze-out transactions (which presently exists under the various state merger statutes in any event) should be upheld after MITE.").

[163] See supra note 69.

going private transactions. Moreover, as noted earlier, the pro ration procedures of Rule 14d-8 are directed at shareholder protection in the first step of the merger, not the second.[164] In the absence of such conflicts, an offeror can easily comply with both the federal and state schemes, and the state laws should be upheld against a procedures-based preemption challenge.

The voting rules should also be upheld against a philosophically based challenge. Because the second step of the two-tier buyout is to be approved by a shareholder vote, unlike the IBTA in which the approving authority was a state official, Congress' intent that it be the shareholders who make the decision is not frustrated. Second, while the bills may deter some two-step offers, thus interfering with Congress' apparent intent to avoid deterrence of tender offers,[165] any deterrent effect will be minimal. Neither bill regulates nor prohibits one-step offers, nor the first step of two-step offers. Both bills permit the second step as well, provided that the offeror pays a "fair price." As the Maryland Attorney General has observed:

> If the Supreme Court were to address a preemption challenge to [the Act], one cannot, on the basis of the Mite and Bendix cases, clearly predict the result. While prior notice and hearing provisions are not part of [the Act], it might be argued on the basis of Mite that the effect of the bill is nonetheless to tip the balance in a hostile takeover bid in favor of incumbent management, to frustrate procompetitive takeover offers and to curb shareholder autonomy insofar as it inhibits opportunities. On the other hand, a number of constitutional arguments can be mounted in the bill's favor. The bill is not aimed solely at takeovers, just the two-stage variety. It permits the traditional one-stage takeover and even permits a "two-stage" takeover if an equal price is paid to all shareholders. It can be argued that the bill fosters shareholder rights and decision-making -- a goal of the Williams Act. In any event, because the full Court has not yet spoken on the Williams Act preemption issue, and because arguments can be made in the bill's favor, we do not find House Bill 1030 invalid under the Supremacy Clause.[166]

Furthermore, fairness in the second step has explicitly been left to state regulation by the SEC.[167] In the absence of supervening congressional or SEC law-making in the fairness area, there is no philo-

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[164] See supra notes 147-48 and accompanying text.

[165] See MITE, 457 U.S. at 633 (White, J.); Great Western, 577 F.2d at 1277-79.

[166] Letter from Stephen H. Sachs, Attorney General of Maryland, to Governor Harry Hughes at 3-4 (May 9, 1983) (commenting on the constitutionality of House Bill 1030, the vetoed predecessor to the current Maryland statute) (footnote omitted) [hereinafter cited as Sachs Letter], reprinted in Maryland Report, supra note 23, at 65, 67-68.

[167] See supra notes 156-62 and accompanying text.

sophical conflict between state fairness requirements and the procedurally oriented federal rules. At present, the federal and state regulatory systems are simply directed at different aspects of the same transaction and can coexist.[168]

It may be argued that the Maryland and Pennsylvania voting provisions tip the balance towards management by permitting the Board to exempt the offeror from the vote requirements or because of management's ability to control shareholder votes through its control of the proxy machinery. However, the Williams Act does not give the offeror "a right . . . to complete its tender offer successfully. Instead, it creates the investor's right to hear a fair presentation of the offeror's proposal."[169] Moreover, Congress' emphasis was on "avoid[ing] tipping the balance of regulation either in favor of management or in favor of the person making the takeover bid."[170] The Maryland and Pennsylvania acts do not interfere with the initial offer and do not prohibit single step offers. Instead, they simply give minority shareholders in the post-offer firm the right to either be paid a similar price as the tendering shareholders or to approve the buyout.

Lastly, it might be argued that the Williams act takes a "market approach to investor protection,"[171] and that by requiring a shareholder vote, the bills derogate from the "market approach." The "market approach" is based on the notion that the tendering decision should be made by an informed shareholder alone.[172] In the context of a shareholder tender decision, such an approach is correct; the investor should be allowed to decide whether to accept or reject the offer without management or state interference. However, the second step of a two-tier acquisition takes place in a different context. The second step is not a "market" purchase of shares by a

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[168] As the Seventh Circuit notes in Panter v. Marshall Field & Co., 646 F.2d 271, 286 (1981), "the distinguishing characteristic of the activity the Williams Act seeks to regulate is the exertion of pressure on the shareholders to make a hasty, ill-considered decision to sell their shares." Rule 14d-8 was adopted to extend the proration period in two-step mergers to avoid just such pressure in that type of merger. The Maryland and Pennsylvania acts will help avoid such pressure by requiring shareholder approval of the second step.

Furthermore, Congress has recently given some indication that it is also concerned by two-step offers. H.R. 5694, 98th Cong., 2d Sess. (1984), would essentially prohibit two-step acquisition by requiring that virtually all tender offers be made for all outstanding shares of the corporation. This legislation, designed to prohibit partial tender offers, the essential first step of the two-tier offers, would of course render the state statutes irrelevant, but also may indicate Congressional distaste for such offers. The SEC Advisory Committee on Tender Offers has recommended that legislation explicitly regulating or prohibiting two-tier offers be adopted. The SEC considered this recommendation, and accepted comments thereon through September 1984. See SEC Securities Exchange Act Release No. 21079 (June 21, 1984).

[169] Great Western, 577 F.2d at 1227 (citations omitted).

[170] Senate Report, supra note 11, at 3. See also House Report, supra note 11, at 3.

[171] Great Western, 577 F.2d at 1277.

