Pennsylvania's Antitakeover Statute: An Impermissible Regulation of the Interstate Market for Corporate Control

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I. Introduction

In July 1989, the Belzberg brothers acquired 9.85 percent of the common shares of Armstrong World Industries, Inc., a Pennsylvania-based manufacturer of floor coverings and building products. The Belzbergs then announced potential plans to acquire control of Armstrong via a tender offer. Armstrong Chairman William Adams responded that Armstrong was not for sale, and began lobbying state legislators for additional legislative ammunition to fend off the Belzbergs. Pennsylvania's Act 36 of 1990 was introduced on October 20, 1989, in response to the Belzbergs' potential takeover bid for Armstrong. The Pennsylvania General Assembly overwhelmingly enacted Act 36, the nation's toughest antitakeover statute on April 27, 1990.

The collapse of the junk bond market in late 1989, as well as the

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1. The three Belzberg brothers became well known in the 1980s as "greenmailers"—those who buy a minority position in a company vulnerable to takeover, hoping to persuade frightened management or another corporate raider to buy them out at a profit. The Belzberg brothers were visible participants in T. Boone Pickens' raid on Gulf Oil in the early 1980s. Fin. Times, Sept. 12, 1990, section I at 29. Greenmailers have no interest in furthering the interests of either shareholders or the national economy. The greenmailer's purpose is only to profit from management's vulnerability.


7. The Act was approved by a margin of 183-17 in the Pennsylvania House and 43-6 in the Senate. N.Y.L.J., Sept. 10, 1990, at 7. Act 36 has control-share provisions fairly representative of state antitakeover statutes. However, certain provisions of Act 36 have appreciably toughened Pennsylvania's stance toward hostile takeovers. See infra notes 141-214 and accompanying text.

8. "Junk bonds" are bonds rated below "investment grade" by the two principal bond rating agencies (Moody's or Standard and Poor's). Coffee, Shareholders Versus Managers: The Strain in the Corporate Web, 85 MICH. L. REV. 1, 4 (1986).
reluctance of commercial banks to participate in highly leveraged deals, dimmed the Belzbergs' prospects of financing a hostile takeover via a tender offer. The Belzbergs continued to press Armstrong with a threatened proxy fight, seeking a change in the company's corporate charter, and representation on the board of directors. The enactment of Act 36 forced the Belzbergs' hand, resulting in a complete liquidation of their 11.7 percent stake in Armstrong, reportedly at a gross loss of $17 million.

Third-generation antitakeover legislation such as Act 36 has proliferated since the Supreme Court upheld the Indiana Control Share Acquisition Statute in *CTS Corp. v. Dynamics Corp. of America*. Act 36 has control-share provisions that are very similar to the Indiana statute upheld in *CTS*. However, certain other provisions of Act 36, particularly the disgorgement provisions, make it the toughest antitakeover statute yet adopted in any state. For this reason, the Pennsylvania statute de-


10. The Belzbergs were successful at electing one director, Professor Michael Jensen of Harvard Business School, to one of the four vacant seats on Armstrong's board. *EXEC. RPT.* p. 22.

11. N. Y. Times, May 31, 1990, Section D, at 5, col. 3. The reported loss of $17 million did not include a subsequent settlement reached between Armstrong and First City Financial, the Belzbergs' financing arm. Under the terms of the settlement, Armstrong paid First City $4.4 million as stated consideration for the Belzbergs' proxy expenses and settlement of all outstanding litigation. Chicago Tribune, June 7, 1990 (Business), at 1. Armstrong shareholders presented constitutional challenges to Act 36 in the federal courts. The Third Circuit recently ruled that the case was not ripe for review since Armstrong was no longer subject to a takeover attempt. Armstrong World Industries, Inc. v. Adams, No. 91-1503, 1992 U.S. App. LEXIS 6473 (3d Cir. Apr. 10, 1992).

12. Statutes enacted after the Supreme Court's decision in *CTS Corp. v. Dynamics Corp. of America*, 481 U.S. 69 (1987) are commonly referred to as third-generation statutes. Statutes enacted prior to the Supreme Court's decision in *Edgar v. MITE Corp.*, 457 U.S. 624 (1982) are commonly referred to as first-generation statutes. Statutes enacted after *MITE* and before *CTS* are commonly referred to as second-generation statutes.

13. *IND. CODE ANN.* Sections 23-1-42 (Burns Cum. Supp. 1986). The control-share statute at issue in *CTS* provided that a person who attained certain threshold limits of share ownership could not vote those shares unless voting rights were affirmatively granted by a majority of the corporation's "disinterested" shareholders. *Id.* Section 23-1-42-4(a)(3). See infra notes 114-40 and accompanying text for a discussion of the Supreme Court's decision in *CTS*.


16. The Act's disgorgement provisions provide that anyone who acquires 20% or more of the voting power in a covered Pennsylvania corporation must disgorge, or forfeit, any profits on subsequent sales of the stock. *Id.* §§ 2571-75.

17. Third generation antitakeover legislation has been adopted in various forms in the different states. Excluding the Pennsylvania statute, there are four types of regulation. First, there are the fair price statutes that require the acquiring person to pay the "best price" to all shareholders within a certain statutory period. See, e.g., *MD. CORPS. & ASSNS. CODE ANN.* § 3-601-604 (1991 Cum. Supp.). Second, there are business combination, or "freeze" statutes that permit a tender offer to proceed without delay, but delay any subsequent unapproved merger for three to five years. See, e.g., *DEL. CODE ANN.* tit. 8, § 203 (1991). Third, there are the control share statutes that condition the acquiring person's voting rights upon approval of the disinterested shareholders. See, e.g., *IND.*
serves special scrutiny, as it may serve as a model for other states to fortify their own antitakeover legislation.

This Note begins with an examination of the policy arguments for and against antitakeover legislation. It then, in Part III, gives a brief history of the development of antitakeover legislation. Part IV focuses on the purposes and specific provisions of the Pennsylvania statute. In Part V, this Note presents a constitutional analysis, concluding that the Pennsylvania statute is constitutionally flawed as an impermissible regulation of the interstate market for corporate control.

II. THE POLICY ARGUMENTS FOR AND AGAINST ANTITAKEOVER LEGISLATION

The debate about antitakeover legislation intensified during the 1980s because of the success of financial entrepreneurs in arbitraging the difference between stock and asset values of public companies. For example, in the RJR Nabisco takeover, the company’s stock price was trading in the $40-$50 range prior to the takeover. However, the underlying value of the assets was worth much more than $40-$50, which ultimately led to the takeover of RJR. As was true in the RJR takeover, this arbitraging was often accomplished by means of a “bust-up” takeover—acquiring control and then liquidating certain of the target corporation’s business operations in order to service acquisition indebtedness.

These “bust-up” takeovers have served as the starting point in the debate about state regulation of takeovers. Certain commentators contend that “bust-up” takeovers, as well as corporate restructurings under-

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18. See infra notes 23-66 and accompanying text.
19. See infra notes 67-140 and accompanying text.
20. See infra notes 141-214 and accompanying text.
21. This Note examines the Pennsylvania statute under the Supremacy Clause and Commerce Clause issues presented in CIS. The Pennsylvania statute also presents the issue, particularly with respect to the Act’s disgorgement provisions, of whether these provisions work an uncompensated taking in contravention of the Fifth Amendment. That issue is beyond the scope of this Note.
22. See infra notes 215-61 and accompanying text.
23. Coffee, supra note 8, at 3. The increased incidence of “bust-up” takeovers is due in no small part to the explosive growth of the junk bond market in the mid and late 1980s. Id. at 4.
taken as a result of threatened hostile takeovers, have brought negative economic and social costs upon stakeholders of the target company, including: layoffs, losses to customers and suppliers of the corporation, and loss of tax revenues to the community. Other commentators reply that investors have prospered as a result of the growth in takeover activity.

Both investors and stakeholders would like to promote policies that further each group’s perceived self-interest. Investors, of course, would prefer policies that foster the growth of corporate profits including the opportunity to receive a control premium in a successful tender offer. Control premium presents investors in a cash tender offer an opportunity to sell their shares at a premium over the pre-existing market price. Stakeholders, on the other hand, would prefer policies that minimize the burden of negative economic and social costs upon in-state interests. Thus, the difference of opinion between these two groups lies in the fact that they would prefer to pursue different policies in the regulation of takeover activity in order to maximize the wealth of their constituencies.

As a result of these differing views, each group has promoted takeover regulation policies at opposite ends of the regulatory spectrum. Those who oppose any antitakeover legislation maintain that state corporate governance law simply cannot interfere with the directors’ duty to maximize investment return to investors. Those who support antitake-

26. Id. at 1461. This comment mentions that the increased use of state antitakeover legislation is due to a fear on the part of state legislatures that the economic and social costs of a bust-up takeover fall disproportionately on the state with substantial connections to the target corporation. Id.
28. “Few trends could so thoroughly undermine the very foundations of our free society as the acceptance by corporate officials of a social responsibility other than to make as much money for their stockholders as possible.” M. FRIEDMAN, CAPITALISM AND FREEDOM 133 (1982), quoted from Nonshareholder Constituency Statutes, supra note 25, at 1451.
30. Coffee, supra note 8, at 10.
31. Judge Easterbrook and Professor Fischel maintain that a rule requiring managerial passivity to any premium tender offer is necessary in order to maximize shareholder welfare. In other words, any resistance by a corporation’s managers to any premium tender offer ultimately results in decreasing shareholder wealth. Easterbrook & Fischel, supra note 29, at 1201. Easterbrook and Fischel note that their argument is founded upon the premise that tender offers increase social wel-
over legislation reply that takeovers cannot simply be viewed as private ordering between the corporation and the shareholder, but must more realistically be viewed as a public law problem—that of preventing the stakeholder from disproportionately shouldering the burden of the externalities associated with takeovers.

Both of these views are artificially narrow. The supporters of antitakeover legislation focus only on in-state stakeholder interests, to the exclusion of national stakeholder interests. Those opposed to antitakeover legislation focus only upon investor interests, to the exclusion of the overall interests of the national economy. It is the contention of this Note that a proper analysis should focus on the broader national interests involved—that of the interstate market for corporate control (i.e., the interests of the national economy). Each of these three positions will be evaluated in turn, concluding that a proper analysis of the merits of antitakeover legislation must begin by focusing upon the broader national interests involved.

A. Opposition to State Antitakeover Regulation: The Case for the Investor's Right to Maximize Investment Return

Certain commentators opposed to state antitakeover legislation have reasoned that if tender offers benefit investors, the directors of the corporation, as part of their duty to maximize investment return, must embrace any premium tender offers. In fact, these commentators maintain that investors possess an absolute right to control premium. Based on the premise that investors have an absolute right to control premium, these commentators propose a rule "severely limiting the ability of managers to resist a tender offer even if the purpose of the resistance is to fare by moving productive assets to higher valued uses. Id. at 1182. They argue that since tender offers move productive assets to higher valued uses, then investors should be protected from managerial resistance to a premium tender offer. In contrast, it is the premise of this Note that since the purpose of state antitakeover legislation is to prevent assets from moving to higher valued uses, the interstate market for corporate control (synonymous with the interests of the national economy) must be protected by the dormant Commerce Clause from this discriminatory legislation. See infra notes 234-61 and accompanying text.

32. "Externalities" are costs imposed on others not reflected in the market price of the goods produced. Ogus, Property Rights and Freedom of Economic Activity, in CONSTITUTIONALISM AND RIGHTS 127-28 (Henkin & Rosenthal ed. 1990). Ogus contends that even systems committed to free alienation of property rights recognize certain instances when such rights must be regulated because pursuit of social welfare is impeded by market failure as a result of externalities. Id. In the context of hostile takeovers, those supporting state regulation of hostile takeovers contend that cities decay and workers are left unemployed after industry leaves, and that the in-state interests are left to clean up the problems. See generally, Coffee, supra note 8.

33. Id. at 8-10.

34. Easterbrook & Fischel, supra note 29, at 1201.

35. Id.
trigger a bidding contest.” Under this rule, erection of any obstacles to takeovers—either urging adoption of antitakeover statutes or charter amendments would be prohibited.

Tender offers benefit investors in at least three ways. First, tender offers result in substantial control premium for investors. Indeed, SEC studies show that investors received average control premium varying from 63.4 percent in “any and all” tender offers to 31.3 percent in partial tender offers.

