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Constitutional Law - Indiana's Third Generation Takeover Statute - Constitutional - CTS Corp. v. Dynamics Corp. of America

Louis B. Lanoux

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CONSTITUTIONAL LAW – INDIANA'S THIRD GENERATION TAKEOVER STATUTE – CONSTITUTIONAL?

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

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I. INTRODUCTION

The popularity and increased frequency of occurrence of corporate takeovers in recent years has spurred a resurgence in state takeover legislation.[1] The federal courts since *Edgar v. MITE Corp. (MITE)*[2] in 1982, have routinely struck down state takeover laws, giving the SEC wide-ranging authority in takeover regulation.[3] In 1987 the United States Supreme Court in *CTS Corp. v. Dynamics Corp. of America (Dynamics)*[4] upheld an Indiana takeover statute designed to protect shareholders from the coercive effects of hostile takeovers.[5] Indiana's takeover statute provides that the offeror must disclose important information concerning the tender offer and its effects on the shareholder, and requires that the shareholders must vote collectively on whether or not the tendered shares

1. Pinto, *Takeover Statutes: The Dormant Commerce Clause and State Corporate Law*, 41 UNIV. MIAMI L. REV. 473, 474 (1987). *See generally* Aranow & Einhorn, *State Securities Regulation of Tender Offers*, 46 N.Y.U. L. REV. 767 (1971) (outlining the various state statutory responses to the tender offer phenomenon); Sargent, *On the Validity of State Takeover Regulation: State Responses to MITE and Kidwell*, 42 OHIO ST. L. J. 689, 690 n. 7 (1981); Note, *A Failed Experiment: State Takeover Regulation After Edgar v. MITE Corp.*, 1983 U. ILL. L. REV. 457, 457 n.4 (1983).

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

3. Warren, *Developments in State Takeover Regulation: MITE and Its Aftermath*, 40 BUS. LAW. 671, 686-94 (Feb. 1985).

4. 107 S. Ct. 1637 (1987).

5. *Id.*

will be sold with voting rights attached.[6] With this decision, the Court spawned a new wave of state takeover legislation.[7] This Note will focus primarily on the Court's decision in *Dynamics* and the judicial treatment of the most recent or "third-generation"[8] state takeover legislation instituted subsequent to *MITE* and will discuss whether the Court's decision in *Dynamics* comports with the Constitution.

II. FACTS

On March 10, 1986, Dynamics Corporation of America (Dynamics)[9] was the owner of 9.6% of the common stock of CTS Corporation (CTS), an Indiana corporation. On that date, Dynamics announced a tender offer[10] for another million shares in CTS.[11] This purchase would have raised Dynamic's ownership interest in CTS to 27.5%.[12] On March 27, 1986, the Board of Directors of CTS elected to be governed by the provisions of Indiana's newly adopted Indiana Business Corporation Law.[13] The Law included the Control Share Acquisitions Chapter

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

7. "Since *CTS*, nine states have enacted antitakeover laws - six following hostile takeover bids . . . bringing to 26 the number of States now having such legislation." Sontag, NAT'L L. J., Oct. 5, 1987, at 2.

8. "Third-generation" statutes have been described as those which allow the tender offer to take place, while severely limiting the offeror's right to vote or to transfer his shares. Pinto, *Takeover Statutes: The Dormant Commerce Clause and State Corporate Law*, 41 UNIV. MIAMI L. REV. 473, 474 (1987).

9. Dynamics Corporation of America is a New York corporation with its principal place of business in Connecticut. Jurisdictional Statement of Appellant CTS Corporation at 3, CTS Corp. v. Dynamics Corp. of America, 107 S. Ct. 1637 (1987) (No. 86-71).

10. No federal statute or regulation defines the term "tender offer," but a tender offer "has been conventionally understood to be a publicly made invitation addressed to all shareholders of a corporation to tender their shares for sale at a specified price." Note, *The Developing Meaning of "Tender Offer" Under The Securities Exchange Act of 1934*, 86 HARV. L. REV. 1250, 1251 (1973) (footnotes omitted).

11. Simultaneously, Dynamics filed suit in the United States District Court for the Northern District of Illinois, alleging that CTS had violated the federal security laws in a number of respects, none of which were deemed relevant by the Court in the instant case. CTS Corp. v. Dynamics Corp. of America, 107 S. Ct. 1637, 1642 (1987).

12. By seeking to raise its ownership interest to twenty-seven and one-half percent (27.5%), Dynamics would be acquiring "control shares," shares that, but for the Act, would bring its voting power in the corporation to or above any of three thresholds: twenty percent (20%), thirty-three and one-third percent (33 1/3%), or fifty percent (50%). IND. CODE § 23-1-42-1 (Supp. 1986). These thresholds are much higher than the 5% threshold acquisition that would bring a tender offer under the Williams Act. *See* Securities Exchange Act of 1934, §§ 13(d)(i), 14(d)(1,5-7)(e) as amended 15 U.S.C. § 78n(d)(1), 78n(d)(1,5-7),(e).

13. IND. CODE §§ 23-1-17-1 to -5 (Supp. 1986).

(Indiana Act)[14] which would apply to any "issuing public corporation"[15] incorporated in Indiana as of August 1, 1987, unless the corporation amended its articles of incorporation or bylaws to opt out of the Indiana Act.[16] Before that date, any Indiana corporation could opt into the Indiana Act by resolution of its board of directors.[17] By adopting the Indiana Act, CTS subjected the proposed acquisition of shares by Dynamics to statutory requirements which effectively "condition[ed] acquisition of control of [the] corporation on approval [by] a majority of the pre-existing disinterested[18] shareholders."[19]

Dynamics responded to CTS's tender offer on March 31, 1986 by filing a motion for leave to amend its earlier complaint[20] in order to allege that the Indiana Act was preempted by the Williams Act[21] and violated the commerce clause.[22] Dynamics sought a temporary restraining order, a preliminary injunction, and declaratory relief against CTS's use of the Indiana Act.[23] On April 9, 1986, the

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14. IND. CODE §§ 23-1-42-1 to -11 (Supp. 1986). The Indiana Act provides that a stock acquisition of "control shares" which would bring the acquiring entity's voting power to or above certain threshold levels would not be accompanied by voting rights unless such rights were approved by a majority vote of all pre-existing disinterested shareholders at a regularly scheduled meeting or a special meeting held within fifty days if the acquiror follows procedures specified in the Indiana Act. *Id.* §§ 23-1-42-7 to -9. The term "disinterested shareholder" is not defined in the statute; however, "interested shares" are the shares of an issuing public corporation with respect to which any of the following persons may exercise or direct the voting power of the corporation in the election of directors:

> (1) An acquiring person or member of a group with respect to a control share acquisition.
> (2) Any officer of the issuing public corporation.
> (3) Any employee of the issuing public corporation who is also a director for the corporation.

IND. CODE § 23-1-42-3 (Supp. 1986).

15. An "issuing public corporation" is defined in the Indiana Act as

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

IND. CODE § 23-1-42-4(a) (Supp. 1986).

16. IND. CODE § 23-1-42-5 (Supp. 1986).

17. IND. CODE § 23-1-17-3(b) (Supp. 1986).

18. *See supra* note 14.

19. CTS Corp. v. Dynamics Corp. of America, 107 S.Ct. 1637, 1641 (1987). Under the Indiana Act "[t]he shareholders decide whether to confer [voting] rights upon the control shares at the next regularly scheduled meeting of the shareholders, or at a specially scheduled meeting. The acquiror can require management of the corporation to hold such a special meeting within fifty days if it: (1) files an "acquiring person statement" - a document describing, *inter alia*, the identity of the acquiror and the terms of the proposed acquisition, (2) requests the meeting and, (3) agrees to pay expenses of the meeting. *See* IND. CODE § 23-1-42-7 (Supp. 1986).

20. *See supra* note 11 and accompanying text.

21. 15 U.S.C. § 78m (d)(e) and 78n (d)-(f) (1982 ed. and Supp. III).