[172] Id. at 1276; MITE, 633 F.2d at 492.

stranger to the corporation, but rather a merger buyout at a set price with another shareholder. Because the interested shareholder may be able to seize control of the board or the shareholder vote and force the merger, there may be no investor decision to be made. Therefore, state fairness regulation of "squeezeout" mergers does not conflict with the Williams Act's "market approach."[173]

While the Maryland and Pennsylvania voting provisions should survive a preemption-based constitutional challenge, the Ohio bill is unlikely to do so. In contrast to the other bills, the Ohio bill directly effects virtually all tender offers for Ohio corporations. Moreover, its philosophical basis substantially conflicts with that of the Williams Act.[174]

A number of philosophical conflicts between the Ohio and Williams Acts may be noted. First, the Ohio Act introduces substantial delay into the tender offer. Under the Williams Act, a tender offer must remain open for at least twenty days, and tendered shares may be taken up thereafter.[175] The Ohio Act, at a minimum, would require the offeror to wait thirty days before unconditionally taking up the tendered shares, since he may not do so without shareholder approval and the target has at least thirty days before it must call a meeting.[176] Such delay would permit additional time for the target's Board to prepare defensive tactics such as authorizing golden parachute contracts for itself and top management or seeking competitive bids from a white knight. It would also permit competing bids to be launched by other unfriendly offerors. Since shareholders have ten days to withdraw untaken-up shares following a competing offer,[177] such delay could defeat the initial offer. Although the Ohio Act does not impose the same type of pre-commencement delay as did the IBTA, the effect will be similar. The courts have repeatedly stressed Congress' rejection of unnecessary delay.[178] While

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[173] On two-step and squeezeout mergers, see generally Freund & Easton, The Three-Piece Suitor: An Alternative Approach to Negotiated Corporate Acquisitions, 34 BUS. LAW 1679 (1979).

[174] Procedurally the Ohio and Williams Acts are fairly compatible. Under the Ohio Act, the tender offer may commence prior to the vote, but purchases must be conditioned on shareholder approval. Such conditional offers are permissible under the Williams Act, provided the timing and disclosure provisions of the Act are met. Moreover, the Ohio Act's disclosure provisions are similar to those of the Williams Act. See generally Profusek & Gompf, supra note 26, at 35-36.

[175] 17 C.F.R. § 240.14e-1 (1984).

[176] See supra text accompanying note 132.

[177] 17 C.F.R. § 240.14d-7 (1984).

[178] The problems of delay and Congress' opposition to unnecessary delay were discussed supra note 83-84 and accompanying text. See also MITE, 457 U.S. at 634-47; Great Western, 577 F.2d at 1276-78. Congress is considering banning certain target defensive tactics during the course of a tender offer, but has not yet acted. See H.R. 5693, 98th Cong., 2d Sess. (1984); H.R. 5695, 98th Cong., 2d Sess. (1984). This expression of Congressional concern with "management self dealing . . . practices neither ethical or fair, and not supported by the majority of the industry or the general public," N.Y. Times, July 18, 1984, at D1 (remark of Rep. Dingel with regard to possible opposition to the proposed SEC legislation by the Administration), reinforced its earlier concerns with the potential hazards of undue delay. The SEC rejected a requirement that tender offers be kept open for thirty days, noting that the rationale for doing so was the facilitation of competing tender offers, and that such a rationale was not one of the purposes of the Williams Act. SEC Rel. No. 33-6158 (Nov. 29, 1979).

"minimal delay" might be acceptable,[179] a delay of ten days is more than sufficient for target management to take defensive measures that may defeat the offer.[180] Delay such as that injected by the Ohio statute substantially tips the balance towards management, violating Congress' intent of neutrality between target and offeror, and thus would serve as the basis for a finding of preemption.

The voting procedure itself also tips the balance sought by Congress towards target management. Superficially, it appears that the Ohio Act permits shareholder approval of the tender offer. This comports with the Williams Act's intent that the tender decision should be made by the investors. However, the bill is at least redundant and perhaps gives management an unfair advantage. Assume that an offeror proposed to purchase all outstanding shares. The shareholders would essentially "vote" by deciding to tender, rendering an actual vote redundant and unnecessary. No special shareholder protection in such a vote is required. Moreover, management is frequently able to control the proxy machinery of a corporation, and so might be able to block an offer shareholders would otherwise accept. When a takeover statute gives management the power to make the shareholder's decision, it must be struck down.[181] The Williams Act "represented a conviction that . . . the investor . . . if furnished with adequate information would be in a position to make his own informed choice."[182] A pre-tender offer vote, where not all shares need be represented[183] and where management may be able to control substantial numbers of proxies, conflicts with this congressional intent. Therefore, the Ohio Act should be found to be preempted, thus in contrast to the narrower post-purchase vote provided by the Maryland and Pennsylvania laws.

B. Commerce Clause

The commerce clause is both a grant of power to Congress and

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[179] Cf. Great Western, 577 F.2d at 1277.

[180] In the Mobil-Marathon takeover struggle, Marathon was able to bring in U.S. Steel as a white knight within ten days of Mobil's announcement for negotiations and to conclude an agreement within nine more days. Radol v. Thomas, 534 F. Supp. 1302, 1305 (S.D. Ohio 1982). Any additional time would only have simplified Marathon's task.

[181] Great Western, 577 F.2d at 1279.

[182] MITE, 457 U.S. at 633-34 (White, J.) (emphasis added).