Second, an unfettered market for corporate control benefits investors by ensuring that assets freely flow through state borders to achieve their highest economic utility. For example, assume Oil Company A, a public company incorporated in the state of Pennsylvania, is an inept company whose main accomplishment is drilling dry holes. Both the national economy and investors would benefit if Exxon were allowed to acquire Oil Company A and put its assets to more productive uses. However, parochial state antitakeover legislation whose main purpose is to keep corporate assets located in-state prevents such a relocation of corporate assets. State antitakeover legislation, by hindering a free market for corporate control, prevents investors from realizing the fullest potential value of their investment.

Third, the threat of a hostile takeover serves as a useful protection for investors against inefficient management. Thus, the threat of hostile takeover polices incumbent management whether or not a tender offer occurs. The mere threat of a hostile offer forces management to concentrate on its primary duty—to maximize investor wealth—or risk being replaced. Champions of a free market for corporate control, such as SEC Chairman Breeden and former SEC Chairman Ruder have

36. Id. at 1162.
37. For example, one common charter amendment is the “poison pill.” Poison pills enable shareholders to receive additional shares of securities at bargain prices when a bidder acquires a specified percentage of a target company’s stock. Dynamics Corp. of America v. CTS Corp., 794 F.2d 250, 254-55 (7th Cir. 1986), rev’d on other grounds, 481 U.S. 69 (1987).
38. Easterbrook & Fischel, supra note 29, at 1201.
40. Blended average control premium in two-tier tender offers was 55.1 percent. Id.
41. Dynamics, 794 F.2d 250.
42. Easterbrook & Fischel, supra note 29, at 1169.
43. Id.
44. SEC Chairman Breeden has said that the new Pennsylvania statute will disenfranchise shareholders and leave incompetent managers free to run a company into the ground. Fin. Times, Oct. 18, 1990, at 34.
45. Former SEC Chairman Ruder has said: Limitations on the free transferability of securities of corporations which are owned by
argued that antitakeover statutes, by removing this built-in check against inefficient management, constitute a clear disenfranchisement of shareholders' rights.

Thus, corporate combinations do offer three major benefits to investors: control premium; allowing corporate assets to freely flow to their highest valued use; and preventing shareholder disenfranchisement. Because these three benefits are available to shareholders, some commentators reason that directors, as part of their duty to maximize the investor's investment return, simply cannot permit any resistance to a takeover attempt. The major weakness in this rule of passivity is that management can take measures to maximize shareholder value that the market will not take unless management signals: its opposition to the first offer; the price that management is willing to sell the company for; and, its willingness to take steps to bottle up the first offer so there is enough time for a "white knight"—a bidder favorable to management—to step in and make a bid for the company at a price which management considers fair. In addition, certain pre-existing defenses (i.e., fair-price poison pills) result in greater shareholder wealth by preventing a low-ball offer from being made. Finally, because some offers are meant to fail, management should have some discretion to discourage such offers.

shareholders nationwide diminish the efficiency, depth and liquidity of the nation's securities markets. Accordingly, I believe that federal law should control in that area by preempting state statutes that unduly interfere with the free transferability of securities. I believe that corporations whose activities and ownership are national in scope should not be given protection against takeovers by the states where their primary production facilities are located. Just as I believe it to be imprudent for Congress to regulate internal corporate affairs through tender offer regulation, I believe it is imprudent for the states to use their authority over matters of internal governance as a means of regulating the interstate market for corporate control.


46. Easterbrook & Fischel, supra note 29.
47. See Revlon, Inc. v. MacAndrews & Forbes Holdings, 506 A.2d 173 (Del. 1986). For example, in Revlon, Revlon's management clearly indicated its opposition to Pantry Pride's initial hostile offer of $47.50 per common share, after being advised by the company's investment bankers that the company's value was in the "mid 50" dollar range. Id. at 177. Revlon management indicated a price it would be willing to sell at by adopting a poison pill which would cash out Revlon shareholders at $65 per share. Id. Finally, Revlon management took steps to bottle up the Pantry Pride offer, by adopting a poison pill and a stock repurchase plan. Id. Management's efforts did result in increasing shareholder value, when Pantry Pride ended up acquiring Revlon at $58 per share.
48. For example, in Revlon, if Revlon had a fair-price poison pill in place prior to the Pantry Pride offer, Pantry Pride's initial offer would undoubtedly have been higher than the initial $47.50 low-ball offer.
49. See Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985). In Unocal, Mesa's offer for Unocal was never meant to succeed. The offer was an attempt by Mesa (controlled by T. Boone Pickens) to "greenmail" Unocal. "Greenmail" refers to the practice of buying out a corporate raider's stock at a premium in order to prevent a takeover. Id. at 956 n.13.
B. The Antitakeover Position

Those who support antitakeover legislation argue that directors, when evaluating a tender offer, have a duty to consider stakeholder interests.\(^5\) Accordingly, regulation of the takeover process, through state antitakeover legislation, is necessary to prevent stakeholders from disproportionately assuming the consequences of the externalities associated with takeovers. Therefore, even if a takeover proposal presents investors with an attractive opportunity to sell their shares at a profit, advocates of the antitakeover position would have directors reject the takeover if it would harm the interests of stakeholder groups.\(^5\)

Restructurings in response to, or as a result of, hostile takeovers often lead to major organizational changes within the target corporation, including plant closings or relocations, with resulting job terminations.\(^5\) By some estimates, approximately 600,000 "white-collar" managers have been eliminated as a result of corporate restructurings.\(^5\) These employee layoffs then have a negative ripple effect throughout the community by reducing the demand for goods and services and reducing the tax base of the local community.\(^5\) While some in-state effects are indisputable, corporate restructurings can have an overall beneficial effect on the economy by creating new jobs elsewhere. Further, new jobs can be created after the completion of a restructuring which utilizes a corporation's assets more efficiently. Consequently, there is no showing that the overall effect upon the national economy is harmful. In fact, one commentator contends that there is no evidence indicating that takeovers produce any more plant closings or layoffs than would otherwise have occurred.\(^5\) Further, takeovers typically improve the economic efficiency of a corporation, by redeploying corporate assets to their most valued uses.\(^5\)

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50. Coffee, supra note 8, at 8.
51. See Coffee, supra note 8.
52. Nonshareholder Constituency Statutes, supra note 25, at 1459.
53. See Greenhouse, Surge in Prematurely Jobless, N.Y. Times, Oct. 13, 1986, at 21, col. 2 (nat'l ed.), quoted from Coffee, supra note 8, at 7, n.14. The macroeconomic effect of these job layoffs has been estimated as costing the economy between 0.5% and 1% of GNP in 1985. Jonas, Berger & Pennar, Do All These Deals Help or Hurt the U.S. Economy?, Bus. Wk., Nov. 24, 1986, at 86, 87 (quoting Edward Hyman of Cyrus J. Lawrence, Inc.), as quoted from Coffee, supra note 8, at 6, n.7. While the empirical results noted above would tend to indicate that the macroeconomic effect of these job layoffs tends to harm the national economy, these results are neither conclusive, nor a definite indication of a harmful effect. A persuasive argument can be made that while the immediate effects of these job layoffs appears harmful, the long-term effect will be beneficial to the national economy by repositioning the labor force into more productive jobs and industries.
54. Nonshareholder Constituency Statutes, supra note 25, at 1453, n.11.
56. Easterbrook & Fischel, supra note 29, at 1190. For example, T. Boone Pickens threatened Gulf Oil with a hostile takeover in 1984. While Gulf Oil eventually wound up being acquired by Standard Oil of California, the eventual takeover resulted in improved economic efficiency by a
The major flaw in the argument in favor of antitakeover legislation is the unduly narrow purpose of the legislation. The predominantly asserted legislative purpose in antitakeover legislation prior to Act 36 has been to protect investors from coercive action. However, it has become clear that the real purpose is to protect incumbent management and in-state stakeholder constituencies from the perceived disruptive effects of hostile tender offers. State legislatures have questioned whether obtaining the benefits of control premium for a widely dispersed class of investors was consistent with the state’s responsibilities to its stakeholders. Accordingly, there has been an increasing tendency for state legislatures to enact antitakeover legislation after lobbying efforts from local companies under siege from hostile tender offers. Unfortunately, this outlook not only takes an artificially narrow view of the national economic interests involved, it also has the practical effect of “rendering shareholders defenseless against their managements” by allowing directors to justify any rejection of a hostile takeover as against the existing interests of the stakeholders.

C. Opposition to State Antitakeover Legislation: Restriction of the Interstate Market for Corporate Control

Up to this point, the policy arguments for and against state antitakeover legislation advocated a drastic reduction in Gulf’s domestic oil exploration costs. Prior to the takeover, Gulf had invested enormous amounts of cash into domestic exploration for crude oil at a point when market prices for crude oil could not justify these expenditures. Standard Oil was able to improve the economic efficiency of the combined company merely by turning off the expenditure spigot. R. Higgins, Analysis for Financial Management, 278-285 (1989). The economic costs of plant closings, loss of employment, and loss of the corporation’s chain of customers and suppliers normally falls inordinately upon the state where the corporation had its most substantial presence. See Nonshareholder Constituency Statutes, supra note 25, at 1460-61. Pennsylvania was particularly sensitive to this issue, with venerable companies such as Gulf Oil and Pennwalt losing their independence. See also, Coffee, supra note 8, at 93. However, to the extent that the focus of the legislative intent in antitakeover legislation has changed from ensuring shareholder protection to affording protection for in-state stakeholder interests, it may be subject to a heightened scrutiny under the Commerce Clause. For an analysis, see infra notes 234-61 and accompanying text. Even Professor Coffee, who supports takeover regulation on behalf of stakeholders, recognizes that virtually any aspect of corporate governance law can be manipulated to chill takeovers. Coffee, supra note 8, at 96.

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57. CTS, 481 U.S. at 89-91.
58. The economic costs of plant closings, loss of employment, and loss of the corporation’s chain of customers and suppliers normally falls inordinately upon the state where the corporation had its most substantial presence. See Nonshareholder Constituency Statutes, supra note 25, at 1460-61. Pennsylvania was particularly sensitive to this issue, with venerable companies such as Gulf Oil and Pennwalt losing their independence. See also, Coffee, supra note 8, at 93. However, to the extent that the focus of the legislative intent in antitakeover legislation has changed from ensuring shareholder protection to affording protection for in-state stakeholder interests, it may be subject to a heightened scrutiny under the Commerce Clause. For an analysis, see infra notes 234-61 and accompanying text. Even Professor Coffee, who supports takeover regulation on behalf of stakeholders, recognizes that virtually any aspect of corporate governance law can be manipulated to chill takeovers. Coffee, supra note 8, at 96.

59. Nonshareholder Constituency Statutes, supra note 25, at 1461. For a listing of third-generation antitakeover legislation adopted by state legislatures under pressure from home-based companies under the pressure of a hostile tender offer, see note 248 infra.
60. See Steinberg, supra note 45, at 83-85. Similarly, the financial press has dubbed the new Pennsylvania statute the “Armstrong Act.” 9 EXEC. RPT. at 22.
61. Dynamics Corp. of America v. CTS Corp., 794 F.2d 250, 255 (7th Cir. 1986). rev’d on other grounds, 481 U.S. 69 (1987). Managers of a target corporation, including outside directors, have a clear conflict of interest by erecting obstacles to a hostile investor who is likely to fire them if the takeover succeeds. Id. at 256.
over law have focused on either the interests of investors or in-state stakeholders. This section proposes that the proper analysis of antitakeover legislation must begin by focusing upon the broader interests involved—that of the national economy.

The main problem with state antitakeover legislation is that it impedes the national economy by unduly restricting the interstate market for corporate control. State antitakeover legislation, by increasing the risk that (i) an offer will not be made, or (ii) an offer will not succeed, significantly reduces competition among potential bidders in the interstate market for corporate control. When tender offers are not made or do not succeed because of state antitakeover legislation, such parochial state legislation is preventing the free flow of assets to their highest and best uses. Preventing the free flow of assets to their most efficient uses impedes the growth of the national economy, by forcing corporate assets to remain in undervalued uses in states that have adopted antitakeover legislation. State legislation preventing the interstate movement of corporate economic assets is just the type of parochial legislation that the Commerce Clause was intended to prevent.