22. U.S. CONST. art. I, § 8, cl. 3.

23. 637 F. Supp. 389 (N.D. Ill. 1986).

district court ruled that the Williams Act preempted the Indiana Act and granted Dynamic's motion for declaratory relief.[24] A week later,[25] on April 17, 1986, the district court issued an opinion accepting Dynamic's claim that the Act violated the commerce clause.[26] The district court certified its decision for immediate appeal on the Williams Act and commerce clause claims[27] and CTS appealed on both claims to the United States Court of Appeals for the Seventh Circuit.[28] The Court of Appeals held that the Williams Act did preempt the new Indiana Act and on April 23, 1986, affirmed the decision of the district court.[29] The court also addressed Dynamic's allegation that the Indiana Act conflicted with the commerce clause. Applying the balancing test of *Pike v. Bruce Church, Inc.*,[30] the court found the Act unconstitutional, holding that "[u]nlike a state's blue sky law the Indiana statute is calculated to impede transactions between residents of other states."[31] Finally, the court addressed the "internal affairs" doctrine[32] and held that "the Indiana Act's regulation by 'jiggering' with voting rights did not remove the procedure from the scope of judicial review."[33] The United States Supreme Court noted probable jurisdiction[34] and reversed the Court of Appeals.[35] Speaking through Justice Powell, the Court held that the Indiana Act did not

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24. *Id.* Relying on Justice White's plurality opinion in Edgar v. MITE Corp., 457 U.S. 624 (1982), the district court concluded that the Act "wholly frustrates the purpose and objective of congress in striking a balance between the investor, management, and the takeover bidder in takeover contests." *Id.* at 399. The district court's discussion was limited to the preemption challenge because the Indiana Attorney General had not been properly certified pursuant to 28 U.S.C. § 2403(b) and had not sought to intervene or submit a statement of position. *Id.* at 400.

25. CTS had moved to certify the April 9, 1986 opinion for immediate appeal under Fed. R. Civ. P. 54(b). The District Court, fearing that the Court of Appeals would remand for resolution of the commerce clause issue, left unsettled by the April 9 opinion, decided to rule on the alternative commerce clause grounds despite the state's failure to intervene. *Id.*

26. That holding rested on the court's conclusion that "the substantial interference with interstate commerce created by the [Indiana Act] outweigh[ed] the articulated local benefits so as to create an impermissible indirect burden on interstate commerce." *Id.* at 406.

27. Dynamics Corp. of America v. CTS Corp., 637 F. Supp. 389 (1986).

28. The Court of Appeals consolidated and expedited the two appeals because CTS's annual shareholder's meeting was imminent. *CTS Corp. v. Dynamics*, 107 S. Ct. at 1643.

29. Dynamics Corp. of America v. CTS Corp., 794 F.2d 250 (7th Cir. 1986). On the claim that the Williams Act preempted the Indiana Act the court adopted the analysis of the plurality in *MITE* and stated that "very few tender offers could run the gauntlet that Indiana has set up. In any event, if the Williams Act is to be taken as a congressional determination that a month (roughly) is enough time to force a tender offer to be kept open, 50 days is too much; and 50 days is the minimum under the Indiana Act if the target corporation so chooses." *Id.* at 263.

30. 397 U.S. 137 (1970). Under *Pike*, a state statute affecting interstate commerce is valid "[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." *Id.* at 142, citing Huron Portland Cement Co. v. Detroit, 362 U.S. 440, 443 (1960).

31. *Dynamics*, 794 F.2d at 264.

32. The "internal affairs" doctrine refers to a "principle of conflict of laws designed to make sure that the law of only one state shall govern the affairs of a corporation or other association." *Id.* For a good discussion of the "internal affairs" doctrine in regard to state takeover legislation, *see* Pinto, *supra* note 1, at 489-92.

33. *Id.*

34. CTS Corp. v. Dynamics Corp. of America, 107 S. Ct. 258 (1986).

35. *Dynamics*, 107 S. Ct. at 1644.

conflict with the provisions or purposes of the Williams Act, was not preempted by it,[36] and did not offend the commerce clause.[37]

III. Background and History

Cash tender offers involving companies with securities listed on national securities exchanges rose from only eight in 1960, to one-hundred seven in 1967.[38] This remarkable rise in the incidence of cash tender offers has been attributed to a combination of economic, tactical and psychological factors prevalent in the marketplace during that period.[39] Generally, the tender offer is a "less complicated and less time-consuming" method of corporate takeover than are proxy contests.[40] Cash offers for controlling amounts of stock were exempt from the type of federal disclosure requirements applicable to takeover attempts initiated through proxy contests[41] or public exchange offers,[42] and cash tender offers allowed for both secrecy and surprise in a takeover attempt.[43]

Investors, however, were increasingly placed in circumstances which required them to make quick and perhaps ill-informed decisions on the retention or sale of their shares.[44] Proponents of takeover control legislation on both the state and federal levels argued that shareholders were entitled to relevant information which would allow them to make informed decisions, because a shift in corporate control resulting from the acquisition of controlling amounts of stock produces virtually a new company and is arguably a "forced exchange"[45] for what is essentially a new security.[46]

The original proposal for federal regulation of cash tender offers, the Williams bill,[47] was introduced for the ostensible purpose of protecting incumbent

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36. *Id.* at 1648. The Court held 1) that the possibility that the Indiana Act would delay some tender offers was insufficient to declare it preempted by the Williams Act, and 2) that the Indiana Act was consistent with the text and purposes of the Williams Act. *Id.*

37. *Id.* "Because nothing in the Indiana Act imposes a greater burden on out-of-state offerors than it does on similarly situated Indiana offerors, we reject the contention that the Act discriminates against interstate commerce." *Id.* at 1649, (Powell, J.).

38. 113 Cong. Rec. 855 (Jan. 18, 1967) (Remarks of Senator Williams).

39. For a listing of several factors which may have spurred this growth, *see* Aranow & Einhorn, Tender Offers for Corporate Control 65-66 (1973).

40. Clark, Corporate Law 546 (1986). A "proxy contest" is a dispute between groups attempting to gain or retain control of the board of directors of a company by using the proxy device to gather sufficient voting support. 5 W. Fletcher, Cyclopedia of the Law of Private Corporations § 25052.2 (rev. perm. ed. 1987).

41. Securities Exchange Act of 1934, § 14, 15 U.S.C. § 78n (1970).

42. A "public exchange" offer is a technique by which an aggressor corporation seeks to obtain control over a target corporation by offering to exchange a package of its securities for the target corporation's voting shares. Hamilton, Corporations 450 (2d ed. 1987).

43. Clark, Corporate Law 546 (1986).

44. *Id.* at 547.

45. *Id.* By "forced exchange" Clark apparently refers to the fact that the individual investors have no control in such a stock transfer.

46. *Id.*

47. 111 Cong. Rec. 28256-60 (Oct. 22, 1965).

management from "industrial sabotage" resulting from what were deemed reckless corporate raids on "proud old companies."[48] Such regulation, cited as "unique in that it represented perhaps the first attempt to enact securities regulation designed primarily for the benefit of the issuer rather than the investor," was inspired by the "conglomerate merger mania" of the early and mid 1960's.[49]

No Congressional hearings were held on the original Williams bill, but a second bill introduced by Senator Williams in 1967 included many of the original bill's proposals.[50] Senator Williams remarked that the essential problem in the transfer of control through cash tender offers was that the purchasers were able to operate in almost complete secrecy, and that this was inconsistent with the disclosure pattern generally prevailing in American securities markets because the competence and integrity of management and controlling persons is of vital importance to stockholders.[51]

The new Williams bill was offered to provide investors confronted with a tender offer with full disclosure of the terms, conditions and financing of the offer, as well as the identity and background of the person, or group, making the tender offer.[52] The Senate hearings on the Williams bill reflect the debate over whether tender offers might promote the best interests of society by providing an effective method of removing "entrenched but inefficient management," or whether tender offers were disguised forms of "industrial sabotage" by "corporate raiders" and "takeover pirates."[53]

Congress apparently adopted the view that investors faced with takeover bids were no less entitled to an opportunity to make an informed decision than investors facing a proxy contest or exchange offer, for in 1968 it passed the Williams Act[54] as an amendment to the Securities Exchange Act of 1934.[55] The Williams Act added sections 13(d)-(e) and 14(d)-(e) of the current 1934 Exchange Act.[56] Designed under what has been referred to as a "market approach,"[57] the Williams Act protects investors by favoring neither management nor the takeover

48. *Id.* (Remarks of Senator Williams on S. 2731).

49. Aranow & Einhorn *supra* note 39, at 64.

50. 113 CONG. REC. 854-56 (1967) (Remarks of Senator Williams on S. 510).

51. *Id.* at 855.

52. *Id.*

53. *See* 113 CONG. REC. 854, 857 (1967) (Remarks by Senator Kuchel on S. 510); *See also* 113 CONG. REC. 24662-66 (1967).

54. Act of July 29, 1968, Pub. L. No. 90-439, 82 Stat. 954 (codified as amended at 15 U.S.C. § 78m(d)-(e), § 78 n(d)(f) (1982)).

55. 15 U.S.C. §§ 78a-78kk (1982).

56. The added sections deal with both acquisitions of control shares through market purchases and acquisitions through tender offers, placing similar disclosure requirements on the two types of acquisitions.