[183] Recall that the quorum for the vote is simply a majority of all shares and a majority of disinterested shares. Whereas all shareholders are able to consider the offer, not all need be present at the vote for it to bind all.

a limitation on state power. Under the Supremacy Clause a valid congressional exercise of the commerce power will preempt conflicting state regulation. However, even in the absence of congressional legislation, the "dormant" commerce clause bars direct state regulation of commerce.[184] Of course, not every exercise of state regulatory power is invalid. Rather, if the law regulates commerce indirectly, the burden on interstate commerce must be balanced against the local interest promoted by the statute. The test set forth by the Supreme Court in Pike v. Bruce Church, Inc.[185] is "perhaps the best recent summary of the law in this area":[186]

> Although the criteria for determining the validity of state statutes affecting interstate commerce have been variously stated, the general rule that emerges can be phrased as follows: Where the statute regulates even-handedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits. If a legitimate local purpose is found, then the question becomes one of degree. And the extent of the burden that will be tolerated will of course depend on the nature of the local interest involved, and on whether it could be promoted as well with a lesser impact on interstate activities. Occasionally the Court has candidly undertaken a balancing approach in resolving these issues, but more frequently it has spoken in terms of "direct" and "indirect" effects and burdens.[187]

Indeed, the test announced in Pike was adopted in MITE[188] by the Supreme Court. In MITE, a majority of the Court found that the IBTA violated the Commerce Clause because it gave Illinois the power to *"block a nationwide* tender offer,"[189] and because the state's interests in protecting shareholders and regulating the internal affairs of its corporations were undermined by the broad jurisdiction reach of the state. Thus, the burden created was "substantial," since national offers could be blocked by one state, while the benefit was merely "speculative." In the Pike balance, the burden was clearly excessive in light of such weak local

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[184] MITE, 457 U.S. at 640 (White, J.). See generally NOWAK, supra note 29, at 266-89.
[185] 397 U.S. 137 (1970).
[186] NOWAK, supra note 29, at 279.
[187] Pike, 397 U.S. at 142 (citations omitted).
[188] MITE, 457 U.S. at 640-46. Although it is less than clear, MITE seems to have adopted an "on its face" test of constitutionality. The tender offer involved was nationwide, and there is no indication that there actually were no resident shareholders in the state. That is, the fact that the state act in MITE was apparently applied in an instance where there were local shareholders was not enough to save the act from constitutional infirmity.
[189] Id. at 643 (emphasis added). See generally supra notes 77-85 and accompanying text.

benefits and interest.

In contrast to the IBTA and most other state statutes struck down following MITE,[190] the Maryland and Pennsylvania statutes apply only to corporations incorporated within the state.[191] The constitutionality of such "internal affairs" regulation by the state of incorporation has long been recognized by the Supreme Court. "Corporations are creatures of state law, and investors commit their funds to corporate directors on the understanding that, except where federal law expressly requires certain responsibilities of directors with respect to stockholders, state law will govern the internal affairs of the corporation."[192] As the Court observed in Burks v. Lasker,[193] "congressional legislation is generally enacted against the back-ground of existing state law; Congress has never intended that the entire corpus of state corporation law is to be replaced."[194]

As Justice White recognized, the "internal affairs" governed by state law include those matters "peculiar to the relationships among or between the corporation and its current officers, directors, and shareholders . . . ."[195] These "matters" include fairness issues[196] and the relationship between controlling and minority shareholders,[197] precisely the issues governed by the Maryland and Pennsylvania statutes. Thus, while a tender offer is not part of the internal affairs of a corporation, shareholder relationships clearly are.[198] As the court stated in Great Western:

> We are not persuaded by the appellant's argument that Idaho's takeover statute is analogous to the state laws governing internal corporate matters and fundamental corporate changes such as mergers, that traditionally have co-existed with federal securities regulation . . . a tender offer involves the sale of securities from one shareholder to another, not a change in the corporation itself. The voting rights of shares and the legal relationship between a corporation and its shareholders does not change because of a tender offer. Although a tender offer can be a substitute for a proxy contest, there are important distinctions between the two. In a proxy contest the existing shareholder transfers only his vote; the other aspects of his existing

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[190] But see Martin Marietta, 690 F.2d at 567, in which the court struck down a Michigan statute that had been interpreted to apply only to Michigan residents.

[191] Md Corps. & Ass'ns Code Ann. § 1-102(a) (1985); Pa. Stat. Ann. tit. 15, § 1004 (Purdon Supp. 1985).

[192] Cort v. Ash, 422 U.S. 66, 84 (1975). See also Santa Fe, 430 U.S. at 479.

[193] 441 U.S. 471 (1979).

[194] Id. at 478. See also Profusek & Gompf, supra note 26, at 29.

[195] MITE, 457 U.S. at 645.

[196] See supra notes 146-48 and accompanying text.

[197] Perlman v. Feldmann, 219 F.2d 173 (2d Cir.), cert. denied, 349 U.S. 952 (1955).

[198] Cf. MITE, 457 U.S. at 645.

> relationship with the corporation remain. A tendering shareholder severs the existing relationship completely. Statutes regulating the internal affairs of a corporation concern the existing relationship between a corporation and its shareholders. Since at the beginning of a tender offer the offeror may be a potential shareholder only, laws governing the offeror's conduct are not logically based on control of internal corporate affairs.[199]

This position was adopted by a majority of the Court in MITE, as well:

> 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.[200]

A state admittedly "has no interest in regulating the internal affairs of foreign corporations,"[201] but Maryland and Pennsylvania do not seek to do so. Therefore, the first prong of the Pike test, a legitimate local interest, is clearly met by these statutes.[202]

The burden on interstate commerce created by the fair value statutes is considerably less than that created by the IBTA. Under the IBTA, Illinois could completely block a nationwide tender offer. In contrast the Maryland and Pennsylvania statutes will at most have a mild deterrent effect, no more so than a corporate shark repellent would have on the offer. All state corporate regulations

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[199] Great Western, 577 F.2d at 1280 n.53 (citations omitted).

[200] MITE, 457 U.S. at 645.

[201] MITE, 457 U.S. at 645-46.

[202] The Maryland Report, supra note 23, at 9-10, sought to defend the statute as a shareholder protection measure. See supra text accompanying note 98. The Pennsylvania bill's chief sponsor also offered a similar argument in favor of that bill. 1983 Pa. Legis. J. Sen. 1433 (Dec. 6, 1983) (remarks of Sen. Fisher). However, as both statutes apply to resident and non-resident stockholders, such a defense is unlikely to be successful. See MITE, 457 U.S. at 644 ("the State has no legitimate interest in protecting nonresident shareholders").