The issue remaining then is what role is available for the states in the field of takeover legislation? Any legislation whose purpose and effect is to either enhance the bidding process or to increase the informational efficiency of the securities markets by requiring additional disclosure regarding a proposed takeover would still be permissible. In contrast, when the purpose and effect of state antitakeover legislation is to prevent assets from freely flowing to their highest valued use (since, as shown in several states, the purpose of state antitakeover legislation is to protect incumbent management and in-state stakeholder constituencies), the interests of the national economy must be protected from this discriminatory legislation.

62. *See infra* notes 223-33 and accompanying text for a discussion of the methods in which state antitakeover legislation makes tender offers riskier and more expensive.
63. *See supra* notes 47-49 and accompanying text for a discussion of steps management of a target corporation can take to enhance the bidding process for the target corporation.
64. While state legislation whose purpose and effect is to increase the informational efficiency of the securities markets would still be permissible under this hypothesis, it would in most cases be superfluous, considering the objectives and requirements of the Williams Act. *See infra* notes 67-80 and accompanying text for a discussion of the Williams Act.
65. *See supra* notes 57-61 and accompanying text.
66. *See infra* notes 234-61 and accompanying text.
III. THE HISTORY OF ANTITAKEOVER LEGISLATION: FROM THE WILLIAMS ACT TO CTS CORP. V. DYNAMICS CORP. OF AMERICA

The proliferation of, and the perceived abuses associated with, cash tender offers in the early 1960s prompted Congress to enact the Williams Act in 1968. The use of cash tender offers had increased during the 1960s as corporate raiders discovered a gap in then-existing federal securities law. By making a cash tender offer for the stock of a target corporation, the corporate raider was able to avoid the federal regulations attendant in either a proxy contest or a stock exchange offer. Cash tender offers were fraught with potential for abuse, as a raider could stampede investors into tendering their shares, without providing adequate time or information with which to evaluate the fairness of the tender offer.

The primary purpose of the Williams Act was to put investors on equal footing with both bidders and incumbent management by requiring adequate disclosure of information regarding tender offers, as well as sufficient time to evaluate the fairness of such offers. While Congress's primary goal in enacting the Williams Act was providing investor protection, Congress sought to achieve this goal by regulating the tender offer process, not the merit of tender offers. Thus, the specific items enacted

67. 15 U.S.C. §§ 78m(d)&(e) and 78n(d)-(f) (1988). The Williams Act is an amendment to the Securities and Exchange Act of 1934. Id.
68. See Hablutzel & Selmer, Hostile Corporate Takeovers: History and Overview, 8 N. ILL. L. REV. 203, 205 (1988). "The need for such legislation has been caused by the increased use of cash tender offers rather than the regular proxy fight to gain control of publicly owned corporations . . . (t)his legislation will close a significant gap in investor protection under the federal securities laws . . . ." 113 CONG. REC. 854 (1967). (Remarks of Senator Williams).
69. Generally, state corporation law allows shareholders to either vote in person or by proxy (agency). Proxy contests occur when insurgent shareholders solicit proxies from other shareholders to obtain control of a company. Hablutzel & Selmer, supra note 68, at 203-4.
70. In a stock exchange offer, the acquiror issues new securities to the target firm's shareholders. Id. at 205. By avoiding the federal regulations attendant in either a proxy contest or stock exchange offer, the corporate raider was able to avoid significant expenses. Id.
71. For example, prior to the Williams Act, a bidder could have made a tender offer with only one or two days for investors to evaluate the offer. By forcing investors to quickly evaluate an offer, investors could have been stampeded to tender, for fear of missing out on an attractive opportunity. Specific provisions of the Williams Act were aimed at ensuring adequate disclosure of information regarding the tender offer, as well as sufficient time to evaluate the terms of the offer. See 15 U.S.C. § 78n(d)(1) (1988) and 17 C.F.R. § 240.14e-1(a) (1990).
72. See Hablutzel & Selmer, supra note 68, at 208. The Senate Committee stated:
The Committee has taken extreme care to avoid tipping the balance of regulation in favor of management or in favor of the person making the takeover bid. The bill is designed to require full and fair disclosure for the benefit of investors while at the same time providing the offeror and management equal opportunity to present their case.
73. Recognizing that Congress only sought to regulate the tender offer process, and not the substance of tender offers, becomes important in a subsequent analysis of whether state antitakeover
to ensure investor protection were the Act's disclosure and cooling-off provisions. The disclosure provisions require that anyone making a tender offer for more than five percent of a class of securities file an information statement with the SEC, the target company, and the target's shareholders when the tender offer is made. The cooling-off provisions of the Williams Act require the tender offer to be kept open at least twenty days, in order to insure investors have adequate time to evaluate the substantive fairness of the offer.

While the Williams Act was enacted to insure investor protection, Congress clearly did not intend to completely prohibit tender offers. In fact, the final provisions of the Williams Act attempted to remain neutral between management and the bidder. While the disclosure provisions of the Williams Act, as originally introduced, "were avowedly pro-management in the target company's efforts to defeat the takeover bid," Congress became convinced "that takeover bids should not be discouraged because they serve a useful check on entrenched but inefficient management." Thus, the Williams Act was intended to prevent abusive tender offers, by establishing a process whereby tender offers could be regulated as a fair fight between incumbent management and the bidder.

In this context of federally legislated neutrality, the states, under pressure from incumbent management, began to enact the first generation of antitakeover legislation. This first generation of antitakeover legislation lasted until the Supreme Court declared the Illinois antitakeover statute unconstitutional in *Edgar v. MITE Corp.* A plurality of the Court found that the Illinois antitakeover statute frustrated the objectives of the Williams Act on three important grounds, and therefore was preempted by the Supremacy Clause. The Court also found that the statutes impermissibly conflict with the Williams Act. See the Supremacy Clause analysis, *infra* Part V-A.

74. 15 U.S.C. § 78n(d)(1) (1988). The information statement must disclose the identity of the proposed acquiror, the source and amount of funds to be used for the tender offer, and plans for the target company. *Id.* §§ 78m(d)(1)(a)-(c).
81. *Id.* at 209-10.
82. 457 U.S. 624 (1982).
83. U.S. CONST. art. VI, cl. 2. The Supremacy Clause provides that "[t]his Constitution, and the Laws of the United States . . . shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding." *Id.*
Illinois statute violated the Commerce Clause. 84

First, the MITE plurality 85 found that the precommencement notification provisions of the Illinois Business Take-Over Act 86 were inconsistent with the objectives of the Williams Act. The precommencement notification provisions of the Illinois statute required a bidder to notify both the secretary of state and the target company of its intent to make a tender offer 20 business days before the offer became effective. 87 The state's asserted justification for the entire statute, including the precommencement notification provisions, was to “protect the interests of Illinois security holders . . . without unduly impeding take-over offers.” 88 The plurality rejected the state's justification, reasoning that the precommencement notification provisions frustrated the Williams Act's balance between management and the bidder, by providing management with additional time to adopt defensive measures to defeat a takeover attempt. 89

Second, the Illinois statute allowed the secretary of state to call a hearing with respect to the tender offer. 90 Further, the tender offer could not proceed until the hearing was completed, and there was no deadline for the completion of the hearing. 91 The plurality reasoned that these provisions frustrated the Congressional intent of the Williams Act “by introducing extended delay into the tender offer process,” 92 thereby favoring management at the expense of investors. 93

Third, the Illinois Act permitted the secretary of state to pass on the substantive fairness of a tender offer, by authorizing the secretary of state to deny registration of a tender offer if “the take-over offer is inequitable

84. U.S. CONST. art. I, § 8, cl. 3. The Commerce Clause provides that “Congress shall have Power . . . to regulate Commerce . . . among the several States.” Id.

85. Justice White delivered an opinion, in which he was joined by Chief Justice Burger and Justice Blackmun as to the conclusion that the Illinois Act was preempted by the Williams Act. Justices White, Burger, Stevens and O'Connor found that the Illinois Act violated the Commerce Clause by directly regulating interstate commerce. In the majority opinion of the Court, Justices White, Burger, Stevens, O'Connor and Powell found that the Illinois Act violated the Commerce Clause by indirectly regulating interstate commerce. MITE, 457 U.S. at 625. Justice Powell made it clear that his purpose in joining the majority opinion was to limit the Court's views on tender offers to the narrowest possible issue (the indirect regulation analysis under the Commerce Clause), thereby leaving some room in state law for regulation of tender offers. Id. at 646.

86. ILL. REV. STAT. ch. 121 1/2, para. 137.51-137.70 (1979), repealed by P.A. 83-365, § 1 (1983).

87. MITE, 457 U.S. at 635-6.


89. MITE, 457 U.S. at 635.

90. The secretary of state was required to call a hearing if at least 10% of the shareholders residing in Illinois requested a hearing. Id. at 637. The plurality reasoned that because management, in many instances, will control at least 10% of a company's shares, that this gave incumbent management a tool with which to impermissibly delay the tender offer process. Id.

91. Id.

92. Id.

93. Id.
While these substantive-fairness provisions attempted to offer protection to investors, they precluded individual investors from making their own evaluation of the fairness of the tender offer. Therefore, the plurality found that the substantive fairness provisions conflicted with the Williams Act's policy of investor autonomy.

The *MITE* Court then addressed the issue of whether the Illinois Act violated the Commerce Clause. First, a plurality of the Court found that the Illinois Act violated the Commerce Clause by directly regulating interstate commerce. The provisions of the Illinois Act were such that, for example, the secretary of state could deny registration of a tender offer for a Delaware corporation merely because Illinois shareholders owned 10% of the stock subject to the tender offer. The plurality reasoned that since the Illinois Act could not only prevent a bidder from making a tender offer to Illinois shareholders, but also to shareholders residing in other states with no connection to Illinois, the Illinois Act attempted to directly regulate interstate commerce by asserting extraterritorial jurisdiction over residents of other states. The plurality opinion noted that the operation of the Illinois statute would thoroughly stifle interstate commerce in securities transactions.

Second, a majority of the *MITE* Court found the Illinois Act violated the Commerce Clause under the *Pike v. Bruce Church Inc.* balancing test. Under this test, when a statute regulates even handedly to effectuate a legitimate local public interest with only incidental effects on interstate commerce, the statute will be upheld; however, where the burden imposed on interstate commerce is clearly excessive in relation to the local benefits, the statute will be overturned. In applying the *Pike* bal-

95. Id. at 640. See also S. Rep. No. 550, supra note 72.
97. The Illinois Act applied even if no shareholders were Illinois residents. A target company covered by the provisions of the Illinois Act was a corporation of which Illinois shareholders owned 10% of the stock subject to the tender offer, or for which any two of the following three conditions were met:
   1) the corporation had its principal executive offices in Illinois,
   2) the corporation was organized under the laws of Illinois, or,
   3) the corporation had at least 10% of its stated capital and paid in surplus represented within the state.
   ILL. REV. STAT. ch. 121 1/2, para. 137.52-10, repealed by P.A. 83-365, § 1 (1983).
99. Id. at 642.
101. Id. at 142. The Arizona statute at issue in *Pike* would have required a commercial grower to pack all cantaloupes in standard packing crates before the fruit could be transported out of state. This regulation would have required the grower to construct extensive packing facilities. The *Pike* Court found that the state's tenuous interest of having the grower's cantaloupes identified as...
ancing test, the *MITE* Court balanced the burden imposed by the Illinois Act against the purported benefits of the statute.

The *MITE* Court found that permitting the Illinois secretary of state to decide whether nationwide tender offers should proceed—for example, because Illinois shareholders might have held 10 percent of the target corporation—would impose a substantial burden on interstate commerce. If Illinois could wield the power to preclude nationwide tender offers, shareholders could be deprived of the opportunity to realize control premium. Further, the reallocation of corporate assets to their highest and most efficient use is hindered. Finally, the built-in check against inefficient, entrenched management by the threat of a hostile tender offer is removed.

On the other hand, the *MITE* Court found the purported local benefits of shareholder protection and regulation of the internal affairs of Illinois corporations to be lacking legitimacy. While protecting shareholders is a legitimate state objective, the *MITE* Court found that Illinois had no interest in protecting nonresident shareholders.

Originating from Arizona could not justify the burden of constructing an unneeded packing facility.

102. See *supra* note 97 and accompanying text for a description of the potential nationwide reach of the Illinois statute. Clearly, a 10 - 20% position in a target corporation which had the power to substantially delay or completely prohibit a bid would preclude many, if not most, hostile tender offers from ever being launched. Moreover, unlike state blue sky regulations, a bidder could not avoid the problems associated with the Illinois statute by excluding the offer from Illinois. The Williams Act requires that tender offers be made to all shareholders nondiscriminately. 15 U.S.C. § 78n(d)(6) (1988).