57. The "market approach" contemplates a regulatory regimen that, through full disclosure, enables the investor to determine the merits of a takeover bid. H.R. REP. No. 1711 90th Cong., 2d Sess. 4, reprinted in 1968 U.S. CODE CONG. & ADMIN. NEWS 2811, 2812. *See also* Great W. United Corp. v. Kidwell, 577 F.2d 1256, 1276 (5th Cir. 1978), *rev'd on other grounds sub nom.*, Leroy v. Great W. United Corp., 443 U.S. 173 (1979) (The Williams bill "is designed to make the relevant facts known so that shareholders have a fair opportunity to make their decision." *Id.*).

bidder[58] in what has been described as a policy of "evenhandedness."[59] In the final analysis, "the Williams Act sought to place tender offers under regulations designed to give investors the same protections that are accorded investors facing proxy contests or exchange offers,"[60] but was "not intended to either encourage or discourage tender offers."[61]

A. State Takeover Regulation

In passing the Williams Act, Congress did not explicitly prohibit the states from regulating takeovers.[62] Consequently, a number of states,[63] "[a]cting pursuant to their police power[64] and under the protection afforded by the savings clause of the Securities Exchange Act of 1934 which permits concurrent regulation,[65] enacted a wide variety of takeover laws that differed significantly from the federal scheme."[66] Generally, these "first-generation" state statutes were "the result of lobbying by management interests who feared that their companies might become takeover targets, and so were designed to make hostile takeovers quite difficult," chiefly by delaying proceedings of the offeror.[67] The need to give share-

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58. Edgar v. MITE Corp., 457 U.S. 624, 633 (1982); *see* 113 CONG. REC. 24664 (1967) (Remarks of Senator Williams: "We have taken extreme care to avoid tipping the scales either in favor of management or in favor of the person making the takeover bids." *Id.*).

59. Edgar v. MITE Corp., 457 U.S. at 633; Piper v. Chris-Craft Industries, Inc., 430 U.S. 1, 31 (1977).

60. H. R. REP. No. 1711, 90th Cong., 2d Sess. 4, reprinted in 1968 U.S. CODE CONG. & ADMIN. NEWS 2811, 2812.

61. *Id.* at 2813.

62. Edgar v. MITE, 457 U.S. at 631. *See also* Note, *Securities Law and the Constitution: State Tender Offer Statutes Reconsidered,* 88 YALE L. J. 510, 519 (1979) (The congressional record reveals no intent by Congress to preempt state regulation of tender offers through the Williams Act. *Id.*). *See generally* Wilner and Landry, *The Tender Trap: State Takeover Statutes and Their Constitutionality,* 45 FORDHAM L. REV. 1 (1976) (Congress has not expressly forbidden the states to regulate tender offers.).

63. In the ten year period following passage of the Williams Act, 37 states enacted statutes regulating tender offers. For a list, *See* Note, *A Failed Experiment: State Takeover Regulation After Edgar v. MITE Corp.*, 1983 UNIV. ILL. L. REV. 457, 457 n.4 (1987).

64. U.S. Const. amend. X. *See* Hall v. Geiger-Jones Co., 242 U.S. 539 (1917) (Prevention of fraud in the purchase and sale of securities recognized as valid exercise of state police power). *See also* Edgar v. MITE Corp., 457 U.S. 624 (1982) ("protecting local investors is plainly a legitimate state objective" *Id.* at 644.).

65. 15 U.S.C. §78bb(a) (1934). Nothing in the 1934 Act will affect the jurisdiction of state securities commissions "insofar as it does not conflict with the provisions of this chapter or the rules and regulations thereunder." *Id. See* Leroy v. Great W. United Corp., 443 U.S. 173, 182 n. 13. (The provision "was plainly intended to protect rather than limit state authority." *Id.*). *See also* Wilner and Landry, *supra* note 62.

66. The neutral stance adopted by the Congress in the Williams Act was not reflected by the states, which tended to take a more "paternalistic" approach in protecting in-state investors and businesses subjected to takeovers. Warren, *Developments in State Takeover Regulation: MITE and Its Aftermath,* 40 BUS. LAW. 671, 674 (1985). Many states adhered to the philosophy embodied in their blue sky laws. *See generally* Goodkind, *Blue Sky Law: Is There Merit in the Merit Requirements?,* 1976 WIS. L. REV. 79 (1976) (State blue sky laws were typically enacted for the purpose of providing investor protection through a combination of antifraud, licensing, and registration procedures. *Id.* at 123.).

67. Clark, CORPORATE LAW 568 (1986). *See also* Langevoort, *The Supreme Court and the Politics of Corporate Takeovers: A Comment on CTS Corp. v. Dynamics Corp. of America,* 101 HARV. L. REV. 96 (1987) (Indiana's takeover legislation described as special interest legislation designed to benefit local managers and the local economy).

holders greater protection than they received under federal law and the exercise of state police power in order to protect citizens from fraud and coercion were invoked as justifications.[68] The statutes generally required more extensive disclosures than those required at the federal level,[69] or required that disclosures be made prior to commencement of an offer rather than concurrently, as specified in the Williams Act.[70] Some statutes gave a state official the authority to call an administrative hearing to assess the adequacy of the information disclosed to the target company investors, and in some instances the official also had the power to pass upon the substantive "fairness" of the offer.[71] Concurrent state and federal regulation in the area made conflicts inevitable and tender offerors frequently challenged the validity of the statutes. In nearly every case the lower federal courts found such state takeover statutes unconstitutional.[72]

In 1982, the United States Supreme Court affirmed[73] the Seventh Circuit decision in *Edgar v. Mite Corp. (MITE).*[74] The *MITE* Court, in a plurality decision,[75] held that the Illinois Business Takeover Act[76] impermissibly burdened interstate commerce, thereby violating the commerce clause of the United States Constitution.[77] The Illinois Act was typical of many of what have been termed "first-generation" statutes. It required that any tender offer for the shares of a target company be registered with the Illinois Secretary of State.[78] In addition, the statute imposed a twenty-day precommencement waiting period,[79] during which time state officials could initiate hearings to determine the substantive fairness of the offer.[80] The statute was applicable to any corporation of which Illinois shareholders owned ten percent of the equity securities subject to the tender offer, as well as to any corporation satisfying any two of the following

68. Clark, CORPORATE LAW 569 (1986).

69. *See, e.g.*, GA. CODE ANN. § 22-1902(b) (1977 & Supp. 1982), ME. REV. STAT. ANN. tit. 13, § 803(2) (1981 & Supp. 1983-1984), PA. STAT. ANN. tit. 70 § 75 (Purdon Supp. 1983-1984).

70. *See, e.g.*, IDAHO CODE § 30-1503(1) (1980 & Supp. 1983), MICH. COMP. LAWS ANN. § 451.905(2) (West Supp. 1983-1984).

71. *See, e.g.*, ME. REV. STAT. ANN. tit. 13, § 803(1) (1981) (repealed 1985).

72. Note, *The Constitutionality of Second Generation Takeover Statutes*, 73 VA. L. REV. 203, 207 (1986) citing

> "Kennecott Corp. v. Smith, 637 F.2d 181 (3d Cir. 1980) (preliminary injunction upheld on ground that the New Jersey takeover statute was likely to be preempted); Great W. United Corp. v. Kidwell, 577 F.2d 1256 (5th Cir. 1978) (Idaho statute unconstitutional on commerce clause and preemption grounds), *rev'd on other grounds sub nom.*, Leroy v. Great W. United Corp., 443 U.S. 173 (1979); Natiomas Co. v. Bryan, 512 F. Supp. 191 (D. Nev. 1981) (Nevada statute unconstitutional on commerce clause and preemption grounds); Crane Company v. Lam, 509 F. Supp. 782 (E.D. Pa. 1981) (Pennsylvania statute unconstitutional on commerce clause and preemption grounds)."

Id. at n. 27.

73. MITE v. Dixon, 633 F.2d 486 (7th Cir. 1980), *aff'd sub nom.*, Edgar v. MITE Corp., 457 U.S. 624 (1982).

74. 457 U.S. 624 (1982).

75. *Id.* (4-3 vote).

76. ILL. REV. STAT. ch. 121 1/2, para. 137.51 to 137.52-9 (1979), (repealed 1983).

77. U.S. CONST. art. I, § 8, cl. 3.

78. ILL. ANN. STAT. ch. 121 1/2, para. 137.54.A (Smith-Hurd 1979).

79. *Id.* para. 137.54.E.