The Tenth Circuit in Mesa v. Cities Services Co., 715 F.2d 1425, 1430 (10th Cir. 1983), in striking down the Oklahoma Take-Over Bid Act, observed that the state's interest in protecting shareholders "is only weakly served in light of overlapping protection provided by the federal securities laws." See also MITE, 457 U.S. at 644-45 ("the Williams Act provides these same substantive protections [as does the IBTA] . . . [so we] conclude that the protections the Illinois Act affords resident security holders are, for the most part, speculative.").

However, the Williams Act does not regulate issues of fairness or of shareholder appraisal rights. See supra notes 143-62 and accompanying text. Therefore, the state interest in protecting shareholders could be regarded as much stronger in this area. Unfortunately, this argument would not justify protection of non-resident shareholders and therefore would probably not be upheld on facial review.

have some effect on interstate commerce and so the burden must clearly outweigh the local interest to invalidate the statute. Unlike the IBTA, the Maryland and Pennsylvania statutes will not create direct bars to tender offers. In light of the substantial local interest in regulating corporate internal affairs, the significantly reduced burden on commerce, and the view of Justice Powell that the Court's "Commerce Clause reasoning leaves some room for state regulation of tender offers,"[203] the Maryland and Pennsylvania redemption and voting provisions should survive a Pike balancing test.

The MITE plurality also struck down the IBTA as a direct restraint on interstate commerce. The reasoning was based on the "sweeping extraterritorial effect" of the statute and its ability to block a national offer. In contrast to the IBTA, the three post-MITE statutes apply only to corporations organized under each state's laws. Ohio, in fact, goes farther and requires that covered companies also have substantial assets, or their principal place of business or executive offices, in Ohio. Despite this more limited extraterritorial effect, the statutes might be considered direct restraints on interstate commerce. In MITE, Justice White stated the IBTA was a direct restraint on commerce because it regulated national tender offers.[204] If other courts extend this reasoning to include statutes that apply only to resident shareholders, as the court in Martin Marietta did, then the state statutes, as with the redemption rights, might be vulnerable.[205]

To apply such reasoning, however, would essentially mean that all state regulation of domestic corporate activities could be struck down on commerce grounds. States currently regulate many corporate transactions that affect interstate commerce. As Professor Sargent had observed:

> State corporate law protects investors by defining their rights as shareholders in certain transactions in the corporation's securities and their relations with directors, officers, and other shareholders. For example, corporate law has traditionally protected shareholders' rights by regulating the techniques of effecting change in the corporation's structure, such as the transfer and voting of shares, shareholder agreements and voting trusts, mergers, dissolutions, and the use of proxies. A state's corporate law, furthermore, travels with the corporation since full faith and credit is given by other states to the law of the state of incorporation, at least with respect to matters of corporate organization. The state of incorporation thus shoulders

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[203] MITE, 457 U.S. at 646 (Powell, J.).
[204] MITE, 457 U.S. at 642 (White, J.). See supra note 82 and accompanying text.
[205] See supra note 89.

the burden of protecting both resident and nonresident shareholders.[206]

Indeed, the state takeover redemption provisions are no more than appraisal rights, long a part of state corporate law. State statutes typically provide appraisal rights in the event of a merger, granting dissenters a fair value redemption right for their shares.[207] Such statutes are certainly constitutional as a part of the state power over firms incorporated in the state, absent excessive extraterritorial effect. The Maryland and Pennsylvania statutes simply extend these rights to control transactions, and should be upheld. It therefore seems, particularly in view of the positions of Justices Powell and Stevens, better to focus on the Pike analysis instead of the direct-indirect test. Indeed, as noted earlier, the Pike court expressly rejected the direct effect test, "candidly undertaking[ing] a balancing approach in resolving these issues."[208]

A Pike type of balancing test should be resolved to uphold these statutes. The burdens on interstate commerce created by them are minimal in comparison to those created by the IBTA and its siblings. Since the statutes only apply to domestic corporations their extraterritorial effect will be much reduced and so will the number of offers regulated by each statute. Moreover, because of their reduced jurisdictional base, the statutes do not interfere with the affairs of corporations incorporated elsewhere, a principal concern of the Great Western court.[209] Second, the Maryland and Pennsylvania statutes cannot serve to block any tender offer, or even to deter one-step offers. This is in substantial contrast to the ability of Illinois or Idaho bureaucrats to stop a national tender offer under the statutes struck down in MITE or Great Western.[210] The Ohio statute admittedly will have more substantial deterrent effect, as it applies to all tender offers. However, even a substantial deterrent effect should weigh less heavily in the Pike balance than complete blocking power.

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[206] Sargent, supra note 18, at 724 (footnotes omitted). See also Profusek & Gompf, supra note 26, at 27-29.

[207] Fischel, The Appraisal Remedy in Corporate Law, 1983 AM. B. FOUND. RESEARCH J. 875.

[208] See supra note 187 and accompanying text.

[209] See Great Western, 577 F.2d at 1284, in which the court observed that "where the rules of different states conflict, the Supreme Court has been severe in its scrutiny of state legislation." Such severe scrutiny is unwarranted here, where none of the statutes seek to regulate foreign corporations and therefore do not conflict with other valid state takeover statutes. Of course, conflict might arise with statutes whose jurisdictional base is not so limited, but such statutes are unlikely to be upheld.

Three states, Hawaii, Indiana and Wisconsin, have recently modified their existing statutes so as to reduce their jurisdictional base. Whether such modification alone is sufficient is, unfortunately, beyond the scope of this Article, as it would require consideration of the entire statutory scheme for preemption and local benefits.