103. There were two kinds of commerce problems present in *MITE*. First, the Illinois statute unduly burdened the interstate market for corporate control, exclusive of economic benefits available to shareholders. Second, the Illinois statute unduly burdened interstate commerce by denying shareholders the economic benefits ordinarily present in a tender offer. The *MITE* analysis narrowly focused only on the second commerce problem. While *MITE* was appropriately decided, exclusion of the first commerce problem caused an improper result in the *CTS* decision. See infra notes 114-40 and accompanying text for a discussion of the Court's decision in *CTS*.

104. *MITE*, 457 U.S. at 643. See *supra* notes 39 and 40 and accompanying text for a discussion of the benefits of control premium.

105. *MITE*, 457 U.S. at 643. See *supra* note 41 and accompanying text for a discussion of the benefits to shareholders from a reallocation of corporate assets. The *MITE* Court only analyzed the reallocation of corporate assets as a benefit to shareholders. As explained in Part II-C of this Note, the broader focus should be on the beneficial effect of the reallocation of corporate assets on the national economy.

106. *MITE*, 457 U.S. at 643. See *supra* notes 42-45 and accompanying text for a discussion of the beneficial effects of the takeover process as a check against inefficient, entrenched management.

107. The internal affairs doctrine is a conflict-of-laws principle stating that only one state should have the authority to regulate matters pertaining to the relationships between a corporation and its officers, directors, and shareholders. The purpose of the internal affairs doctrine is to prevent a corporation from facing conflicting demands. *MITE*, 457 U.S. at 645.

108. *Id.* at 644. This analysis crystallizes the fact that it is virtually impossible to protect a state's resident shareholders without regulating the entire tender offer. Thus, second and third-generation antitakeover statutes have been rewritten to regulate only transactions of a state's created corporations, but not to regulate interstate commerce *per se*. So, to the extent that second and third-
not impressed with provisions in the Illinois Act that exempted a management self-tender from the Act’s coverage. The Court found these provisions at variance with the asserted legislative purpose of shareholder protection.\textsuperscript{109}

Furthermore, the MITE majority found Illinois’ proposed justification of the Illinois Act under the internal affairs doctrine to be “incredible,” since the terms of the statute could have been specifically applied to foreign corporations.\textsuperscript{110} The majority held that Illinois had no interest in regulating the internal affairs of foreign corporations.\textsuperscript{111}

Based on the MITE decision, many commentators believed any state antitakeover legislation was preempted by federal law.\textsuperscript{112} Accordingly, many state antitakeover statutes began to fall in the courts.\textsuperscript{113} In this context, the Court’s decision upholding the Indiana Control Share Acquisitions Chapter\textsuperscript{114} (Indiana Act) in \textit{CTS Corp. v. Dynamics Corp. of America},\textsuperscript{115} came as a surprise to some commentators.\textsuperscript{116}

Under the terms of the Indiana Act at issue in \textit{CTS}, a person acquired “control shares” whenever shares were acquired that, but for the operation of the Indiana Act, would bring a person’s voting power to or above any of three thresholds: 20\%, 33 1/3\%, or 50\%.\textsuperscript{117} Control shares can only obtain voting rights if conferred by a majority of the corporation’s “disinterested shareholders.”\textsuperscript{118} Alternatively, the control

generation antitakeover legislation is justified as providing protection for resident shareholders, the state’s interest still lacks legitimacy.

\textsuperscript{109} \textit{Id.} at 645. Further, the Court was not convinced that the Illinois Act afforded investors any more-substantial protection than already offered under the Williams Act. \textit{Id.} at 644-45.

\textsuperscript{110} \textit{Id.} at 645. The terms of the Illinois Act could apply if 10\% of the outstanding shares of the target company were held by Illinois residents, regardless of the target’s state of incorporation. \textit{Id.}

\textsuperscript{111} \textit{Id.} at 645-46.

\textsuperscript{112} See, e.g., Hablutzel & Selmer, supra note 68, at 213; see also, Booth, \textit{The Promise of State Takeover Statutes}, 86 Mich. L. Rev. 1635, 1639 (1988).

\textsuperscript{113} See Dynamics Corp. of America v. CTS Corp., 794 F.2d 250 (7th Cir. 1986), rev’d, 481 U.S. 69 (1987) (invalidating Indiana statute); Fleet Aerospace Corp. v. Holderman, 796 F.2d 135 (6th Cir. 1986) (invalidating Ohio statute); Mesa Petroleum Co. v. Cities Serv. Co., 715 F.2d 1425 (10th Cir. 1983) (invalidating Oklahoma statute).


\textsuperscript{115} 481 U.S. 69 (1987).

\textsuperscript{116} See Booth, supra note 112, at 1639.

\textsuperscript{117} \textit{CTS}, 481 U.S. at 73. See \textit{IND. CODE ANN.} § 23-1-42-1 comment. The first threshold (20\%) represents a significant level of dominance in a public corporation with dispersed share ownership. Thus, a 20\% position can constitute effective control in some circumstances. Indiana believed the second threshold (33 1/3\%) is generally recognized to constitute effective control of a corporation in most circumstances. The 50\% threshold constitutes literal control. \textit{Id.} The operation of the Indiana Act would apparently require control-share approval any time someone acquired voting power that would cross any of the three levels. Thus, control-share approval would be required once at 20\%, a second time at 33 1/3\%, and a final time at 50\% if the shares were acquired in a series of separate transactions. See \textit{IND. CODE ANN.} § 23-1-42-1.

\textsuperscript{118} “Disinterested shareholders” excludes all shares with respect to which the acquiring per-
shares can be denied voting rights by a majority of the corporation's disinterested shareholders.\textsuperscript{119} Voting rights may be conferred upon control shares either at the next regularly scheduled meeting of shareholders, or at a specially scheduled meeting.\textsuperscript{120} The acquiring person may require management to hold a special meeting of shareholders to consider the issue of voting rights. Such a special meeting shall be held within 50 days from the acquiring person's request for such a meeting, if an "acquiring person statement" is filed and the acquiring person agrees to pay the expenses of the meeting.\textsuperscript{121} The practical effect of these provisions is to "condition acquisition of control of a corporation on approval of a majority of pre-existing disinterested shareholders."\textsuperscript{122}

On March 27, 1986, the board of directors of CTS, an Indiana corporation, opted into coverage of the revised Indiana Business Corporation Law,\textsuperscript{123} the provisions of which included the Indiana Act. Previously, on March 10, 1986, Dynamics Corporation of America (Dynamics) had commenced a tender offer for one million shares of CTS common stock. This tender offer, if successful, would have raised Dynamics' ownership interest in CTS to 27.5%.\textsuperscript{124} Thus, Dynamics' tender offer, which would have elevated its percentage ownership in CTS above the 20% threshold, brought the tender offer squarely within the coverage of the Indiana Act.\textsuperscript{125} As a result, Dynamics brought suit seeking to enjoin the enforcement of the Indiana Act on the grounds that the Act violated both the Commerce and Supremacy Clauses.\textsuperscript{126}

In analyzing whether the Indiana Act was preempted by the Wilson, officers, or inside directors of the corporation may exercise voting control. \textit{IND. CODE ANN.} § 23-1-42-3.

\textsuperscript{119} Control shares only have voting rights "to the extent granted by resolution approved by the [disinterested] shareholders of the issuing public corporation." \textit{IND. CODE ANN.} § 23-1-42-9 (Burns Cum. Supp. 1986).

\textsuperscript{120} \textit{Id.} § 23-1-42-7.

\textsuperscript{121} \textit{Id.} The requirements of the "acquiring person statement" include both the identity of the acquiring person and the terms of the control share acquisition. \textit{Id.} § 23-1-42-6.

\textsuperscript{122} \textit{CTS}, 481 U.S. at 74. By requiring a majority vote of the disinterested shareholders, the Indiana law requires that the shareholders affirmatively grant the new owner power to carry out a change in the corporation's control.

\textsuperscript{123} \textit{IND. CODE ANN.} § 23-1-17-1. Generally, the revised Indiana Business Corporation Law (BCL) was to apply to certain Indiana corporations in existence after July 31, 1987. However, as in CTS, the board of directors of an Indiana corporation could opt into the statute's coverage before that date by a resolution electing to have the revised BCL apply prior to July 31, 1987. \textit{Id.} § 23-1-17-3. The Indiana Act also includes an opt out scheme whereby a corporation may opt out of the coverage of the control share acquisition provisions. \textit{Id.} § 23-1-42-5.

\textsuperscript{124} \textit{CTS}, 481 U.S. at 75. Prior to announcing the tender offer, Dynamics owned 9.6% of the common stock of CTS. \textit{Id.}

\textsuperscript{125} See \textit{IND. CODE ANN.} § 23-1-42-1.

\textsuperscript{126} Dynamics Corp. of America v. CTS Corp., 794 F.2d 250, 251 (7th Cir. 1986), rev'd on other grounds, 481 U.S. 69 (1987).
liams Act, the CTS Court, although not required to do so, adopted the line of reasoning of the MITE plurality. The Supremacy Clause reasoning of the MITE plurality was summarized by Justice Powell as follows: any state statute which upsets the delicate balance between incumbent management and bidders, to the detriment of shareholders, is preempted by the Williams Act. Unlike the Illinois statute before the MITE Court, the CTS Court concluded that the Indiana Act furthered the purposes of the Williams Act, by protecting the independent shareholder against both management and the bidder.

In reaching this conclusion, the Court emphasized two primary features of the Indiana Act. First, the CTS Court found that the principal effect of the Indiana Act was "to grant shareholders the power to deliberate collectively about the merits of tender offers." By this method of collective deliberation, the Court found that the Indiana Act protects shareholders from the coercive effects of tender offers. Second, the Court noted that although the Indiana Act provided that the special meeting of shareholders could be held within 50 days of the commencement of the tender offer, nothing in the Indiana Act imposed an absolute 50 day delay on the consummation of a tender offer, nor did the Indiana Act prohibit a bidder from purchasing shares immediately after the 20 day period provided under the Williams Act. Further, the CTS Court found nothing in the MITE plurality opinion suggesting that any delay

127. As the MITE plurality opinion did not represent the views of the majority of the Court as to the preemptive effect of the Williams Act, the CTS Court was not bound by the MITE analysis. The CTS Court chose to use the MITE analysis, however, because it found that the Indiana Act could still pass muster under a broad interpretation of the Williams Act. CTS, 481 U.S. at 81.

128. Id. at 80-82.

129. Id. at 82.

130. Id. at 82, n.7. The Court concluded that the Indiana Act operated on the assumption that independent shareholders confronted with a tender offer are often at a disadvantage. Id. See also Booth, supra note 112. The concern in a two-tier or partial tender offer is that shareholders may be coerced into tendering their shares at a lower price than might be available in an "any and all" tender offer. A bidder may offer a higher price for the first 51% of a target's shares, and a lower price for the remaining 49% of the target's shares. Shareholders may therefore be coerced into tendering in the first tier, in order to avoid being forced to tender their shares at the lower price in the second tier. Id. This accounts for the CTS Court's reasoning that independent shareholders confronted with a tender offer are often at a disadvantage.

131. The Court explained that shareholders, acting as a group under the provisions of the Indiana Act, could reject a coercive, two-tier tender offer. Such a coercive offer could be rejected by denying voting rights to the control shares. However, an individual shareholder confronted with a coercive, two-tier tender offer would rush to tender in the first tier, for fear of being cashed out at a depressed price in the second tier of the coercive offer. CTS, 481 U.S. at 83.

132. Of course, if the bidder moves forward and purchases the control shares within the 20 day period permitted by federal law, the bidder runs the risk of subsequently being denied voting rights. However, the Court reasoned that if a bidder feared a rejection of voting rights by the disinterested shareholders, a tender offer could be made conditional upon the grant of voting rights to the control shares. Id. at 84.
was impermissible—only delay that would unreasonably impede the investor and offeror from going forward with the transaction was prohibited. For these reasons, the CTS Court held that the Indiana Act was not preempted by the Williams Act.