80. ILL. ANN. STAT. ch. 121 1/2, para. 137.57.E (Smith-Hurd 1979). It was this aspect of the statute which the Court found to have the most substantial negative impact upon interstate commerce in that the Commissioner could terminate the offer on his own initiative. 457 U.S. at 626-27.

criteria: a corporation with its principle executive offices in Illinois, a corporation organized under the laws of Illinois, or a corporation with at least ten percent of its stated capital and paid-in surplus represented within the state.[81] The Illinois Act was challenged by a tender offeror on grounds that it was preempted by the Williams Act and unconstitutionally burdened interstate commerce. The majority in *MITE* agreed that the Illinois statute was excessively burdensome when balanced against the state's asserted interests in protecting resident shareholders from fraudulent and inequitable tender offers, and in regulating internal affairs of domestic corporations.[82] In the Court's view, these interests were significantly outweighed by the effect on both nonresident shareholders and foreign corporations.[83] The Court held that the protection afforded to resident shareholders was primarily "speculative" and that any benefits to the shareholders were outweighed by the likelihood that a target company's management would use the delay period to develop tactics to defeat the tender offer.[84]

The state's asserted interest in regulating the internal affairs of domestic corporations was also rejected.[85] The Court, pointing to the fact that the Illinois statute applied to corporations not incorporated in or having their principal place of business in Illinois, and the fact that tender offers involve shareholder sales of stock to third parties and are not included in the internal affairs doctrine anyway, concluded that the burdens on interstate commerce imposed by the Illinois Business Takeover Act outweighed the state's interest in regulating tender offers.[86] A majority decision was never reached on the preemption issue. Justice White, with whom Chief Justice Burger and Justice Blackmun concurred, reasoned that the Illinois provisions for precommencement notice, hearings with no deadlines, and adjudication of the tender offer's substantive fairness frustrated the objectives of the Williams Act.[87] Justice White considered the possibility of extended delays under the Illinois scheme to be "outweighed by the increased risk that the tender offer will fail due to defensive tactics employed by incumbent management."[88] Justice Stevens concurred in the judgment,[89] but disagreed with Justice White's view that a state, by providing special protection for incumbent management, was in conflict with the federal statute and declined to join the Court in its preemption holding.[90]

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81. ILL. STAT ANN. ch. 121 1/2, para. 137.52-10(2) (Smith-Hurd 1979).
82. 457 U.S. at 644.
83. *Id.*
84. *Id.* at 645.
85. *Id.*
86. *Id.* at 646.
87. *Id.*
88. *Id.* at 645.
89. *Id.* at 647.
90. *Id.* at 655.

B. "Second Generation" State Takeover Legislation

State takeover legislation was struck a harsh blow by *MITE*, but the commerce clause reasoning in *MITE* apparently left "some room for state regulation of tender offers."[91] It was believed by some that the preemption question was still open, and that the commerce clause holding of *MITE* could be distinguished with respect to statutes of narrower scope.[92] In response to *MITE*, several states enacted new types of takeover legislation formulated so as not to create the "indirect burden" upon interstate commerce which led to the demise of the Illinois Act in *MITE*.[93]

These so-called "second generation" statutes were aimed not at directly conditioning or restraining the tender offer or the consequent tender of shares, but rather at regulating the takeover process through manipulation of the internal affairs of corporations organized under the laws of the state.[94] Typically, these statutes were applicable to corporations incorporated within the state, having a certain percentage of in-state shareholders, and having the corporation's principal executive offices or significant assets located within the state. Further, many of the statutes included an opting-out or opting-in provision which would permit a corporation to elect whether or not it was to be regulated by the statute.[95]

Several different statutory models were devised and implemented in an effort to regulate within the narrowed commerce clause limits. Though most of these second generation statutes have been held unconstitutional, the litigation concerning them has certainly compressed the scope of state tender offer regulation.[96]

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91. *Id.* at 646. (Powell, J., concurring opinion).

92. L. Loss, Fundamentals of Securities Regulation 603 (1983).

93. *See, e.g.*, Md. Corps. & Ass'ns Code Ann. §§ 1-102 (a), 3-601 to -603 (1985 & Supp. 1986); N. Y. Bus. Corp. Law §912 (a)(13) (McKinney 1986); Ohio Rev. Code Ann. §1701.01 (Y) (Anderson 1985); Pa. Stat. Ann. tit. 15, §§ 1004, 1910 (Purdon Supp. 1986). Some states enacted statutes requiring that the target corporation have a specified number of resident shareholders or a certain value of assets maintained in the state. *See, e.g.*, Ohio Rev. Code Ann. § 1701.01 (Y) (Anderson 1985) (requiring that a corporation have fifty shareholders and that the corporation's principal place of business, principal executive offices, or substantial assets be located in Ohio). Some states merely modified their pre-*MITE* statutes by making them applicable only to target shareholders who reside in the state. *See, e.g.*, Minn. Stat. Ann. § 80B (West 1986). "The constitutionality of these modified first generation statutes remains unsettled. *Compare* Cardiff Acquisitions, Inc. v. Hatch, 751 F.2d 906 (8th Cir. 1984)(upholding Minnesota's modified statute) *with* Martin-Marietta Corp. v. Bendix Corp. 690 F.2d 558 (6th Cir. 1982) (invalidating Michigan's statute on commerce clause grounds, although the statute had been construed to apply only to resident shareholders)." Note, *supra* note 72, at 208, n.32.

94. For a good discussion of the characteristic features of the various models enacted, *see generally* Sargent, *Do the Second Generation State Takeover Statutes Violate the Commerce Clause?* 5 Corp. L. Rev. 3 (1984), Pinto, *supra* note 8, at 478-83. Note, *The Constitutionality of Second Generation Takeover Statutes*, 73 Va. L. Rev. 203 (1986).

95. *See, e.g.*, Ind. Code § 23-1-17-3(b) (Supp. 1986).

96. *See* Mesa Petroleum Company v. Cities Serv. Co., 715 F. 2d 1425 (10th Cir. 1983) (Oklahoma statute violated commerce clause); Telvest Inc. v. Bradshaw, 697 F.2d 576 (4th Cir. 1983) (Virginia statute violated commerce clause), Martin-Marietta Corp. v. Bendix Corp., 690 F.2d 558 (6th Cir. 1982) (Michigan takeover statute limited to resident shareholders violates the commerce clause); National City Lines, Inc. v. LLC Corp., 687 F.2d 1122 (8th Cir. 1982) (Missouri takeover statute violates both commerce and supremacy clauses).

C. "Third Generation" State Takeover Legislation

Two of the "second generation" statutory models may be singled out from the others in that they permit the tender offer to take place without interference, but inhibit the offeror from exercising corporate control by restricting its rights to vote its newly acquired shares. These models, referred to by one commentator as the "voting rights model" and the "business combination model" represent a "third-generation" of state takeover legislation.[97]

The "business combination model" does not directly affect an offeror's ability to acquire or vote its shares but restricts the ability of the acquiror as a newly designated shareholder to use the target's assets after control shares have been acquired. Approval from the corporation's directors is required before the acquiror may purchase more shares or before it may seek a business combination with the corporation.[98] Failure to receive the necessary director approval precludes future business combinations between the acquiror and the corporation for a specified period.[99]

Under the "voting rights model,"[100] acquirors who buy control shares, shares sufficient to provide the buyer with a certain amount of voting control in the corporation, may be denied voting rights unless they adhere to the statutory requirements. Typically, the statutes require that the disinterested shareholders meet and vote their approval in order for the offeror to have voting rights in his newly acquired shares.[101] Both the "voting rights" and the "business combination" models permit the tender offer to take place and thus do not present the direct interference of interstate commerce which frequently caused second-generation "shareholder approval" statutes to be struck down.[102]

Prior to the Supreme Court's decision in the instant case these "third-generation" statutes had seen little success in the courts. The validity of a statute restricting

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97. *See* Pinto, *supra* note 8, at 482; Note, *The Constitutionality of Second Generation Takeover Statutes*, 73 VA. L. REV. 203, 231-39 (1987).

98. Pinto *supra* note 8, at 482 n. 53.

99. *Id.*

100. *Id.*

101. IND. CODE §§ 23-1-42-1 to -11 (1986). The statute may also restrict the transferability of the shares and provide for redemption by the target corporation. *Id.* § 23-1-42-10. Wisconsin has a variation of this type wherein anyone acquiring in excess of twenty percent of the voting power shall be limited to ten percent of the voting power of those shares. WIS. STAT. § 180.28(9)(a) (1986).