[210] See Great Western, 577 F.2d at 1284.

Balanced against these burdens must be the states' interest in the legislation and the local benefits. Admittedly, as with the redemption provisions, the local investor protection rationale is not a strong enough local interest to justify the statutes.[211] However, as with those provisions, the special voting rules are legitimate invocations of the state's power over the internal affairs of its corporations, at least as to the Maryland and Pennsylvania statutes. These two bills are, like the redemption rights, simply an extension of the traditional state control over corporate mergers, appraisal rights and the relationships between shareholders generally.[212] The bills do not directly regulate the tender offer stage of the takeover, but rather the relationship of a majority shareholder to a minority shareholder.

In contrast, the Ohio legislation does directly regulate the tender offer. As such, it cannot be protected by the "internal affairs" doctrine, unlike the other two statutes. Under this reasoning, the Pennsylvania and Maryland statutes may avail themselves of the protections of the internal affairs doctrine, but the Ohio Act may not. Thus, a Pike balancing test would conclude that the Maryland and Pennsylvania statutes are constitutional, but that the Ohio bill, having no legitimate interest to counter balance the burden it places on commerce, is not.

V. Federalism Concerns

The preceding analysis argued that there is a constitutionally permissible area, albeit fairly narrow, for state regulation of tender offers under current law. It is important to emphasize that this zone of permissible regulation exists at congressional sufferance. Through its exercise of the commerce power, Congress can at any time expand or contract this zone. This section examines whether Congress should respond to the state's continued efforts to regulate tender offers, and if so, how. However, before asking the question of who should regulate tender offers, it examines whether such offers should be regulated at all.

A. Should Tender Offers Be Regulated?

Professor Daniel Fischel of the University of Chicago has cogently argued that regulation of tender offers results in a net decrease in social welfare.[213] In capsule form, his argument runs as follows. First, Fischel asserts that the cash tender offer is "the most effective means of wresting control from a resisting

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[211] See supra note 202 and accompanying text.
[212] See supra notes 206-08 and accompanying text.
[213] See Fischel, supra note 5.

management," and that the tender offer premium usually results from the offeror's "belief that it can manage the company more efficiently than present management."[214] Further, "the firm and society in general . . . benefit from a transfer of control to more capable management."[215] To explain Fischel's analysis with a mathematical hypothetical,[216] assume that under current management, the target's shares are priced at $100 per share and that under the offeror's management, they would trade at $200 per share. Thus, if the offer is successful there is a net increase in social welfare of $100 per share.

Fischel then argues that the disclosure requirements of the Williams Act force the offeror to "alert the [target] shareholder that his share will be worth more under new management."[217] This increases the cost of the tender offer by increasing the premium the offeror must pay,[218] thereby "greatly reducing the incentive to undertake a takeover attempt."[219] It is this disincentive that produces regulatory inefficiency.

Expanding the hypothetical, further assume that there are 100 companies that are potential targets, each with 100 shares, and that each would be subject to a successful offer in the absence of regulation. Thus, when all offers are completed, there will be a net social gain of one million dollars.[220] Now assume that regulation of tender offers will deter 10% of all offers, because of the increased costs of completing the offer. Thus, there would be a $100,000 reduction in net social welfare. It is this reduction to which Fischel objects.[221] As he summarizes:

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[214] Id. at 2. In a later article written with Frank Easterbrook, see supra note 4, Fischel recognizes that factors other than inefficient target management may motivate a tender offer. However, since the company is moving to a higher-valuing owner, there is still a net social benefit from all tender offers.

[215] Fischel, supra note 4, at 2.

[216] This hypothetical is used throughout this section, with modifications made as necessary. For now the hypothetical makes several assumptions. First, it assumes that transaction costs are zero. Second, it assumes that all tender offers are made for efficient reasons, i.e., it assumes that phenomena such as greenmail and the like do not exist. Last, it assumes that stock markets are efficient. It must be admitted, however, that the usefulness of hypotheticals with such assumptions is limited. See Bainbridge, The Inside Trading Prohibition, _____ U. FLA. L. REV. _____ (1986).

[217] Id. at 25.

[218] Moreover, it increases the transaction cost associated with the offer substantially, but again, such costs are ignored in this analysis.

[219] Id. at 14.

[220] 100 companies times 100 shares each times 100 dollars per share equals 1,000,000 dollars.

[221] The logical extension of this argument is that anything which deters tender offers is socially inefficient and therefore undesirable. Easterbrook and Fischel, in a series of articles, cited supra note 4, make this point with regard to target management defensive tactics. Compare these with the Gilson and Bebchuk articles, also cited supra note 4, which reach a similar conclusion. But see the Lipton articles, cited supra note 4, for the argument that tender offers are not economically desirable. Justice White appears to have adopted the Easterbrook and Fischel position. See, e.g., MITE, 457 U.S. at 643-44.

> The existence of a takeover device such as the cash tender offer provides a mechanism for shifting control to those who can manage assets more effectively. The possibility that control could change hands gives incumbent management an incentive to perform efficiently and keep stock prices high in the interest of all shareholders. By increasing the cost of making a tender offer and by reducing the exchange value of privately produced information, the Williams Act limits the effectiveness of cash tender offers and thereby undermines a check against entrenched inefficient management to the detriment of current shareholders . . . . State takeover statutes [pre-MITE] contain provisions similar to those of the Williams Act, but go further to eliminate the element of surprise generally necessary for a successful tender offer and, in some cases, to let target company management exercise a great degree of control over the struggle with the tender offeror. These statutory and regulatory impediments to the smooth functioning of the market for corporate control serve no valid purpose.[222]

If Fischel's argument is correct, cost-benefit analysis suggests that the answer to the question of who should regulate tender offers is nobody. However, as Justice Brennan recently and cogently observed in another context, "the language of deterrence and of cost/benefit analysis, if used indiscriminately, can have a narcotic effect. It creates an illusion of technical precision and ineluctability. It suggests that not only constitutional principle but also empirical data supports the . . . result."[223] In particular, slavish adherence to the banner of cost-benefit analysis can obscure competing normative options and principles.