The CTS Court then addressed whether the Indiana Act violated the Commerce Clause. The Court's Commerce Clause analysis examined whether the Indiana Act: discriminated against interstate commerce; created an impermissible risk of inconsistent regulation; or was rationally related to its regulatory scheme. The Court quickly disposed of the first two questions. The Court concluded that the Indiana Act did not discriminate against interstate commerce, because nothing in the Indiana Act imposed a greater burden on out-of-state bidders than on bidders residing in Indiana. Second, the CTS Court concluded that because the Indiana Act sought to regulate only Indiana corporations, nothing in the statute created an impermissible risk of inconsistent regulation by the states.

Finally, the CTS Court addressed whether the purposes of the Indiana Act were rationally related to the Act's regulatory scheme. The test used was whether the regulatory scheme of providing for control-share approval was rationally related to the Indiana Act's stated goals of investor protection and state power to delineate the powers and rights of shares in the state's created corporations. The CTS Court placed special emphasis on the internal affairs doctrine. The Court recognized that the effect of laws regulating corporate governance would, in certain circumstances, incidentally regulate interstate commerce. However, to the

133. The 50-day period provided for in the Indiana Act was within the 60-day period Congress provided for reinstatement of withdrawal rights. See 15 U.S.C. § 78n(d)(3). The Court found that a delay within a congressionally proscribed period could not be held unreasonable. CTS, 481 U.S. at 85. However, in the context of a hostile tender offer, an additional 30-day possible delay, under the control of incumbent management, can give management an enormous advantage in erecting obstacles to the takeover. See, e.g., Easterbrook & Fischel, supra note 29. For this reason, this particular part of the Court's reasoning is questionable.

134. CTS, 481 U.S. at 86-87.

135. The CTS Court apparently did not engage in the Pike balancing test discussed in notes 100-11 and accompanying text. At least one commentator has concluded that the CTS Court did not engage in the Pike balancing test. See Regan, Siamese Essays: (I) CTS Corp. v. Dynamics Corp. of America and Dormant Commerce Clause Doctrine; (II) Extraterritorial State Legislation, 85 Mich. L. Rev. 1865, 1866 (1987). In addition, Justice Scalia's concurring opinion in CTS states that the inquiry of the Pike balancing test is ill suited to the judiciary and should be undertaken "rarely if at all." CTS, 481 U.S. at 95.

136. CTS, 481 U.S. at 88.

137. Id. at 89. "So long as each State regulates voting rights only in the corporations it has created, each corporation will be subject to only the law of only one State." Id.

138. "It thus is an accepted part of the business landscape in this country for States to create corporations, to prescribe their powers, and to define the rights that are acquired by purchasing their shares." Id. at 91.
extent that the Indiana Act hindered the interstate market for corporate control, the CTS Court found this burden was justified by Indiana's "substantial interest" in protecting its created corporations and in protecting shareholders. Accordingly, the Court held that the Indiana Act's stated purposes of protecting its created corporations and shareholders in these corporations were rationally related to the Act's regulatory scheme. Thus, the Court held the Indiana Act did not violate the Commerce Clause.\textsuperscript{139}

In light of the CTS decision, the Court has made it clear that it ascribes to no particular policy as to the merits of antitakeover legislation. However, the Court's opinion should not be read as validating all antitakeover legislation in the wake of CTS.\textsuperscript{140} The real issue that must be examined in the future of antitakeover legislation is how far the internal affairs doctrine can be used to control the interstate market for corporate control. With that issue in mind, this Note next examines the specific provisions and purposes of the Pennsylvania statute.

IV. THE PENNSYLVANIA STATUTE

The provisions of Act 36 significantly restrict the ability of a hostile bidder to launch a successful tender offer or proxy fight for a registered Pennsylvania corporation. The specific provisions of Act 36 make a hostile takeover more difficult and expensive by: 1) allowing the corporation's directors to consider stakeholder interests in evaluating the effect of a proposed business combination; 2) requiring a majority vote of the "disinterested shares" of the corporation in order to obtain control of the corporation; 3) providing for a forced redemption of any shares denied voting rights in a control-share acquisition; 4) requiring a controlling person to "disgorge," or forfeit, any profits realized on an unapproved disposition of the target corporation's stock within eighteen months of becoming a controlling person; 5) requiring minimum severance compensation to be paid to any employee terminated within two years of a control-share acquisition; and, 6) requiring continuation of labor contracts within five years of a business combination. While the final two provisions regulating severance compensation and labor contracts are permissible areas for state regulation, these provisions have no legitimate place in a state's antitakeover law. The following sections analyze both the specific provisions and the articulated intent of Act 36.

\textsuperscript{139} Id. at 94.

\textsuperscript{140} The Indiana Act only concerns the voting rights of bidders. Other state antitakeover legislation may still be struck down as an undue restraint on the interstate market for corporate control. Booth, supra note 112, at 1680-81.
A. Fiduciary Duties of Directors

Prior to Act 36, Pennsylvania corporation law permitted directors to consider stakeholder interests as part of their fiduciary duties to the corporation.\textsuperscript{141} What was apparently lacking under existing corporation law was the statutory authorization for directors to determine that the interests of the corporation's nonshareholder constituencies could predominate over the interests of the corporation's shareholders.

The fiduciary duty provisions of Act 36 erased any doubt that directors of Pennsylvania corporations may consider stakeholder interests as predominant over those of the shareholder. The fiduciary duty provisions permit directors to consider "the effects of any action upon any or all groups affected by such action, including shareholders, employees, suppliers, customers and creditors of the corporation, and upon communities in which offices or other establishments of the corporation are located."\textsuperscript{142} Directors also are not required, in considering the best interests of the corporation, "to regard any corporate interest or the interests of any particular group affected by such action as a dominant or controlling factor."\textsuperscript{143} By way of specific example, Act 36 enumerates that the fiduciary duty of a director does not require a director to act "solely because of the effect such action might have on an acquisition or potential or proposed acquisition of control of the corporation or the consideration that might be offered or paid to shareholders in such an acquisition."\textsuperscript{144}

A registered Pennsylvania corporation could elect to opt out of the coverage of the fiduciary duty provisions either by amending the corporation's bylaws on or before July 26, 1990 or by specifically opting out of such coverage in the corporation's articles of incorporation.\textsuperscript{145} Thus, the opt out scheme provides an option for the corporation to remain under

\textsuperscript{141} 15 PA. CONS. STAT. ANN. § 511(b) (Purdon Supp. 1989). In discharging their fiduciary duties, directors were allowed to "consider the effects of any action upon employees, upon suppliers and customers of the corporation and upon communities in which offices or other establishments of the corporation are located." \textit{Id.}

\textsuperscript{142} Act of April 27, 1990 § 511(d)(1), \textit{supra} note 5. The fiduciary duty provisions also provide that directors may consider both the short-term and the long-term interests of the corporation. \textit{Id.} § 511(d)(2). Similarly, the Delaware Supreme Court recently upheld the decision of the Time Inc. board of directors to reject a hostile tender offer and manage the company for long-term value. \textit{See} Paramount Communications, Inc. v. Time Inc., 571 A.2d 1140 (Del. 1989).

\textsuperscript{143} Act of April 27, 1990 § 511(d)(4), \textit{supra} note 5.

\textsuperscript{144} \textit{Id.} § 511(e).

\textsuperscript{145} \textit{Id.} § 511(g)(1)-(2). One could argue that the opt out scheme blunts the harsh operation of Act 36, by leaving investors free to invest only in corporations that elect to opt out of statutory coverage. The reply to this argument is that the interests of the national economy can still be harmed by the companies that do not elect to opt out of the coverage, thus shielding themselves from a competitive market, which is the essence of our free market system.
the full sway of the forces of the market. In fact, 91 of Pennsylvania’s 300 public companies have opted out of the coverage of Act 36.146

B. Control-Share Acquisition Provisions

The Indiana control-share acquisition statute147 was upheld as constitutional in CTS Corp. v. Dynamics Corp. of America.148 Therefore, the control-share statute in CTS would serve as a good model for any state seeking to include control-share provisions as part of its antitakeover law. Pennsylvania’s new antitakeover statute is no exception in this regard. The control-share acquisition provisions of Act 36 were obviously patterned after the Indiana statute and are identical in many respects.149

As in the Indiana statute, Act 36 attempts to establish the required nexus with the state by making the control-share provisions applicable only to registered corporations.150 Under Pennsylvania corporation law, a registered corporation is generally any domestic (Pennsylvania) corporation that has a class of securities registered under the Securities Exchange Act of 1934.151 Act 36 lists numerous exceptions whereby the control-share acquisition provisions do not apply,152 including an opt out scheme in which the corporation’s articles or bylaws may be amended to exclude a company from the statute’s coverage.153

“Control shares” are voting shares of a corporation that, if acquired, would result in a control-share acquisition.154 A “control-share acquisition” is an acquisition of voting power in such shares, that, if added together with all other voting power of the acquiring person,155 would enable the person to cast votes at or above any of the following three

148. 481 U.S. 69 (1987). CTS was a 6-3 majority decision authored by Justice Powell. The majority opinion was joined by Justices Rehnquist, Brennan, Marshall, O’Connor and Scalia. Justice White filed a dissenting opinion in which he was joined by Justices Blackmun and Stevens. Justices Powell, Brennan and Marshall have since left the Court, and have been replaced by Justices Kennedy, Souter and Thomas. The viability of third-generation antitakeover legislation such as Act 36 will depend on the votes of the latest jurists added to the Court.
149. For example, the Pennsylvania statute states that an “acquiring person” acquires “control shares” whenever shares are acquired that, but for the operation of the statute, would bring its voting power at or above any of three thresholds: 20%, 33 1/3%, or 50%. Act of April 27, 1990 § 2562, supra note 5. The Indiana statute contains identical provisions. IND. CODE ANN. § 23-1-42-1 (Burns Cum. Supp. 1986).
150. Act of April 27, 1990 § 2561(a), supra note 5.
151. Id. § 2502(1)(i).
152. Id. § 2561(b)(1)-(5).
153. Id. § 2561(b)(2).
154. Id. § 2562.
155. An acquiring person is a person who makes or proposes to make a control-share acquisi-
thresholds: 20%, 33 1/3%, or 50%.\textsuperscript{156} In the key provision, control shares do not have any voting rights unless a resolution approved by a vote of shareholders grants voting rights to the control shares.\textsuperscript{157} Any such resolution according voting rights to the control shares can be approved only by an affirmative vote of the corporation’s “disinterested shares.”\textsuperscript{158} “Disinterested shares” include all voting shares of the target corporation that are not beneficially owned by an acquiring person, executive officers or directors who are officers, or employee stock plans of the target whose voting power is not confidentially vested in the employee participants of the plan.\textsuperscript{159}

The issue of whether voting rights should be accorded the control shares may be presented either at the next annual meeting of shareholders, or at a special meeting of shareholders called to consider the issue of voting rights.\textsuperscript{160} The acquiring person may request a special meeting only if the acquiring person: 1) makes a written request for a special meeting; 2) files a detailed information statement with the registered corporation; 3) makes a control-share acquisition or a bona fide written offer to make a control-share acquisition, and; 4) agrees, in writing, to reimburse the corporation for the expenses of the special meeting.\textsuperscript{161} Requiring the acquiring person to pay the expenses of the special meeting adds one additional cost to the total acquisition effort. It is this increase in the total cost of the acquisition effort, coupled with the heightened potential to lose the takeover contest (through the operation of the control-share provisions) that deters hostile bids. Further, control-share meeting costs reduce shareholder wealth by contributing to overall acquisition expenses that might otherwise increase the control premium.

A fully conforming information statement must include: the identity of the acquiring person;\textsuperscript{162} the number and class of shares owned prior to the control-share acquisition and at the time of filing the information statement;\textsuperscript{163} the number and class of voting shares acquired or proposed to be acquired and a specification of which three threshold levels (20%, 33 1/3%, or 50%) the acquiring person’s consummation of the control-
share acquisition will result in;\textsuperscript{164} the terms of the acquisition, including source of financing, plans for debt service and any pension fund which is a potential source of consideration for the acquisition;\textsuperscript{165} and, any plans or proposals for the target corporation, including business combinations, liquidations, plant or facility shutdowns, asset sales, transfers of business operations to different locations, or any material changes in relationships with suppliers, customers, or communities in which the corporation has operations.\textsuperscript{166} While the requirements of a fully conforming information statement are comprehensive, they are virtually identical to the disclosure requirements of the Williams Act\textsuperscript{167} and therefore, the information statement itself presents no Supremacy Clause problems.