102. Shareholder approval statutes typically require that the shareholders vote their approval of a tender offer before it may transpire. *See* Pinto, *supra* note 8, at 478-83. The courts, in most cases, have held takeover statutes which require shareholder approval in order for the transaction to take place to be unconstitutional. *See, e.g.*, APL Ltd. Partnership v. Van Dusen Air, Inc., 622 F. Supp. 1216 (D. Minn. 1985) (requiring approval by the affirmative vote of the holders of a majority of the voting power of all shares entitled to vote), Icahn v. Blunt, 612 F. Supp. 1400 (D. Mo.1985) (requiring a supermajority vote of shareholders before any shareholder could sell his shares to an offeror seeking control status), Terry v. Yamashita, 643 F. Supp.161 (D. Hawaii 1986) (requiring a majority shareholder approval), Fleet Aerospace Corp. v. Holderman, 637 F. Supp. 742 (S.D. Ohio 1986), *aff'd* 796 F.2d 135 (6th Cir. 1986) (requiring an affirmative vote of a majority of the voting power), Gelco Corp. v. Coniston Partners, 652 F. Supp. 829 (D. Minn. 1986) (requiring shareholder approval of certain tenders and not others).

the shareholder from exercising his voting rights in his shares was first considered in *APL Ltd. Partnership v. Van Dusen Air, Inc.*[103] in which Minnesota's Control Share Acquisition Act (MCSAA),[104] was struck down on commerce clause grounds. The court concluded that though the MCSAA differed considerably from the Illinois Act under consideration in *Edgar v. MITE Corp.*, the Minnesota statute suffered from many of the same constitutional infirmities.[105] The benefits were deemed speculative at best and were outweighed by the direct burden imposed on interstate commerce.[106] However, the Minnesota statute also contained, as penalties for failure to comply with the statute, the denial of voting and transfer rights for a year and possible redemption at the same price at which the shares were acquired.[107] The validity of these penalties was determined to be dependent on whether or not the internal affairs doctrine was controlling.[108] The court found that the internal affairs doctrine did not apply because the "[r]egulation of *shareholders* – and those who would become shareholders – is not the same thing as regulating the corporation itself."[109]

Van Dusen was consistent with *MITE* in that it was determined that the acquisition of shares does not implicate the internal affairs doctrine. However, the district court's language indicated that the use of shareholder's power once the shares have been acquired might well be a proper subject of state regulation.[110]

The "voting rights model" was considered by the Seventh Circuit in *Dynamics Corp. of America v. CTS Corp. (CTS).*[111] In *CTS*, Indiana's Control Share Acquisition Act[112] was found to be preempted by the Williams Act and was declared unconstitutional on interstate commerce grounds.[113] The Indiana Act required approval by a majority of disinterested shareholders before any newly acquired control shares could be voted by the purchaser of those shares.[114] Although the offeror was not precluded from acquiring shares, failure to receive shareholder approval would mean the denial of voting rights and the inability to effect corporate changes.[115] Applying the *Pike* balancing test, the court found the statute unconstitutional because it impeded takeovers and interfered with transactions between nonresident shareholders, with little or no benefit to Indiana or its resi-

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103. 622 F. Supp. 1216 (D. Minn. 1985).
104. MINN. LAWS Ch. 488 § 2 (1984).
105. Van Dusen, 622 F. Supp. at 1225.
106. *Id.* at 1225.
107. *Id.* at 1219.
108. *Id.* at 1223.
109. *Id.*
110. *Id.* at 1223-24.
111. 794 F.2d 250 (6th Cir. 1986), *prob. juris. noted*, CTS Corp. v. Dynamics Corp. of America, 107 S. Ct. 258 (1986), *rev'd* CTS Corp. v. Dynamics Corp. of America, 107 S. Ct. 1637 (1987).
112. IND. CODE. §§ 23-1-42-1 to -11 (Supp. 1986).
113. *CTS*, 794 F.2d at 250.
114. IND. CODE §§ 23-1-42-7 to -9. *See supra* note 14.
115. *Id.* Also, if the offeror failed to file an acquiring person's statement, the corporation could redeem the shares at "fair value." *Id.*

dents. The court recognized "that a state has broad latitude in regulating internal affairs even if the regulating complicates takeover efforts; but when a statute's effect on the interstate market in securities and corporate control is direct, intended, and substantial[,] it is not merely the incidental effect of a general regulation of internal corporate governance."[116]

IV. INSTANT CASE

This case presented the United States Supreme Court with two issues: whether the Control Share Acquisitions Chapter of the Indiana Business Corporation Law[117] was preempted by the Williams Act,[118] and whether it violated the commerce clause of the United States Constitution.[119]

The Court began the opinion by noting that without an explicit indication by Congress of an intent to preempt state law, a federal statute preempts a state statute only "where compliance with both federal and state regulations is a physical impossibility,"[120] or where the "[state] law stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress."[121] The Court reasoned: "[b]ecause it is entirely possible for entities to comply with both the Williams Act and the Indiana Act, the state statute can be preempted only if it frustrates the purpose of the federal law."[122]

The Court then proceeded to make a determination as to the intent and purpose of the Williams Act,[123] an Act passed in 1968 in response to the increasing number of hostile tender offers which were previously not regulated by the disclosure requirements of the federal securities laws.[124] Addressing its 1982 opinion in *MITE*,[125] in which an Illinois control share acquisition statute[126] was held unconstitutional as "frustrat[ing] the objectives of the Williams Act,"[127] the Court resolved that *MITE* did not control because the Indiana Act in the instant case "operate[d] to protect the independent shareholder against both of the contending parties" whereas the Illinois statute in *MITE* "operated to favor management

116. *CTS*, 794 F.2d at 264. (In *Fleet*, the court cited with approval the discussion of internal affairs in *CTS*, and the distinction between mergers and tender offers found in *Van Dusen*. *Fleet*, 637 F. Supp. at 761-63, *aff'd* 796 F.2d 135 (6th Cir. 1986) (*citing CTS*, 794 F.2d at 264; *Van Dusen*, 622 F. Supp. at 1223-24)).

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

118. 82 Stat. 454, as amended, 15 U.S.C. §§ 78m(d)(e) and 78n(d)-(f), (1982 ed. and Supp. III 1985).

119. U.S. CONST. art. I, § 8, cl. 3.

120. Ray v. Atlantic Richfield Co., 435 U.S. 151, 158 (1978).

121. Florida Lime & Avocado Growers, Inc. v. Paul, 373 U.S. 132, 142 (1963).

122. *Dynamics*, 107 S. Ct. at 1644.

123. *Id.*

124. *Id.* at 1644 (*citing* Piper v. Chris-Craft Industries, Inc., 430 U.S. 1, 22 (1977)) ("The proliferation of cash tender offers . . . removed a substantial number of corporate control contests from the reach of existing disclosure requirements of the federal securities laws.") *Id.*

125. 457 U.S. 624 (1982).

126. ILL. REV. STAT. ch. 121 1/2, para. 137.51 to 137.52-9 (1979) (repealed 1983).

127. *MITE*, 457 U.S. at 635.

against offerors, to the detriment of shareholders."[128] The Court held that the Indiana Act operates on the assumption, implicit in the Williams Act, that independent shareholders faced with tender offers are often at a disadvantage and that by allowing the shareholders to vote as a group the Act protects them from coercive aspects of some tender offers.[129] The Court found that the Indiana Act did not give either management or the offeror an advantage in communicating with the shareholders about the impending offer and did not impose an indefinite delay on tender offers as was possible under the Illinois Act in *MITE*. The Indiana Act did not allow the state government to interpose its views of fairness between willing buyers and sellers of shares of the target company but "allows *shareholders* to evaluate the fairness of the offer collectively."[130]

The Court rejected the reasoning of the Court of Appeals: (1) that no rational offeror would purchase shares until it gained assurance that those shares would carry voting rights; and (2) that the Act's fifty-day delay conflicted with the SEC's shorter twenty-business day minimum period for which a tender offer may be held open.[131] The Court held that "[t]he Act does not impose an absolute 50-day delay on tender offers, nor does it preclude an offeror from purchasing shares as soon as federal law permits."[132] Further, the Indiana Act provides "that full voting rights will be vested – if this eventually is to occur – within 50 days after the commencement of the offer."[133] Because the fifty-day period was within the sixty-day maximum period Congress established for tender offers in 15 U.S.C. § 78n(d)(5),[134] the Court was unwilling to characterize "a delay within that congressionally determined period [as] unreasonable."[135]

The Court noted that, if the Williams Act were construed to preempt any state statute which might limit or delay the free exercise of power after a successful tender offer, the Williams Act would preempt a variety of state corporate laws of "hitherto unquestioned validity."[136] The possibility that the Indiana Act would delay some tender offers was held to be insufficient to require a conclusion that the Williams Act preempted the Indiana Act.[137]