As Fischel states, "[t]he legislative history of the Williams Act and leading cases unequivocally state that the Act was intended to protect shareholders."[224] He argues that the Williams Act is designed to protect shareholders primarily from the "risk" that the offeror stands to profit considerably from the transaction, in spite of the premium.[225] In other words, the Act forces the offeror to disclose much of his anticipated gains, and thereby share more of them with the target's shareholders. He then argues that the deterrence created by this effect is undesirable.

Assuming, arguendo, that Fischel is correct that there is a substantial deterrent effect created by the Williams Act, that does not necessarily mean that there should be no regulation of tender offers.

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[222] Fischel, supra note 5, at 26, 45.
[223] United States v. Leon, 104 S. Ct. 3405, 3430 (1984) (Brennan, J., dissenting) (exclusionary rule decision).
[224] Fischel, supra note 5, at 24.
[225] Id. at 25.

Rather, it could be argued that Congress implicitly, or subconsciously, accepted some reduction in the social gains of tender offers in order to redistribute some of these benefits from the offeror to the target's shareholders. Thus, the Williams Act "protects" shareholders not by its explicit disclosure and regulatory effects, but through indirect allocative effects. Such a policy choice would, of course, be a legitimate compromise for Congress to make between the competing norms of "efficiency" and "fairness."[226]

To further consider the distributional effects of tender offer regulation, modify the hypothetical as follows. Assume that all offers are of the two-tier variety. Next, assume that in the absence of regulation the offeror would pay a first step premium of twenty dollars and a second step premium of ten. In such a scheme there would be a net social gain of one million dollars. Two hundred thousand dollars of the social gain would go to shareholders, with eight hundred thousand going to offerors. Again, assume that the number of tender offers decreases by ten percent if they are regulated.[227] Assume that the Williams Act forces the first step premium up to 64 dollars and the second step premium up to 47 dollars, with a blended premium of 55 dollars.[228] Under the Williams Act, our hypothetical shareholders would get $495,000 dollars,[229] the offerors would get 405,000

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[226] No claim is being made that this argument was considered by Congress. However, it is a legitimate interpretation of the economic efforts of the Williams Act. Moreover, such an approach appears to have been adopted by the SEC Advisory Committee. "The Advisory Committee apparently saw its task as 'balancing' fairness and deterrence. It wanted to obtain more fairness -- more equality in the distribution of gains, given the existence of an offer -- without unduly reducing the number of tender offers." Advisory Report, supra note 158, at 79 (separate statement of members Easterbrook and Jarrell).

[227] It is difficult to accurately measure the deterrent effect of tender offer regulation. "[C]ertain members of the [SEC Advisory] Committee have expressed the view that regulation of tender offers is a major factor in determining the number of tender offers. They believe that since the adoption of the Williams Act, the number of tender offers that would have commenced would be significantly higher but for the regulation." Advisory Report, supra note 158, at 11 n.9. The following table shows that the number of tender offers significantly decreased immediately after the Williams Act was passed, but subsequently increased.

Fiscal Year	Number of Tender Offers	Fiscal Year	Number of Tender Offers
1965	105	1974	105
1966	77	1975	113
1967	113	1976	100
1968	115	1977	162
1969	70	1978	179
1970	34	1979	147
1971	43	1980	104
1972	50	1981	205
1973	75	1982	117

Id.

[228] These numbers are drawn from the SEC study of two-tier offers. They are the actual averages for 1981-83. See supra note 115.

[229] 55 dollars per share times 90 companies times 100 shares per company equals 495,000 dollars.

dollars,[230] and the social gain would be 900,000 dollars. The effect of state fair price voting rights statutes can now be seen. Since they essentially force the two-tier offeror to pay the first tier price on the second tier, shareholders would now get 576,000 dollars,[231] while the offerors would get 324,000 dollars,[232] assuming no further deterrent effect. This example may incidentally provide the best argument for the philosophical compatibility of the regimes. The ultimate effect of both the federal and state schemes is to redistribute social gains from offerors to target shareholders. If such an effect is a legitimate choice for Congress to make, it should also be a legitimate one for states.[233] At any rate, it does indicate that there is a powerful normative basis for regulating tender offers despite the deterrent effect of such regulation.[234] Thus, the answer to the question of who should regulate tender offers is at least "somebody."

B. Who Should Regulate Tender Offers?

For a number of years there has been an ongoing debate over the conflict between state and federal regulation of corporations. A number of commentators have argued that corporate law should be "federalized,"[235] while others have argued that federal law already excessively intrudes into traditional state powers. The full range of this debate is beyond the scope of this Article, but the narrower issue presented here may provide some useful insights.

Perhaps the most important analysis of this issue is that contained in the recent

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[230] 45 dollars per share times 90 companies times 100 shares equals 405,000 dollars. Of course, transactions costs would reduce this amount further.

[231] 64 dollars per share time 90 companies times 100 shares equals 576,000 dollars.

[232] 36 dollars per share times 90 companies times 100 shares equals 324,000 dollars.

[233] It is not contended that this purpose was any more a conscious one of the states than it was for Congress. Moreover, if the deterrent effect of the state statutes is significantly greater than that of the Williams Act, the argument admittedly fails. While it seems unlikely that the additional deterrent effect will be substantial, the question will be an open one until empirical data can be collected. At any rate, the argument does not apply to the Ohio statute at all. That bill does not force offerors to offer a higher premium, since it contains no additional disclosure requirements or any price provisions. Further, it seems unlikely that a higher premium would be required to persuade shareholders to vote for the offer than to persuade them to tender. Rather, the Ohio statute will simply deter offers, without causing any additional reallocation to target shareholders. Therefore, unlike the other statutes, the Ohio Act's ultimate effect is philosophically incompatible with the Williams Act and it is thus preempted by the Act.