If the acquiring person can meet all of these requirements, the special meeting of shareholders must be held within 50 days.\textsuperscript{168} The board of directors of the target corporation is then required to provide notice of the meeting to shareholders, including an statement expressing approval, rejecting approval, or expressing no opinion with respect to according voting rights to the control shares.\textsuperscript{169} Unlike the permissive nature of the fiduciary duty provisions of Act 36, in making this recommendation to shareholders, the directors must specifically consider stakeholder interests.\textsuperscript{170} At the special meeting, the “disinterested shares” of the corporation either accord or deny voting rights to the control shares.\textsuperscript{171} Providing for voting appears to be a good idea if the deal is just an offer. In this way, the disinterested shares get an opportunity to determine whether a change in control is appropriate. Unfortunately, when the bid is opposed, the control-share provisions act as a significant roadblock for management to thwart good offers.

C. Forced Redemption

Act 36 provides that the corporation may redeem the control shares if voting rights are denied, accorded and subsequently lapse, or if the acquiring person does not request presentation of the issue of voting rights.\textsuperscript{172} Unlike the Indiana Act which provides for forced redemption

\begin{footnotes}
\item[164] Id. § 2565(a)(4).
\item[165] Id. § 2565(a)(5).
\item[166] Id. § 2565(a)(6).
\item[167] See 15 U.S.C. §§ 78m(d)&(e) and 78n(d)-(f) (1988).
\item[168] Act of April 27, 1990, § 2564(a), supra note 5.
\item[169] Id. § 2564(c).
\item[170] Id. § 2564(c)(3).
\item[171] See supra note 157 and accompanying text.
\item[172] Act of April 27, 1990 § 2566, supra note 5. Voting rights accorded can subsequently lapse if the control-share acquisition which was the subject of shareholder approval is not consummated within 90 days of shareholder approval. Id. § 2563(b).
\end{footnotes}
at a fair price,\textsuperscript{173} Act 36 presents a hidden danger for the hostile bidder. The hidden danger to the acquiring person in the forced redemption provision is that the corporation may redeem the control shares at the average of the high and low sales prices, upon notice, at any time within twenty-four months of the denial, lapse, or failure to present the issue of voting rights.\textsuperscript{174} Thus, the acquiring person may incur a substantial loss on her front-end investment by a fluctuation in the market price of the target corporation's stock.\textsuperscript{175} The forced redemption provisions constitute another substantial deterrent to making a hostile bid for a Pennsylvania corporation.

D. Disgorgement of Profits

The provisions of Act 36 providing for disgorgement of profits are among the most controversial of the statute because they provide that, in certain circumstances, profits on dispositions of securities of Pennsylvania corporations will be “disgorged,” or forfeited, to the corporation.\textsuperscript{176} These provisions are controversial because, before Act 36, any such profits belonged solely to the person selling the corporation's securities. For this reason, the disgorgement provisions of Act 36 will certainly be subject to extensive scrutiny as other states attempt to define how far their corporate governance law can be used to regulate takeover activity.

Perhaps because the Pennsylvania legislature recognized that the disgorgement provisions would be subject to extensive scrutiny, both the policy and the purpose of the disgorgement provisions were set forth in section 2572 of Act 36. That section states that its purpose is to protect covered corporations and the interests of various groups related to such corporations from manipulative and coercive actions.\textsuperscript{177} The specific manipulative and coercive actions section 2572 seeks to regulate are: “greenmail,”\textsuperscript{178} preventing corporations from being put “in play;”\textsuperscript{179} ensuring speculators who put corporations “in play” do not misappropriate

\textsuperscript{173} IND. CODE ANN. § 23-1-42-10.
\textsuperscript{174} Act of April 27, 1990 § 2563(b), supra note 5.
\textsuperscript{175} This is the exact scenario played out in the Belzberg-Armstrong drama. The Belzbergs sustained a gross loss of $17 million as a result of market fluctuations in Armstrong's stock from July, 1989 to May, 1990. N.Y. Times, May 31, 1990, Section D, at 5, col. 3.
\textsuperscript{176} Act of April 27, 1990 §§ 2571-2575, supra note 5.
\textsuperscript{177} Id. § 2572(a).
\textsuperscript{178} Id. § 2572(a)(1). “Greenmail” is a process whereby a corporate raider will purchase a minority position in a company vulnerable to takeover, hoping to intimidate management in repurchasing the corporation's shares at a profit for the raider. Fin. Times, Sept. 12, 1990, Section I, at 29.
\textsuperscript{179} Act of April 27, 1990 § 2572(a)(2), supra note 5. A company can be put “in play,” or on the auction block, by any number of actions either outside of or within the company. For example, a company can be put “in play” as result of a management self-tender for the company's shares in a leveraged buy-out.
corporate values; and discouraging speculators from putting corporations “in play” for means of reaping short-term speculative profits. With the exception of greenmail, it is difficult to conceive how any actions related to putting a company “in play” represent manipulation or coercion. While greenmail clearly is a coercive tactic, greenmail practices could easily be eliminated by erecting a state regulation prohibiting greenmail. This alternative would eliminate the coercive practice of greenmail, while allowing otherwise legitimate bids to proceed.

Section 2572 further states that it recognizes “the right and obligation of the Commonwealth to regulate and protect the corporations it creates from abuses ... of its own laws affecting ... corporate governance ... .” This sentence attempts to bootstrap the internal affairs doctrine as the state’s asserted purpose for its antitakeover law, as was successfully done in the control-share statute at issue in CTS. This appears to be little more than a self-serving legislative justification for discouraging takeovers of Pennsylvania companies, because the Pennsylvania provisions go beyond mere corporate governance to substantive economic regulation, which is beyond the scope of the internal affairs doctrine.

As with the control-share provisions of Act 36, the disgorgement provisions establish the required nexus with the state by generally applying to all registered corporations. There are also numerous exceptions when the disgorgement provisions do not apply. These exceptions include both an opt out scheme and a safe harbor for any dispositions approved by both the board of directors and a majority of the corporation’s shares entitled to vote on the issue of granting a safe harbor exemption. Thus, once a bidder gained control of a target corporation, the disgorgement provisions could be effectively disarmed via the safe harbor exemption.

The disgorgement provisions generally provide that any profit when a bidder gained control of a target corporation, the

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180. Id. § 2572(a)(3).
181. Id. § 2572(a)(4).
182. See Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985). In Unocal, T. Boone Pickens’s offer for Unocal was never meant to succeed. The offer was made to attempt to “greenmail” Unocal into buying back Pickens’s Unocal stock at a premium not available to other Unocal shareholders. Id. at 956 n.13.
183. Act of April 27, 1990 § 2572, supra note 5.
185. Act of April 27, 1990 § 2571, supra note 5. See supra note 151 and accompanying text for the definition of a registered corporation.
186. Id. §§ 2571(b)(2) & (b)(7).
187. “Profit” is defined as the positive value, if any, of any difference between consideration received on the disposition of securities and consideration paid on the acquisition of the securities, including usual and customary broker’s fees on both the purchase and the sale. Id. at § 2573.
alized by any controlling person from the disposition of any equity security of the target corporation to any other person (including the corporation)\textsuperscript{188} belongs to the corporation.\textsuperscript{189} A "controlling person" is anyone who has acquired, offered to acquire, or intends to acquire at least 20% of the voting power over voting shares or any person who has disclosed that it may seek to acquire control of the corporation.\textsuperscript{190} The disgorgement provisions apply to any profitable dispositions of equity securities within eighteen months after attaining controlling person status.\textsuperscript{191} Further, the provisions apply to any equity securities acquired within twenty-four months prior to or eighteen months after attaining controlling person status.\textsuperscript{192}

The disgorgement provisions are designed primarily to deter hostile bids for Pennsylvania corporations. The only apparent benefits provided by the disgorgement provisions are either illegitimate, or could be better accomplished with a rule prohibiting greenmail. First, the disgorgement provisions provide the corporation and the shareholders with a benefit by providing additional funds for the corporate treasury after the disgorgement of profits. However, this is not a legitimate objective of state corporate governance law, as it goes against the very principles on which our free market system is founded. Second, while protecting a corporation from the coercive practice of greenmail is a legitimate objective, it can be more efficiently accomplished by merely erecting a rule prohibiting greenmail. A rule prohibiting greenmail would protect the corporation from coercion, while allowing legitimate bids to proceed.

By examining the disgorgement provisions carefully, one can see that their primary purpose was to completely discourage a hostile bidder from seriously considering a bid for a Pennsylvania corporation. The disgorgement provisions apply to all securities bought even before the offer is launched, thus further reducing competition for corporate control and helping to entrench management. After all, entrenching management is the whole point of the statute. State legislators need contributions from rich, entrenched managers who want to continue to be rich, entrenched managers. The new owners, trying to efficiently run the target company after a takeover are not likely to be so friendly to the state

\textsuperscript{188} Since the statute's coverage includes dispositions to the corporation, "greenmail" is explicitly covered by the statute.
\textsuperscript{189} Id. § 2574.
\textsuperscript{190} Id. § 2573. The definition of controlling person is quite broad, as it includes anyone who merely announces an intention to seek control, regardless of whether they control any of the target's voting shares.
\textsuperscript{191} Id. § 2574(1).
\textsuperscript{192} Id. § 2574(2).
legislators who tried to close the door on hostile bids. Again, to the extent that the true purpose of the legislation is recast in this protectionist light, it should be subject to a heightened scrutiny.

E. Severance-Compensation Provisions

The severance-compensation, or tin parachute, provisions of Act 36 generally provide that any eligible employee whose employment is terminated within ninety days before the control-share approval, or within twenty-four months after the control-share approval, shall receive a one-time lump sum payment from the employer equal to the minimum severance amount. An eligible employee is defined as any employee of a corporation who was employed within ninety days before or on the date control-share approval was granted and had been so employed for at least two years. Eligible employees must also perform their duties within the Commonwealth of Pennsylvania. The minimum severance amount is equal to the employee's weekly compensation times the number of years of service, up to a maximum of twenty-six years.

The severance compensation provisions are triggered by control-share approval. Control-share approval occurs when both a control-share acquisition takes place and when such control shares are accorded voting rights. Control-share approval also includes a control-share acquisition which occurs pursuant to a merger, consolidation or plan of share exchange to which the corporation is a party, if such control-share acquisition is the result of incumbent management fending off a hostile bidder. Thus, management self-tenders or a business com-

193. Severance compensation arrangements for upper level management are usually explicitly contracted for and referred to as "golden parachutes." Conversely, severance arrangements for middle and lower-level corporate employees are typically not made by contract. Any such severance arrangements are typically provided by statute and referred to as "tin parachutes." Tin parachute provisions are provided by federal statute under the Worker Adjustment and Retraining Notification Act, 29 U.S.C. § 2101 (1989).

194. A termination is defined as any involuntary termination or a layoff of at least six months. Act of April 27, 1990 § 2581, supra note 5. The statute recognizes exceptions for employee terminations due to willful misconduct of the employee. Id. at § 2582(a).

195. The statute provides for severance compensation if an employee was terminated within 90 days before the control-share approval if the termination was pursuant to either a formal or informal arrangement with the acquiring person. Id.

196. Id.

197. Id. § 2581.

198. Id.

199. Id. The minimum severance amount is reduced for any payments made to the employee due to the termination. Id. at § 2582(a)(2). No payment is required if the employer voluntarily pays the employee severance at least equal to the minimum severance amount. Id. at § 2582(b).

200. See supra note 156.

201. Act of April 27, 1990 § 2581, supra note 5. See supra note 157 and accompanying text.

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bination with a "white-knight" are not exempt from the statute's severance compensation provisions.

Standing alone, severance compensation provisions such as those included in Act 36 are clearly within the state's police power. What is troubling is the fact that such provisions have been made part and parcel of the state's antitakeover law. Further, while the severance compensation provisions appear to provide workers of Pennsylvania corporations with increased financial protection in the event of job termination, such protection is a red herring. Act 36 provides no more severance protection than currently offered under federal law. One possible alternative explanation for the inclusion of severance compensation provisions in the state's antitakeover law is that the provisions were calculated to garner political support from Pennsylvania workers.