The Court also addressed whether the Act violated the commerce clause of the United States Constitution.[138] Dynamics alleged that the statute was impermissibly discriminatory under the Constitution because it would apply most often

128. *Dynamics*, 107 S. Ct. at 1645.
129. *Id.*
130. *Id.* at 1646 (original emphasis).
131. *Id.* at 1647.
132. *Id.* "The Williams Act permits tender offers to be conditioned on the offeror's subsequently obtaining regulatory approval." *Id.*
133. *Id.*
134. *Id.*
135. *Id.*
136. *Id.* at 1647.
137. *Id.* at 1648.
138. *Id.*

to out-of-state entities. Dynamics based this contention upon the premise that, as a practical matter, most hostile tender offers are launched by offerors outside of Indiana.[139] The Court rejected this argument "[b]ecause nothing in the Indiana Act impose[d] a greater burden on out-of-state offerors than it [did] on similarly situated Indiana offerors."[140] The Court stated that the Act did not adversely affect interstate commerce by "subjecting activities to inconsistent regulations"[141] and "[s]o long as each State regulates voting rights only in the corporations it has created, each corporation will be subject to the law of only one State."[142] Dynamics also argued that the state had "no legitimate interest in protecting the nonresident shareholder."[143] The Court flatly rejected this argument saying that Indiana has a substantial interest in preventing the corporate form from acting as a "shield for unfair business dealing."[144] The Court reasoned that because "the Indiana Act applies only to corporations that have a substantial number of shareholders in Indiana, every application of the Indiana Act will effect a substantial number of Indiana residents, whom Indiana indisputably has an interest in protecting."[145] Dynamic's argument that the Act was unconstitutional ultimately rested on the contention that the Act would limit the number of successful tender offers.[146] However, the Court noted that the "Act did not prohibit any entity – resident or nonresident – from offering to purchase, or from attempting thereby to gain control. It only provides regulatory procedures designed for the better protection of the corporation's shareholders."[147]

Justice Scalia, concurring only as to the preemption ruling, was of the opinion that the judiciary is ill-suited to determine "whether the burden on commerce imposed by a state statute is clearly excessive in relation to the putative local benefits," and should undertake to do so rarely, if at all.[148] Justice Scalia agreed with the Court that the Indiana Act was not preempted by the Williams Act.[149] His conclusion was based not on any declared purpose of the two statutes, but upon the anti-preemption provision of the Securities Exchange Act of 1934.[150] The 1934 Act provides that nothing it contains "shall affect the jurisdiction of the securities commission (or any agency or officer performing like functions) of any State over any security or any person insofar as it does not conflict with the provisions of this chapter or the rules and regulations thereun-

139. *Id.* at 1649.
140. *Id.*
141. *Id.*
142. *Id.*
143. *Id.* at 1651.
144. *Id.* at 1651-52.
145. *Id.* at 1652.
146. *Id.*
147. *Id.*
148. *Id.*
149. *Id.* at 1653.
150. *Id.; see also supra* note 65 and accompanying text.

der."[151] Justice Scalia agreed that "[u]nless it serve[d] no function, that language foreclose[d] pre-emption on the basis of conflicting 'purpose' as opposed to conflicting 'provision'."[152]

Justice White, joined by Justices Blackmun and Stevens (as to Part II of the opinion) dissented. Justice White argued that the Indiana Act "undermine[d] the policy of the Williams Act by effectively preventing minority shareholders, in some circumstances, from acting in their own best interests by selling their stock."[153] Justice White was of the opinion that the Indiana Act would "substantially burden the interstate market in corporate ownership," thereby directly inhibiting interstate commerce in conflict with the commerce clause.[154]

V. ANALYSIS

The Court was not bound by its plurality opinion in *MITE* because the Indiana Act was recognized as being fundamentally different in operation from the Illinois Act invalidated in *MITE*.[155] In light of *MITE*, Indiana's "third-generation" takeover statute was drafted more narrowly to avoid the constitutional pitfalls which invalidated the Illinois statute.[156] On its face, the Indiana Act appears to protect the independent shareholder in the spirit of the Williams Act, by 1) affording the shareholder information concerning the tender offer, 2) providing the shareholders the power to protect their interest in the corporation by blocking the transfer of voting rights on acquired "control shares" while, 3) permitting the tender offer to take place without imposing indefinite or unreasonable delays.[157] However, in operation, and contrary to the stated purposes of the Williams Act,[158] the Indiana Act will 1) effectively prevent some tender offers from taking place, 2) potentially impair the individual shareholder's freedom to sell his shares for profit in a takeover bid and 3) interfere with the operation of tender offers without sufficient justification.

A. *The Preemption Issue*

The *Dynamics* Court clearly recognized that because concurrent compliance

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151. *Dynamics*, 107 S. Ct. at 1653.
152. *Id.*
153. *Id.* at 1653-54.
154. *Id.*
155. *Id.* at 1645. First generation statutes such as the Illinois Act in *MITE* generally regulated the tender offer phase of the takeover. The statutes tended to be more restrictive than the Williams Act, placing significant restrictions and requirements on the tender offer itself, and generally permitted extensive intervention into the process by state officials. *See generally* Clark, CORPORATE LAW 546 (1986); *see supra* notes 63-71 and accompanying text.
156. *Dynamics*, 107 S. Ct. at 1644-46.
157. *Id.*
158. *See supra* notes 55-58 and accompanying text.

with both the Williams Act and the Indiana Act is possible, the Indiana Act would be preempted only if it frustrated the purposes of federal legislation.[159] Dynamics' argument that the Indiana Act impermissibly delays tender offers by its requirement of prior shareholder approval on the transfer of voting rights was found to be illusory.[160] Reasoning that "if Congress had intended to pre-empt all state laws that delay the acquisition of voting control following a tender offer, it would have said so explicitly," the Court held that "the possibility that the Indiana Act [would] delay some tender offers [was] insufficient to require a conclusion that the Williams Act pre-empt[ed] the [Indiana] Act."[161] The Court distinguished the possible delay under the Indiana Act from the potential of indefinite delay apparent in *MITE* and held that a delay within the congressionally determined period of sixty days[162] would not be unreasonable.[163]

The Court determined that the implementation of a "conditional tender offer"[164] could sufficiently protect an offeror who feared an adverse shareholder vote.[165] Dynamics argued that a conditional tender offer is not an adequate alternative because conditional offers leave current management in place for three extra weeks with "free rein to take other defensive steps that will diminish the value of the tendered shares."[166] The Court found this argument insufficient because by taking actions designed to diminish the value of the corporation's shares, management may incur liability under state law.[167]

The Court reasoned that the possibility of delay which might result from the shareholder approval requirement was no more egregious than the inherent delays imposed by a variety of state laws of "hitherto unquestioned validity" such as corporate laws permitting corporations to stagger the terms of their direc-

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159. *Dynamics*, 107 S. Ct. at 1644.

160. *Id.* at 1647.

161. *Id.* at 1648.

162. 15 U.S.C. § 78n(d)(5) (1982 ed. and Supp. III).

163. *Dynamics*, 107 S. Ct. at 1638. In *MITE*, the Court concluded that the Illinois Act offered "investor protection at the expense of investor autonomy – an approach quite in conflict with that adopted by Congress." 457 U.S. at 640 (citing, MITE Corp. v. Dixon, 633 F.2d at 494). The *MITE* Court struck down the Illinois Act containing provisions for a hearing to review the tender offer because no deadline was established to limit the length of such a hearing and provisions requiring the Illinois Secretary of State to determine the substantive fairness of the offer and bar it at his discretion. *Id.*

164. In a conditional tender offer:

> all shareholders are invited to tender their shares . . . , the bidder may set an upper limit on the number of shares he will purchase. In addition, the bidder may condition the offer on the tendering of a minimum number of shares. Tendered shares are placed with a depository until the expiration of the offer period. At that time, if the conditions of the offer have been satisfied, the bidder will purchase the tendered shares according to the terms of the offer and the requirements of the regulatory scheme.

Note, *The Constitutionality of Second Generation Takeover Statutes*, 73 VA. L. REV. 203 n. 1 (1987).

165. *Dynamics*, 107 S. Ct. at 1647.

166. Brief for Appellee Dynamics Corp. of America at 37, CTS Corp. v. Dynamics Corp. of America, 107 S. Ct. 1637 (1987) (No. 86-71).