[234] This argument, of course, ignores the effects of reallocation on offeror shareholders. Easterbrook and Jarrell object to this, arguing that "shareholders of bidders and the shareholders of offerors are, or can easily be, the same people." Advisory Report, supra note 158, at 79. However, this point does not defeat the argument. Offeror shareholders are unlikely to get the full gains realized by the offeror. Transaction and agency costs, coupled with retaining of earnings by the corporation, will significantly reduce the offeror shareholders' gains. Thus, Congress may have decided that investors would be most benefited by a regime that favored target shareholders.

[235] See, e.g., Cary, Federalism and Corporate Law, 83 YALE L.J. 663 (1974); Comment, Law for Sale, 117 U. PA. L. REV. 861 (1969).

SEC Advisory Committee Report.[236] The Committee, while agreeing that some regulation was "desirable,"[237] took a confusing position on state regulation. On the one hand, the Committee believed that "[s] tate regulation of takeovers should be confined to local companies."[238] On the other hand, the Committee felt that, "[e]xcept to the extent necessary to eliminate abuses or interference with the intended functioning of federal takeover regulation, federal takeover regulation should not preempt or override state corporation law."[239] As the Committee summarized:

> A principal issue defined by the Committee is the extent to which federal regulation should intrude into [state corporate law]. Resolution of the issue requires a balancing of two competing interests: minimal preemption of traditional state corporate law and maintenance of the integrity of the national securities market in which tender offers take place. As to the first interest, the Committee concludes as follows:
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> > The Committee supports a system of state corporation laws and the business judgment rule. No reform should undermine that system . . . .
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> While the Committee supports a system of state corporation law, however, it concluded that provisions generally restricting the transfer of control of an issuer, whether contained in state statutes or included in an issuer's charter or by-laws, improperly interfere with the conduct of takeovers in the national market place. Courts have invalidated state tender offer statutes that interfere with the bidder's conduct of a tender offer under federal rules and burden tender offers in interstate commerce. Newly developed state statutes which, through regulation of target companies, have substantially similar effects on the ability to conduct a tender offer should not be permitted regardless of the form in which they are drafted. This category would include not only provisions incorporated into state corporation law but also broad policy enactments such as environmental quality legislation. Similarly, the Committee does not believe a company should be permitted to adopt charter or by-law provisions that erect high barriers to change of control and accomplish the very results that the Committee recommends be prohibited under state statutes. Based on these conclusions, the Committee recommends

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[236] See supra note 158.

[237] Id. at 17. But see separate statement by Easterbrook and Jarrell, id. at 70-107.

[238] Id. at 17. Although it left the definition of local to the Commission, it suggested that a local company would have "more than 50% of the voting shares held within the state of incorporation, no listing on a national securities exchange, aggregate market value of voting stock . . . of $20 million or less, and annual trading volume of less than one million shares." Id.

[239] Id. at 18. They made an exception for state regulated industries, such as banking and insurance companies. Id. Easterbrook and Jarrell concurred in this view. Id. at 84.

as follows:

> State laws and regulations, regardless of their form, that restrict the ability of a company to make a tender offer should not be permitted because they constitute an undue burden on interstate commerce. Included in this category should be statutes that prohibit completion of a tender offer without target company shareholder approval and broad policy legislation written so as to impair the ability to transfer corporate control in a manner and time frame consistent with the federal tender offer process . . . .
>
> The Committee adopted as basic objectives of the regulation of corporate control acquisitions certain broad policies that should govern the interrelationship of federal securities laws and state securities and corporate law. First, the Committee agreed that the regulation of control acquisitions should recognize that the transactions take place in, and are frequently only possible because of, a national market in securities. Second, for this reason, state regulation of control acquisitions, whether under the auspices of state securities or state corporate law, should be confined to local companies. Third, except to the extent necessary to eliminate abuses or interference with its intended functioning, federal securities regulation of tender offers should not preempt or override state corporation law.[240]

In the current regulatory system, where traditional state corporate law governing mergers and appraisal rights directly affects at least two-tier offers,[241] federal law could not be the sole regulatory body without making severe inroads on state authority. The only way to make federal law the sole tender offer regulatory regime would be to suspend the application of much of state corporate law during the entire course of the tender offer. This would necessarily result in the federalization of appraisal rights, shareholder approval of mergers and director and shareholder fiduciary rights. But the Advisory Committee implicitly rejected such federalization.[242]

While Congress certainly has the power to declare complete federal occupation of the tender offer field, there are legitimate state interests which suggest that a better approach would be to find a balance whereby the dual regulatory systems could coexist. Whether they intended to do so or not, it is apparent that Maryland and Pennsylvania have found a regulatory scheme that can achieve such a balance.

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[240] Id. at 34-35, 55 (footnotes and captions omitted).

[241] See supra notes 206-12 and accompanying text.

[242] Advisory Report, supra note 158, at 32 ("nor should federal law provide for state law-type appraisal rights") and 43 (approving of state fiduciary duty regulation).