F. Continuation of Labor Contracts

The labor contract provisions of Act 36 provide that "[n]o business combination transaction shall result in the termination or impairment . . . of any covered labor contract . . . ." Business combination transactions that are within the statute's reach include any business operations owned by a registered corporation (or any subsidiary) at the time of a control-share approval. The business operations must be within the Commonwealth of Pennsylvania and the business combination must occur within five years of the control-share approval. The statute's provisions apply irrespective of the fact that the business operation is still

203. A "self-tender" by management takes place when a group led by existing management of the corporation makes a tender offer for the corporation's shares, thus taking the company private, typically through a leveraged buy-out (LBO). For a discussion of the increasing trend toward LBO's, see Jensen, supra note 27.

204. Often, when management of a target corporation becomes the subject of a hostile tender offer, they will seek out a "white knight," an acquiror that is friendly to existing management. For example, when T. Boone Pickens made an unsolicited bid for Gulf Oil in late 1983, Gulf solicited and ultimately ended up being acquired by Standard Oil of California, in March, 1984. R. HIGGINS, supra note 56, 278-79.

205. See the Worker Adjustment and Retraining Notification Act, 29 U.S.C. § 2101 (1989). Under either the federal or the Pennsylvania approach, the target corporation will pay the costs of the severance compensation. Thus, there are no apparent disincentives for the bidder of a Pennsylvania company.

206. In support of the premise that in-state political interests often motivate the passage of state antitakeover legislation, see generally, Romano, The Political Economy of Takeover Statutes, 73 VA. L. REV. 111 (1987).

207. Act of April 27, 1990 § 2587, supra note 5.

208. Business combination transactions include any merger, consolidation, sale, lease, exchange or other disposition. Id. § 2586.

209. Id. § 2585(a).

210. Id. § 2585(b)(2).

211. Id. § 2585(b)(1).
owned by the registered corporation after control-share approval.\textsuperscript{212} Thus, the statute's provisions would still apply in the case of a substantial restructuring of the corporation's operations as a result of fending off a hostile takeover.

The Act preserves covered labor contracts until the contract terminates by its provisions or until otherwise agreed by the parties to the contract.\textsuperscript{213} A covered labor contract includes any contract in effect covering persons employed in Pennsylvania relating to a business operation owned by the corporation at the time of the control-share approval.\textsuperscript{214}

Standing alone, the provisions calling for the continuation of labor contracts are clearly permissible as a legitimate state concern. The troubling fact is that such provisions are included as part of the state's antitakeover statute. Such provisions close the door on any renegotiation of a covered labor contract, thus acting as one additional deterrent to making a bid for a Pennsylvania company. By preventing the impairment of any covered labor contract, the Act negates a major incentive for entering into a takeover, namely increasing the operating efficiency of the target company by reducing labor costs. By preventing any impairment of a covered labor contract, the Act prevents a redeployment of corporate assets to their highest valued uses.

V. CONSTITUTIONAL ANALYSIS

The end of the 1980s seems to have brought a temporary slowdown for the soaring takeover market, when mergers and acquisitions were fueled by junk bonds and leveraged buyouts.\textsuperscript{215} In fact, some commentators note that the market has made a self-correction (by a reduction in available means of financing) for some of the perceived abuses in the takeovers of the 1980s, just as state legislatures are increasing their legislative efforts in the antitakeover field.\textsuperscript{216} On the other hand, the market for corporate control appears to have shifted into the hands of giant worldwide companies snapping up their competitors in order to strategically enlarge their businesses.\textsuperscript{217} Therefore, while no immediate challenge to Act 36 is on the horizon, such a challenge probably will surface

\textsuperscript{212} Id. § 2585(a).
\textsuperscript{213} Id. § 2587.
\textsuperscript{214} Id. § 2586.
\textsuperscript{216} Fin. Times, Oct. 18, 1990 at 34.
\textsuperscript{217} For example, in December 1990, American Telephone & Telegraph made a $6 billion unsolicited bid for NCR Corp., only a week after Matsushita's $6.59 billion acquisition of MCA. Wall St. J., Dec. 4, 1990, at C1.
in the not-too-distant future. This section analyzes what provisions, if any, of Act 36 are likely to withstand constitutional scrutiny.

A. Supremacy Clause Analysis

In analyzing the Pennsylvania statute to determine whether it is preempted by the Williams Act, one must reexamine the purposes and mechanisms established in the Williams Act to regulate the conduct of tender offers. As noted by Judge Easterbrook:

[t]he Williams Act regulates the process of tender offers: timing, disclosure, proration if tenders exceed what the bidder is willing to buy, best-price rules. It slows things down, allowing investors to evaluate the offer and management's response . . . . After complying with the disclosure and delay requirements, the bidder is free to take the shares.\(^{218}\)

Therefore, while Congress's primary goal in enacting the Williams Act was providing investor protection, Congress sought to achieve this goal by regulating the tender offer process, including disclosure, and not the business merit of tender offers.

In \textit{Edgar v. MITE Corp.},\(^{219}\) three Justices concluded that the Illinois statute was preempted by the Williams Act because the statute impermissibly attempted to regulate both the merit and the process of tender offers, in contravention of the mandate of the Williams Act. Conversely, in \textit{CTS Corp. v. Dynamics Corp. of America},\(^{220}\) the Court concluded the Indiana Act was not preempted by the Williams Act. The Indiana Act gave a majority of the corporation's "disinterested shareholders" the power to affirmatively grant or withhold voting rights to the shares sought in a hostile tender offer—facially, a mere regulation of the process of conducting a tender offer. The \textit{CTS} Court found no inconsistency between federal and state law because the Indiana Act allowed the bidder to acquire shares without interference, even though the acquisition of voting rights was conditioned on obtaining the majority approval of the corporation's disinterested shareholders.\(^{221}\) Because nothing in the Indiana Act purported to pass judgment on the merits of tender offers, the \textit{CTS} Court held the Indiana Act did not conflict with federal law.\(^{222}\)

\(^{219}\) 457 U.S. 624 (1982).
\(^{221}\) Amanda, 877 F.2d at 497.
\(^{222}\) The \textit{CTS} Court adopted the following standard in order to determine whether a state's antitakeover law impermissibly conflicts with the Williams Act's primary purpose of investor protection: does the state statute upset the delicate balance between incumbent management and bidders, to the detriment of shareholders? \textit{CTS}, 481 U.S. at 80-82. This standard was an adoption of the \textit{MITE} plurality opinion. Although the \textit{CTS} Court was not required to adopt the \textit{MITE} plurality
The problem with the CTS preemption analysis is a failure to meaningfully probe the effects of the state regulation at issue. When process regulation becomes unduly burdensome, it leaves no tender offer process for federal law to regulate. Clearly, the Indiana Act "makes tender offers more risky and expensive . . . . [f]rom this, one can fairly assume some chilling effect." Tender offers subject to control-share provisions like the Indiana Act are made more risky and expensive by the "additional expense of seeking a shareholder vote . . . coupled with the risk that the shareholders will fail to grant voting rights . . . reduc[ing] the expected value of a bid, which in turn lessens the likelihood that a bid . . . will be launched." Thus, the effect of the Indiana Act completely chills the tender offer process, which in turn robs shareholders of the right to make a free decision. This impermissibly conflicts with the Williams Act's primary purpose of investor protection, by upsetting the delicate balance between incumbent management and bidders, to the detriment of shareholders. Thus, a broader analysis of the Indiana Act would have concluded that the state law impermissibly interfered with the policy of investor choice mandated by federal disclosure law, and that the Indiana Act was preempted by the Williams Act.

If the Indiana Act placed new obstacles in the path of hostile bids, Pennsylvania’s Act 36 will derail them entirely. In a systematic and carefully crafted piece of legislation, Pennsylvania has set forth five provisions designed to completely prohibit hostile tender offers for Pennsylvania corporations.

First, the fiduciary duty provisions of Act 36 allow the directors to reject a hostile tender offer by concluding that stakeholder interests predominate over the interests of the shareholders. Assuming the bidder still has enough fortitude to proceed with a hostile bid, and the attendant litigation, Act 36 requires any shares acquired in a control-share acquisition to be subject to a majority vote of the corporation’s disinterested shareholders before obtaining voting rights. Requiring control-share approval presents a formidable obstacle to a hostile takeover by introducing additional expense and risk into the tender offer process.

opinion because it did not represent the views of the majority of the Court, the CTS Court adopted what it felt was a “broad” reading of the Williams Act, concluding that the Indiana Act could withstand a preemption challenge even upon such a broad interpretation. Id. at 81.


224. Id. at n.47.

225. CTS, 481 U.S. at 80.


227. Id. § 2563(a).

228. See supra notes 222-25 and accompanying text.
Additional expense will be incurred by requiring the bidder to pay the expenses of the special meeting required to decide the issue of according voting rights to the control shares. These expenses may ultimately prove to be quite significant. Additional risk is introduced into the hostile bid by making voting rights conditional on control-share approval.

Third, an additional significant risk awaits the hostile bidder in the form of the Act's forced redemption provisions. If the bidder seeks control-share approval and fails, the target corporation can redeem the control-shares at the average of the high and low sale prices of the shares at any time within twenty-four months of the denial of voting rights. A hostile bidder treads in dangerous waters if she seeks and fails to gain control-share approval. Failure to obtain control-share approval will permit the target corporation to wait for a significant decline in the target's stock price before redeeming the hostile bidder's shares at bargain prices.

However, if the fiduciary duty provisions, the control-share provisions and the forced redemption provisions are not enough to deter a hostile bidder, the disgorgement provisions of Act 36 enter the picture, by essentially acting as a penalty for anyone foolhardy enough to make a hostile bid for a Pennsylvania company and fail. A typical scenario in which these provisions might operate would be as follows. Even though discouraged by incumbent management, who rejected a bid as contrary to stakeholder interests, the bidder sought to consummate a deal by seeking control-share approval. The shareholders, perhaps adopting management's recommendation against the bid, deny control-share approval. Can the hostile bidder cut her losses (incurred paying for the special meeting of shareholders, the Williams Act requirements, the attorneys and the accountants), by closing out her profitable position in the target corporation? No, because the disgorgement provisions kick in and penalize the hostile bidder for having the temerity to make a hostile bid for a Pennsylvania corporation.

Finally, the continuation of labor contract provisions prevent the reduction or renegotiation of a covered labor contract. The labor con-
tract provisions, if standing alone, would present no Supremacy Clause problems. The troubling fact is that these provisions have been included as part and parcel of the state's antitakeover law, as one additional deterrent to a hostile takeover. These provisions of Act 36 negate a major incentive for entering into a corporate takeover, by forbidding a corporate realignment that would deploy a target corporation's assets in the most efficient manner possible.

Thus, while nothing in Act 36 overtly regulates the merit of tender offers, the heavy-handed nature of Pennsylvania's regulation of its created corporations is so unduly burdensome that it leaves no process for federal law to regulate. By making tender offers riskier and more expensive, and by seeking to penalize those who would make a hostile offer for a Pennsylvania corporation, Act 36 completely chills the tender offer process. Because these provisions give management a decided advantage in forestalling even good bids, Act 36 tips the scale in the favor of incumbent management, and thus conflicts with the Williams Act's primary goal of investor protection. Act 36 should thus be preempted as impermissibly conflicting with the Williams Act.

B. Commerce Clause Analysis

The Commerce Clause provides that "Congress shall have Power . . . to regulate Commerce . . . among the several States." At least since Cooley v. Board of Wardens in 1852, it has been settled that the dormant Commerce Clause, by negative implication, limits the authority of the states to enact legislation restricting the flow of interstate commerce, even absent congressional action.

In analyzing the Pennsylvania statute to determine whether it violates the dormant Commerce Clause, one must remember the primary purpose of the Commerce Clause. The primary reason the Commerce Clause was included in the Constitution was to grant Congress power over the national economy, in order to prevent the economic warfare prevalent between the states under the Articles of Confederation. As severance compensation provisions are a political measure calculated to gain support from Pennsylvania workers, as identical protection is currently offered under federal law.

233. For example, a major incentive for Carl Icahn's takeover of TWA was that the carrier's unions agreed to renegotiate covered labor contracts. These renegotiated labor contracts allowed TWA to substantially lower its operating costs after Icahn acquired the company. Travel Weekly, May 19, 1988.