167. *Dynamics*, 107 S. Ct. at 1647.

tors.[168] The Court's determination that the Indiana Act was not preempted by the Williams Act clearly rested on the fact that any delay imposed by the Indiana Act was "consistent with the text and purpose of the Williams Act."[169] The Court, however, ignored the fact that a termination of a tender offer resulting from a failure of a majority of the target's shareholders to confer voting rights upon the control shares sought results directly in the loss of a sale by shareholders who have tendered their shares. Justice White, arguing in dissent, recognized this oversight and in recalling the earlier finding of the *MITE* plurality, stated: "Congress . . . did not want to deny shareholders 'the opportunities which result from the competitive bidding for a block of stock of a given company,' namely, the opportunity to sell shares for a premium over the market price."[170]

The *Dynamics* Court merely assumed that the collective vote provision would be beneficial to shareholders, and apparently relied on an SEC finding[171] that shareholders might be coerced into selling their shares early to avoid being forced to sell at a depressed price later.[172] The Court's apparent deference to the state legislature[173] and to the SEC report, with its conclusion that the shareholders might be coerced by "two-tier"[174] tender offers to sell early, is unfortunate. Although the Court's concern for the protection of the shareholder may be well founded, the Court, by focusing on the consistencies between the federal and state regulations, has overlooked the apparent conflicts. The Court appears to ascribe a motivating concern for the corporation's best interest, which may not exist, to the individual shareholder's decision to sell or keep his stock.[175] One shareholder faced with a tender offer may wish to sell his stock at a profit in complete disregard of the corporation's best interest. Another shareholder may wish to retain his stock in the belief that a takeover would be injurious to the corporation. The Court's holding is silent as to whether the Indiana Act conflicts with the stated purpose of the Williams Act in protecting the individual

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168. *Id.*

169. *Id.* at 1648.

170. *Id.* at 1654 (citing Edgar v. MITE, 457 U.S. 624, 633 n.9 (1982)) (remarks of Sen. Javits from 113 CONG. REC. 24666 (1967)).

171. Two-Tier Tender Offer Pricing and Non-Tender Offer Purchase Programs, Exchange Act Release No. 21,079 [1984 Transfer Binder] FED. SEC. L. REP. (CCH) para. 83,637 at 86,914 (June 21, 1984).

172. *Id.; see Dynamics*, 107 S. Ct. at 1651 ("the possibility of coercion in some takeover bids offers additional justification for Indiana's decision to promote the autonomy of independent shareholders").

173. *Dynamics*, 107 S. Ct. at 1651 ("We are not inclined to 'second-guess the experienced judgments of lawmakers concerning the utility of the legislation.' " Kassel v. Consolidated Freightways Corp., 450 U.S. 662, 679 (1981) (Brennan, J., concurring in judgment)).

174. A two-tier bid usually involves an acquisition that is accomplished in two steps. In the first step, the bidder uses a tender offer to buy, at a premium price and generally for cash, enough shares to establish a controlling position in the target. Once control is established, the offeror will take the second step in the acquisition, a merger of the target into the bidder or a subsidiary, thus freezing out minority shareholders with a forced acceptance of cash or securities valued at a lower price than the original tender offer. The second step merger generally is disclosed in the tender offer materials and usually involves securities of the bidder. Two-Tier Tender Offer Pricing and Non-Tender Offer Purchase Programs, *supra* note 170 at 86,914 n.1.

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

shareholder's right to decide whether to keep or to sell his stock. Although the Court stated that it was not bound by *MITE*, the opinion does not reject the *MITE* plurality's finding that Congress, in passing the Williams Act, intended that *investors* and the takeover offeror would be free to go forward without unreasonable delay[176] and that *investors* would be free to make their own decisions.[177] By upholding the statute, the Court has either equated the trading motives of the individual shareholder with the motives of the majority in a collective vote or has determined that the interest of the collective majority is superior to that of the individual investor. In either case, the Court has strayed from the articulated purpose of the Williams Act which was "to make the relevant facts known so that shareholders have a fair opportunity to make their decision"[178] and to protect "investor autonomy."[179]

State corporation laws typically permit shareholders to amend articles of incorporation or bylaws to include such collective approval provisions should the shareholders desire them. The Indiana Act makes a majority shareholder vote mandatory unless the shareholders vote to opt out of the Act.[180] In large corporations trading on the national exchange, and where the bulk of the voting control is in the hands of management through proxies, a majority shareholder vote to opt out is extremely unlikely to succeed unless management favors the takeover. Imposing such voting requirements by statute creates the potential for a controlling majority to effectively block tender offers by defeating the transfer of voting rights and to prevent the corporation from ever opting out of the Act as well.

Should a tender offer be voted down or fail due to the delay imposed by the requirement of a collective shareholder vote, the individual shareholder who desired to tender his shares would have lost the opportunity to sell his shares at a premium. The decision of "whether to buy or to sell [is] taken out of the hands of the shareholder and the purchaser and placed in the hands of management and the other shareholders."[181]

Further, the statute substantially encroaches upon the individual shareholder's

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176. *MITE*, 457 U.S. at 639.

177. *Id.* at 639-40 (quoting MITE Corp. v. Dixon, 633 F.2d at 494).

178. *MITE*, 457 U.S. at 639-40; *accord* MITE Corp. v. Dixon, 633 F.2d 486, 494 (7th Cir. 1980) (citing H.R. REP. No. 1711, 90th Cong., 2d Sess; Senate Report at 3).

179. MITE Corp. v. Dixon, 633 F.2d. 486, 494, *aff'd sub nom* Edgar v. MITE Corp., 457 U.S. 624 (1982). The Williams Act contemplates "unfettered choice by well informed visitors." *Id.* Investor protection under the Williams Act is aimed at the individual investor rather than shareholders of a corporation collectively. Great W. United Corp. v. Kidwell, 577 F.2d 1256 (5th Cir., 1978), *rev'd on other grounds sub nom,* Leroy v. Great W. United Corp., 443 U.S. 173 (1979).

180. IND. CODE § 23-1-42-5 (Supp. 1986).

181. Icahn v. Blunt, 612 F. Supp. 1400, 1420 (W.D. Mo. 1985) (statute requiring prior shareholder approval before sale could take place held unconstitutional). *See also* Terry v. Yamashita, 643 F. Supp. 161 (D. Hawaii 1986) (prior shareholder approval requirement unconstitutional), Fleet Aerospace Corp. v. Holderman, 637 F. Supp. 742 (S.D. Ohio 1986)(prior shareholder approval requirement unconstitutional), Gelco Corp. v. Coniston Partners, 652 F. Supp. 829 (D. Minn. 1986) (prior shareholder approval requirement unconstitutional).

right to sell his stock at a premium in instances where an offer is thwarted by the failure to obtain majority approval of the transfer of voting rights on control shares. Although the degree to which the statute will actually inhibit the sale of stock by individual shareholders on a national level is difficult to quantify, both of the above results are certainly contrary to the intent of the Williams Act of furthering investor autonomy and permitting the individual investor to decide for himself whether to buy or sell.

B. The Commerce Clause Issue

The commerce clause grants Congress the power "[t]o regulate Commerce . . . among the several States . . . ."[182] The states have long been prohibited from taking certain actions respecting interstate commerce in the absence of congressional action.[183] Yet, the line between "those regulations that the commerce clause permits and those regulations that it prohibits" remains undefined.[184]

State authority to regulate domestic corporations, including the authority to define the voting rights of shareholders, is firmly established.[185] "Every state in the United States has enacted laws regulating corporate governance."[186] These laws regulate a variety of corporate transactions and can make it more difficult for corporations to engage in certain activities which substantially affect shareholder interests. For example, many states require supermajority votes to approve mergers.[187] Others require a corporation to purchase the shares of dissenting shareholders who disagree with corporate decisions.[188]

The *Dynamics* Court, in traditional fashion,[189] first scrutinized the Indiana Act to determine whether it discriminated against interstate commerce or subjected interstate commerce to inconsistent regulations.[190] Finding that it did neither, the Court, rather than attempting to employ the balancing test of *Pike v. Bruce*

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182. U.S. CONST. art. I, § 8, cl. 3.

183. *See, e.g.*, Cooley v. Board of Wardens, 53 U.S. (12 How.) 299, 319 (1852) (prohibiting the states from regulating objects that are national in nature or that are best regulated by one uniform system).

184. *Dynamics*, 107 S. Ct. at 1648, *see, e.g.*, Raymond Motor Transportation, Inc. v. Rice, 434 U.S. 429, 441, n.15 (1978) (discussing the local versus national theory, the direct versus indirect affects theory and the distinction between the exercise of police power and the regulation of commerce).

185. *See* RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 304 (1971).

186. *Dynamics*, 107 S. Ct. at 1650.

187. *Id.*

188. *Id.*

189. *See, e.g.*, Lewis v. BT Investment Managers, Inc., 447 U.S. 27, 36-37 (1980); Philadelphia v. New Jersey, 437 U.S. 617 (1978); *see generally* Regan, *The Supreme Court and State Protectionism: Making Sense of the Dormant Commerce Clause*, 84 MICH. L. REV. 1091 (1986) (discussing Supreme Court commerce clause analysis).