1. Legitimate state interests.--The courts and commentators have identified a number of state interests which may not properly be used to justify state takeover regulation. Among these are protection of local industry,[243] protection of non-resident shareholders[244] and regulation of foreign corporations.[245] On the other hand, regulation of the internal affairs of domestic corporations and the protection of local shareholders have generally been recognized as legitimate state interests in the tender offer field.[246]

The Maryland and Pennsylvania statutes have been narrowly tailored to achieve these legitimate state interests. They apply only to domestic corporations and become effective only after the offeror has become a shareholder of significant size. Further, they are directed at the fairness of transactions, an area historically left to the states.[247] Lastly, they are simply extensions of traditional state internal affairs regulation of appraisal rights and shareholder approval of mergers.[248]

2. Legitimate federal interests.--A number of federal interests in tender offer regulation may also be identified. Among these are protection of shareholders,[249] promotion of the national economy and protection of the market for corporate control,[250] and uniformity of regulation.[251] Under the pre-MITE state regimes, state statutes were non- uniform, and since their jurisdictional bases frequently took in non-domestic corporations, the state regimes often conflicted.[252] This conflict, coupled with the significant deterrent effect of the state laws, significantly impeded achievement of the federal interests. Therefore, the MITE decision placed necessary limits on state power in this field. The question is, how far should those limits extend?

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[243] Great Western, 577 F.2d at 1282 ("the purpose of preserving local industry cannot support the legislation"). Although preventing local protectionist legislation is a fundamental purpose of the Constitution, and indeed was one of the reasons of the demise of the Articles of Confederation, Justice Powell's opinion in MITE implies that he, at least, would not strike down a protectionist statute were that its only defect. See, MITE, 457 U.S. at 646-47 (Powell, J.). The potential protectionist effect of this type of legislation was recognized by one of the Pennsylvania bill's supporters, who admitted that while it "will probably have a chilling effect on adverse corporate takeovers . . . that is not necessarily a bad thing." Pa. Legis. J. Sen. 1431 (remarks of Senator Fumo). Despite this admittedly protectionist sentiment, the bill is still supported by legitimate state interests, such as regulation of domestic corporations.

[244] MITE, 457 U.S. at 644.

[245] Id. at 645-46.

[246] See supra notes 190-202 and accompanying text.

[247] See supra notes 156-62 and accompanying text.

[248] See supra notes 206-08 and accompanying text.

[249] MITE, 457 U.S. at 632-34.

[250] Cf. id. at 643.

[251] Great Western, 577 F.2d at 1284-85.

[252] Id.

3. Can a balance be struck?--Unless corporate law is to be completely federalized, some balance must be reached between state and federal power.[253] The most defensible line which can be drawn is that drawn by the Maryland or Pennsylvania statutes. This line most comports with the goals of tender offer regulation.

Modern tender offer jurisprudence entails a number of assumptions and goals. First, it assumes that tender offers are economically desirable since they provide a means for displacing inefficient incumbent management and for moving corporate assets to their highest valuing user. Therefore, a principle goal of tender offer regulation is to avoid excessive deterrence. Second, in what some see as a position contradicting the first, it assumes that investors need protection and seeks to provide that protection through disclosure and antifraud provisions. Third, it assumes that the initial offer is a matter between the shareholders and the offeror -- not an internal affair of the corporation, although this assumption is admittedly more controversial than the preceding ones. Last, it assumes that all shareholders should benefit equally from the transaction. This, like the third assumption, is also controversial.

From these assumptions the optimal regulatory regime may be derived. Such a regime would require sufficient disclosure to let target shareholders reach an "informed" decision and give them time to consider it. The disclosure, pro rata and withdrawal provisions of the Williams Act address this concern. Second, such a regime would try to be neutral as between management and offeror, so as to let the final decision be the shareholders'. Third, such a regime would be limited enough in scope so as not to excessively deter offers. Fourth, such a regime would insure that all shareholders receive a roughly equal premium for their shares. Last, the regime would seek to optimally balance the competing state and federal interests.

Such a regime would look much like the present one, with the Williams Act governing the initial offer and the procedural aspects of a second-step transaction, and the states governing the fairness of the second step for their domestic corporations. States generally should not regulate one-step tender offers or, in two-tier mergers, the initial offer. The Williams Act currently provides shareholders with adequate protections in that stage, and permissible state regulation would merely be redundant. Moreover, in the first step, state fairness regulation is irrelevant. Whether a price is fair in that step is purely a shareholder

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[253] As noted earlier, the general question of whether corporate law should be federalized is beyond the scope of this Article. It is the author's view that corporate law should not be completely "federalized." This Article assumes, arguendo, that that view would prevail in any serious legislative or judicial review of the issue. Cf. supra notes 192-94 and accomp anying text.

decision. As long as adequate disclosure is required, shareholders may decide whether the premium is "fair." Disclosure beyond that presently required by the Williams Act might excessively deter offers, and so state disclosure statutes correctly have been struck down.

In contrast, fairness regulation is entirely appropriate in the second step. There, the shareholder has fewer options and competing bids are significantly less likely. That fairness be a subject of state regulation is also appropriate. Such regulation is a logical extension of current state law.

Thus, the correct balance between state and federal regulation is struck by the "internal affairs" doctrine. State regulation of domestic companies, which is limited to the stage of the tender offer where the offeror has become a shareholder, entirely comports with the traditional state "internal affairs" power over the relationship between shareholders. Since such regulation does not prohibit one-step offers and merely increases the cost of two-step offers, the deterrent effect should be minimal. Therefore, such statutes should be upheld. Statutes, such as that of Ohio, which go beyond the traditional limits of the internal affairs rule to govern shareholder relations with a non-shareholder, should be struck down.

VI. Conclusion

This article has attempted to show that there is a valid and constitutionally permissible role for the states in tender offer regulation. The line separating valid from invalid state regulation admittedly carves out a fairly limited state role. However, the line drawn is one which provides for protection of legitimate state interests, while not permitting state regulation to exceed those interests. It further provides a fairly certain method of separating valid from invalid legislation. Until or unless Congress acts either to entirely federalize this area or to prohibit two-step offers, the Maryland and Pennsylvania statutes should be upheld.