234. U.S. CONST. art. I, § 8, cl. 3.
235. 53 U.S. (12 How.) 299 (1852).
236. CTS, 481 U.S. at 87.
noted by Justice White in *CTS*:

The few simple words of the Commerce Clause — 'The Congress shall have Power . . . To regulate Commerce . . . among the several States . . .' — reflected a central concern of the Framers that was an immediate reason for calling the Constitutional Convention: the conviction that in order to succeed, the new Union would have to avoid the tendencies toward economic Balkanization that had plagued relations among the Colonies and later among the States under the Articles of Confederation.\(^{238}\)

The *MITE* decision reflected this central concern of the Commerce Clause, by concluding that the Illinois takeover statute at issue violated the Commerce Clause in two ways. First, by attempting to directly regulate the interstate market for corporate control, the Illinois statute represented an attempt at extraterritorial legislation. Second, by engaging in a balancing process, the *MITE* Court concluded that the purported benefits of the statute were outweighed by the statute's substantial burden on the interstate market for corporate control.

Conversely, the *CTS* Court concluded that nothing in the Indiana Act discriminated against interstate commerce,\(^ {239}\) and that the Act created no risk of inconsistent regulation.\(^ {240}\) Finally, unlike the *MITE* Court, the *CTS* Court declined to scrutinize the Indiana Act under the general-purpose balancing test advocated in *Pike v. Bruce Church Inc.*\(^ {241}\)

\(^{238}\) *CTS*, 481 U.S. at 100 (White, J., dissenting), (quoting Hughes v. Oklahoma, 441 U.S. 322, 325-26 (1979)). *See also*, H.P. Hood & Sons v. DuMond, 336 U.S. 525, 537-538 (1949). "[The] principle that our economic unit is the Nation, which alone has the gamut of powers necessary to control the economy, including the vital power of erecting customs barriers against foreign competition, has as its corollary that the states are not separable economic units." *Id.*

\(^{239}\) *CTS*, 481 U.S. at 88. "Because nothing in the Act imposes a greater burden on out-of-state offerors than it does on similarly situated in-state offerors, we reject the contention that the Act discriminates against interstate commerce." *Id.* When analyzing a state statute to determine if the effects are discriminatory, the Court has found that "[w]hen simple economic protectionism is effected by state legislation, a virtual per se rule of invalidity has been erected." *Philadelphia v. New Jersey*, 437 U.S. 617, 624 (1978).

\(^{240}\) The Court concluded that the Indiana Act created no risk of inconsistent regulation, because unlike the Illinois statute at issue in *MITE*, the Indiana Act only applied to Indiana corporations. *CTS*, 481 U.S. at 89. *See also* Bibb v. Navajo Freight Lines, 359 U.S. 520 (1959), in which the Court struck down an Illinois statute specifying that contour mud guards be used on any trucks operating in Illinois. Because the Illinois statute disallowed interstate trucking operations from using mud flaps that were legal in the majority of the other states, the Court held that the Illinois regulation was a clear burden on interstate commerce. *Id.*

\(^{241}\) 342 U.S. 140 (1970). The majority opinion of the *CTS* Court never cited *Pike*. Further, Justice Scalia's concurring opinion stated that the inquiry of the *Pike* balancing test is ill suited to the judiciary and should be undertaken "rarely if at all." *CTS*, 481 U.S. at 95. Justice Scalia was reluctant to engage in an ends balancing approach because he believes a task which balances the purported local benefits of a statute against the supposed burdens of the statute involves a fact-finding function better suited to the legislature. *Id.* One commentator has proposed that in the area of dormant Commerce Clause jurisprudence, no matter what tests the Court has set forth (i.e., balancing), the Court has only been concerned (and properly so) with preventing the states from engaging in purposeful economic protectionism. *See* Regan, *The Supreme Court and State Protectionism*:...
Instead, the CTS Court analyzed whether the purported goals of the Indiana Act were rationally related to the Act's regulatory scheme. The Court concluded that the Act's stated goals of investor protection and protection for Indiana corporations were rationally related to the Act's regulatory scheme providing for control-share approval. Thus, the Court concluded that the Indiana Act did not violate the dormant Commerce Clause.

The main weakness in CTS's Commerce Clause analysis is a failure to probe beyond the surface of the Indiana Act, both in terms of purpose and the effect of the statute. The analysis is rather unimaginative as to what type of discriminatory purpose might underlie the statute. One such possible discriminatory purpose could have been to protect Indiana businesses from the interstate market from corporate control. Further, the CTS analysis fails to challenge whether the Indiana Act will have a substantial negative impact on the national economy—just the type of protectionist state legislation the Commerce Clause was intended to prevent.

However, if the Court were to apply a more probing analysis in a review of Pennsylvania's Act 36, such an analysis would reveal that although Act 36 is facially neutral, it represents an effort to favor in-state interests at the expense of national economic growth through optimal allocation of assets, which Congress sought to encourage via Williams Act neutrality. Act 36 represents an effort to favor in-state interests because, like other third-generation antitakeover legislation, it...
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has clearly been aimed at protecting in-state stakeholder interests. The "benefit" provided by Act 36 is nothing more than protection for Pennsylvania stakeholder interests such as Pennsylvania workers, the enacting state, and in-state corporations under siege from a hostile tender offer.

Pennsylvania's Act 36 was enacted to provide protection for Armstrong World Industries, cowering under the threat of a hostile bid from the Belzbergs. In fact, in support of antitakeover legislation like Act 36, Pennsylvania's Attorney General Ernie Preate said, "Pennsylvania has the right to protect the future of its communities against exploitation by speculators." But, Pennsylvania does not have the right to close its borders to the flow of interstate commerce. The motivation of protecting local interests "flies in the face of a core commerce clause value: avoiding local protectionism with respect to the interstate movement of economic resources."

However, Act 36 is "outwardly cloaked 'in the currently fashionable garb'..." of shareholder protection, which protected the Indiana Act in CTS. While Act 36 is carefully crafted to apply equally to both Pennsylvania bidders and out-of-state bidders, no one can seriously contend that Pennsylvania will be forced to accept any significant negative economic costs by forbidding Pennsylvania bidders to forego hostile bids for Pennsylvania companies. In Amanda Acquisition Corp. v. Universal Foods Corp., Judge Easterbrook concluded that Wisconsin's antitakeover statute did not discriminate against interstate commerce because the statute equally discouraged both in-state and out-of-state tender offers. Judge Easterbrook correctly observed that "[d]oubtless most bidders...

248. The stakeholder interests served by state antitakeover legislation include the enacting state as well as in-state target corporations under siege from a hostile tender offer. Professor Booth notes that the true motivation behind antitakeover legislation may be prospects of gains to be realized by the enacting state (for example, by retaining the state and local tax base). Booth, supra note 112, at 1668-69. See also Steinberg, supra note 45, at 83-85. Steinberg notes that a large number of third-generation antitakeover legislation was enacted by state legislatures under pressure from home-based companies under siege from hostile tender offers. Id. For example, the following states enacted antitakeover legislation at the behest of the following large private employers: Minnesota - Dayton Hudson; Arizona - Greyhound; North Carolina - Burlington Northern; Massachusetts - Gillette; and Washington - Boeing. Id. Even Professor Coffee admits that a persuasive argument can be made that the "benefit" provided by antitakeover legislation is no more than thinly-disguised protectionism designed to protect in-state stakeholder interests. Coffee, supra note 8, at 100.

249. 21 SEC. REG. LAW RPT. 1223 (1989). In a similar vein, Governor Dukakis's recent signing of Massachusetts's new antitakeover bill took place on the steps of the Gillette factory. Steinberg, supra note 45, at 85.

250. Langevoort, supra note 223, at 107.


252. 877 F.2d 496 (7th Cir.), cert. denied, 493 U.S. 955 (1989).

253. Id. at 505.
are located outside Wisconsin.” 254 He missed the point however, when he concluded that “... unless the law discriminates according to residence alone [the fact that most bidders are located outside Wisconsin] does not matter.” 255 In the past, the Supreme Court has not failed to look beyond facially neutral statutes to determine if the harmful effects of such statutes are disproportionately visited upon out-of-state actors. 256

Thus, a legitimate claim can be made that Act 36 represents Pennsylvania’s protectionist attempt to prevent an unrestricted market for corporate control from operating within Pennsylvania. Pennsylvania cannot be permitted to block the flow of interstate commerce at its border. Applying the rule of Philadelphia v. New Jersey, when “simple economic protectionism is effected by state legislation, a virtually per se rule of invalidity has been erected.” 257 Thus, Act 36 violates the Commerce Clause as purposeful economic protectionism.

In addition, Act 36 represents a statute whose harmful effects are disproportionately shouldered by out-of-staters. Protectionist legislation like Act 36 “is inefficient because it diverts business away from presumptively low-cost producers without any colorable justification in terms of a benefit that deserves approval from the point of view of the nation as a whole.” 258 Act 36 will injure the national economy 259 by precluding hostile takeovers that would otherwise serve national economic interests, by optimally allocating corporate assets, irrespective of state borders.

Again, Act 36 is carefully crafted to apply equally to both Pennsylvania and out-of-state hostile bidders. Pennsylvania, however, receives all the “benefits” of Act 36—protection of Pennsylvania workers, Pennsylvania corporations, and Pennsylvania’s state and local tax base. The rest of the nation bears the costs of Act 36—the prevention of a free flow of the nation’s economic resources to their highest and most efficient use. 260

254. Id. at 506.
255. Id.
258. Regan, supra note 241, at 1118.
259. In Amanda, Judge Easterbrook recognized that state antitakeover legislation injures the economy, by preventing premium hostile bids which reflect the better use to which the bidder can put the target company’s assets. Amanda, 877 F.2d at 500. Professor Langevoort maintains that “no one seriously can deny that [hostile bids] are of some (if indeterminate) value to the national economy.” Langevoort, supra note 223, at 116.
260. Concluding that Pennsylvania could be forced to accept some costs present in a hostile takeover, Pennsylvania responds by erecting such large barriers as to preclude a bidder from even seriously entertaining thoughts of making a hostile bid for a Pennsylvania company. See supra notes 223-33 and accompanying text for a discussion of the ways in which Act 36 operates as a formidable barrier to the successful completion of a hostile tender offer.
Thus, Act 36 clearly represents a statute whose harmful effects are disproportionately visited upon out-of-state interests. Applying the rule of *Hunt v. Washington State Apple Advertising Commission*, when a statute is facially neutral, but with a disproportionate harmful effect on out-of-staters, the Court has not hesitated to find that the statute violates the Commerce Clause. The disproportionate harmful effects of Act 36 unduly burden the interstate market for corporate control. Accordingly, Pennsylvania’s Act 36 should be struck down as an impermissible regulation of the interstate market for corporate control.

**VI. CONCLUSION**

This Note has examined the policy arguments for and against state antitakeover legislation, concluding state antitakeover legislation should not be allowed to restrict the free flow of corporate assets to their highest valued use within the entire national economy.

Pennsylvania's Act 36 should be preempted as a result of the Williams Act. Applying the reasoning of the Supreme Court in *CTS Corp. v. Dynamics Corp. of America*, none of the provisions of Act 36 facially conflict with the Williams Act. However, a broader analysis shows that the heavy-handed nature of Act 36 is so unduly burdensome on bidders that it upsets the delicate balance between incumbent management and the bidder, to the detriment of the investor. For this reason, Act 36 impermissibly conflicts with the Williams Act's primary goal of investor protection, and thus, should be preempted.

Moreover, because Act 36 embodies the type of purposeful economic protectionism which the Commerce Clause was intended to prevent and because the effect of Act 36 is to unduly burden the national economy, Act 36 should be struck down as a impermissible restraint of interstate commerce. Since both the purpose and the effect of Act 36 is to prevent the free flow of corporate assets within the national economy, the statute is an impermissible regulation of the interstate market for corporate control.

261. 432 U.S. 333 (1977). *Hunt* declared a North Carolina law requiring closed cartons of apples shipped into North Carolina to bear only the USDA grading label unconstitutional as an undue burden on interstate commerce. *Id.* While the North Carolina law was facially neutral, the Court found the law's effect to be discriminatory, because unlike other states, North Carolina had no separate state grading system. Thus, the North Carolina law imposed burdens on out-of-staters (principally Washington state) that were not imposed on in-staters. *Id.* at 351-54. Similarly, in *South Carolina State Highway Dept. v. Barnwell Bros.*, 303 U.S. 177, 184 n.2 (1938), Justice Stone, speaking for the Court said:

"... when the regulation is of such a character that its burden falls principally upon those without the state, legislative action is not likely to be subjected to political restraints which are normally exerted on legislation where it affects adversely some interests within the state."