190. *Dynamics*, 107 S. Ct. at 1649; *e.g.*, Brown-Forman Distiller's Corp. v. New York State Liquor Authority, 476 U.S. 573 (1986); Edgar v. MITE, 457 U.S. at 642; Kassel v. Consolidated Freightways Corp., 450 U.S. 662 (1981) (plurality opinion of Powell, J.). *See* Southern Pacific Co. v. Arizona, 325 U.S. 761 (1945), Cooley v. Board of Wardens, *supra*, 56 U.S. (12 How.) 299 at 319 (prohibiting the states from regulating objects that "are in their nature national, or admit only of one uniform system, or plan of regulation").

Church[191] as did the lower federal court[192] in its ruling, applied a simpler cost-benefit analysis more akin to that seen in *South Carolina State Highway Dep't v. Barnwell Bros.*[193] Under *Barnwell*, should the Court determine that an issue is one better suited to state regulation, it simply defers to the will of the State legislature.[194] The *Dynamics* Court held that the limited extent to which the Indiana Act affected interstate commerce was justified by the State's interest in defining the attributes of shares in its corporations and in protecting shareholders.[195] The reason for the Court's reluctance to apply the *Pike* balancing test is not expressed in the majority opinion. Justice Scalia, in his concurring opinion, voiced his view that the Court is ill-suited to determine "whether the burden on commerce imposed by a state statute 'is clearly excessive in relation to the putative local benefits.' "[196] The Court relied chiefly on its determination that the Indiana Act does not prohibit either a resident or nonresident from offering to purchase, or from actually purchasing, shares in an Indiana corporation.[197] Under *Exxon Corp. v. Governor of Maryland*,[198] which rejected the "notion that the commerce clause protects the particular structure or methods of operation in a . . . market," the facial neutrality of the Indiana Act would satisfy commerce clause concerns.[199]

The *Dynamics* Court recognized that "[a] state has an interest in promoting stable relationships among parties involved in the corporations it charters, as well as ensuring that investors in such corporations have an effective voice in corporate affairs . . . but that the primary purpose of the [Indiana] Act is to protect the shareholders of Indiana corporations."[200] The Court held that Indiana has a substantial interest in "preventing the corporate form from becoming a shield for unfair business dealing" and that because "every application of the Indiana Act will effect a substantial number of Indiana residents . . . [the] limited extent [to which] the [Indiana] Act affects interstate commerce . . . is justified by the State's interest in defining the attributes of shares in its corporations and in protecting shareholders."[201] Dynamics' argument that the Indiana Act would

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191. 397 U.S. 137 (1970) (under *Pike*, the Court would weigh the burden imposed on interstate commerce by the state statute to see whether it was clearly excessive compared to the putative local benefits).

192. Edgar v. MITE Corp., 457 U.S. 624 (1982). Application of the *Pike* balancing test by the lower court drew the criticism of Justice Scalia, who was of the opinion that an inquiry into whether the burden on commerce imposed by a state statute "is clearly excessive in relation to the putative local benefits," is a function "ill suited" to the judiciary. Justice Scalia would have declared the Indiana Act valid under the Court's holding that it neither "discriminates against interstate commerce," nor "create[s] an impermissible risk of inconsistent regulation by different states." *Id.*

193. 303 U.S. 177 (1938).

194. *Id.*

195. *Dynamics*, 107 S. Ct. at 1652.

196. *Id.* (*citing Pike*, 397 U.S. at 142).

197. *Id.*

198. 437 U.S. 117 (1978).

199. *Id.* at 127.

200. *Dynamics*, 107 S. Ct. at 1651.

201. *Id.* at 1651-52.

substantially limit the number of successful tender offers was considered by the Court to be illusory and, even if found to be true, would not have "substantially affect[ed] [the Court's] commerce clause analysis."[202] However, the Court's deference to the rationale of Indiana's legislature or to claimed prospective benefits to shareholders is questionable in that any benefit to shareholders is purely speculative, if not illusory. Further, the real force behind the statute is arguably a state legislative interest in "protecting *local businesses* from the rigors of the interstate market for corporate control" by creating a chilling effect on tender offers.[203] The Court noted that although corporate law has an inherent extra-territorial impact, it is nonetheless traditionally within the realm of state lawmaking.[204] The Court may have recognized an implicit consent by shareholders to be governed by state law, "thereby eliminating at least part of the justification for heightened federal court scrutiny."[205] The implication of the holding is that, where the effects of a state statute on interstate commerce are facially neutral, the Court will not attempt to weigh burdens and benefits but will simply defer to the state legislatures.[206] The Court's apparent rejection of the *Pike* analysis as the proper test of the facially neutral Indiana Act leaves the Court without a means to effectively weigh the effect such collective vote provisions have on the interstate trade of corporate shares. There is precedent, however, for the Court to look past the facial neutrality to measure whether the statute negatively impacts interstate commerce.[207] The likelihood that the Indiana Act will work disproportionately to discriminate against out-of-state offerors is arguably sufficient to warrant looking behind the statute. The Court's reluctance to look behind Indiana's facially neutral statute may stem more from a desire not to embark upon interpretations of legislative intent in the area than from any degree of faith in the legislative process. Would a statute similar to Indiana's, but requiring supermajority approval before voting rights may be transferred on control shares, also be held constitutional? Under the Court's present analysis it arguably would be.

VI. CONCLUSION

With *Dynamics*, the Court has created a commerce clause niche into which

202. *Id.* at 1652.

203. Langevoort, *The Supreme Court and the Politics of Corporate Takeovers: A Comment on CTS Corp. v. Dynamics Corp. Of America*, 101 HARV. L. REV. 96, 107 (1987) (original emphasis).

204. *See Dynamics*, 107 S. Ct. at 1649-51.

205. Langevoort, *supra* note 203 at n.45.

206. However, the district court record which the *Dynamics* Court was reviewing was practically devoid of any evidence on the effect of the statute or its legislative intent. Perhaps, given more detailed evidence from both parties, the Court might distinguish *Dynamics* and apply a *Pike* balancing test.

207. *See* Hunt v. Washington State Apple Advertising Comm'n, 432 U.S. 333 (1977) (North Carolina statute whose clear purpose was to favor local economic interests by discriminating against out-of-state interests held unconstitutional); Dean Milk Co. v. City of Madison, 340 U.S. 349 (1951) (city statute having discriminatory *effects* on interstate commerce struck down).

state legislatures may shelter anti-takeover legislation from judicial scrutiny. The *Dynamics* analysis leaves no room to incorporate the adverse effects that the statute imposes on interstate commerce by preventing shareholders from selling their shares in instances where the offeror withdraws due to the chilling effect of the statute. By simply including a statement in such legislation stating that it was designed to protect shareholders from fraud and coercion during takeover actions, state lawmakers, subject to corporate lobbying interests, can pass anti-takeover laws which infringe upon the rights of individual shareholders to trade their shares. By validating the majority shareholder approval provision, the Court has taken the decision of whether to buy or sell out of the hands of the individual shareholder and given it to management and a collection of shareholders. A shareholder who decides to sell will be thwarted by a failure of the disinterested shareholders to approve the transfer of voting rights. The Supreme Court's deference to state legislative intent leaves the individual shareholder with no recourse if his right to buy and sell his stock on the national market is encroached upon. Though the implementation of a balancing test is difficult and imperfect at best, it would at least permit the shareholder's right to trade his shares to be weighed in the preemption analysis. A balancing test would also allow for any infringement upon free trade to be considered as a violation of the commerce clause. Alternatively, the Court could elect to uphold only the "least restrictive means of achieving a reasonable legislative goal."[208] Under such an approach, the Court might find that a statute permitting the shareholders to opt-in rather than opt-out of the scope of the law sufficient to protect the shareholder from fraud and coercion during a hostile takeover bid. Similarly, the Court might find fair price statutes or the power of the shareholders to pass their own shareholder approval amendments to corporate bylaws would be sufficient to fulfill legislative aims. By simply validating the majority shareholder approval provision, the Court, in effect, has defined a model provision for state legislatures to follow and has provided the means by which states may enact laws to protect in-state corporations from hostile takeovers.[209] Multiplication of such provisions will have a chilling effect on tender offers and interfere with the free trade of stock on a national level.

Louis B. Lanoux

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208. Langevoort, *supra* note 202 at 108. *See also Dean Milk*, 340 U.S. 349 (1951) (availability of reasonable nondiscriminatory alternatives contributed to statute being struck down).

209. *See supra* note 7.