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Hostile Corporate Takeovers: History and Overview (with D. Selmer)

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Hostile Corporate Takeovers: History and Overview

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I. INTRODUCTION

The method, tactics and law of hostile corporate takeovers have gone through a number of transformations over the past sixty-five years. This article will outline that history and the interplay between state and federal law. Two of the durable problems underlying this development are how many of the legal ground rules should be federal law and whether such federal law should be exclusive or concurrent with a state law scheme. A third recurring theme is whether the legal ground rules should be neutral in the contest between acquirers and reluctant target firms. As soon as the United States Supreme Court handed down its decision in CTS Corp. v. Dynamics Corp. of America,1 in April 1987, it became apparent that there was an area for state regulation of takeovers which would be constitutional. Since that date, many states have enacted legislation to occupy that area and several such proposals are pending in the Illinois General Assembly. In preparing oneself to assess such proposals, it is useful to see how this field of law has evolved. In describing this history, several large fields of law and practice will be summarized in a broad way, while a few of the particular statutory schemes will be described in more detail.

II. BEFORE THE WILLIAMS ACT: PROXY FIGHTS

Before the Williams Act2 was passed, and indeed before the Depression of the 1930’s, the method of a hostile takeover was to conduct a proxy fight. State corporation statutes allow shareholders

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2. 15 U.S.C. §§ 78m(d) & (e), 78n(d) - (f) (1986).
to vote in person at shareholders’ meetings or to vote by proxy. Proxies are agencies which are revocable unless “coupled with an interest.” A minority group of insurgent shareholders would solicit proxies from the general mass of shareholders. Proxy fights could become expensive and highly publicized; some proxy contests were legendary. Because some were also perceived as dirty, Congress passed the proxy regulation provisions of the Securities Exchange Act of 1934. Under rule-making authorization contained in the Securities Exchange Act of 1934 as amended (“1934 Act”), the Securities and Exchange Commission has promulgated regulations known as the “proxy rules.” The rules apply to solicitation of proxies in respect to securities registered under the 1934 Act. Congress did not seek to abolish the use of proxy fights in a hostile takeover situation, but rather to regulate those fights and make them fair. However, by increasing the paperwork and legal fees necessary, Congress also made them more expensive.

It was said during the 1950’s that insurgents were not likely to win such a fight unless dividends had not been paid for several years. This is due to the fact that management had several advantages in addition to shareholder inertia. The corporate treasury would pay the proxy fight expenses of incumbent management if they won, and maybe also if they lost. In marked contrast, insurgent shareholders who lost a proxy contest paid their own expenses. Also, management could usually rely on the votes from shares held by trustees of pension plans, trusts, and similar entities. Bank trust officers and

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4. Id. at 520.
5. Id. at 523 n.37. The New York Central Railroad proxy fight of 1954 cost management some $550,000 and $1.3 million was spent by insurgent shareholders. The Montgomery Ward & Co. proxy contest of 1955 involved $700,000 on the part of management and $500,000 by insurgents. A more recent proxy contest ending in 1978, between the Curtiss-Wright Corp. and the Kennecott Copper Corp., cost Kennecott between $2.4 and $4.2 million. Id.
8. Applicable to companies with a class of equity securities registered under § 12(g) of the 1934 Act, 15 U.S.C § 78e(g). Section 12 applies to issuers engaged in or affecting interstate commerce whose securities are either listed on a national securities exchange or are held of record by at least 500 persons if the issuer has total assets exceeding $3 million.
other trustees regularly voted for incumbent management, due, in part, to the belief that such votes could be defended as the safe and prudent thing to do and not a breach of the fiduciary duties of the trustees to the beneficiaries.

By the 1960's, corporate raiders had learned how to avoid the expense and risk of federal regulation under the proxy rules.\(^\text{10}\) Instead of soliciting the vote of existing shareholders, one would solicit to buy their stock.\(^\text{11}\) The tender offer was born and its use expanded rapidly. The tender offer could be of two major types. In the exchange offer (or "paper offer" or "stock swap offer"), the acquirer would issue new securities to be given to the target firm's shareholders. This new issue would normally need to be registered under the Securities Act of 1933\(^\text{12}\) ("1933 Act") and the necessary prospectus would require detailed disclosures.\(^\text{13}\) Thus, exchange offers involved regulatory risk and the legal expenses necessary to minimize that risk. In comparison, cash tender offers did not involve the issuance of securities, nor the solicitation of proxies, and thus were outside the federal regulatory schemes.\(^\text{14}\) Once this unregulated "gap" between the securities issue regulations of the 1933 Act and the proxy rules of the 1934 Act was discovered in the early 1960's, the use of cash tender offers expanded dramatically.\(^\text{15}\) The Williams

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10. Proxy fights involved two kinds of risks. First, the regulatory risk that one might violate the proxy rules. Second, the economic risk that one would incur the expenses, lose the proxy contest, and have nothing to show for the expenditure. However, under a stock purchase, if one's purchase plan failed to achieve the ultimate takeover, one might still have the value of the stock.

11. This circumvented the two major situations which normally triggered the formal disclosure requirements of the federal regulations. This was not (1) the issuance of securities to the target shareholders, nor (2) the solicitation of proxies from target shareholders.


13. An exchange offer is made when a corporation makes an offer to shareholders of a target corporation to exchange shares of the offering corporation for the individual's shares. Such an offer mandates compliance with certain registration requirements of the Securities Act of 1933, 15 U.S.C. § 77e(c) (1986).

14. See 113 Cong. Rec. 854 (1967). "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 ..." Id. (remarks of Senator Williams).

15. The factor described as most directly responsible for the increase in the number of cash tender offers was the presence of rigid pre-acquisition filing requirements affixed to the traditional takeover or merger, when accomplished through a proxy contest or an exchange offer, and the absence of any regulation in the case of the cash tender offer. See Sowards & Mofsky, Corporate Take-Over Bids: Gap in Federal Securities Regulation, 41 St. John's L. Rev. 499, 501 (1967).
Bill\textsuperscript{16} was introduced to bring cash tender offers under SEC jurisdiction.

III. \textbf{The Williams Act}

Congress extended the coverage of the securities laws to tender offers by enacting the Williams Act in 1968.\textsuperscript{17} The Williams Act amends Sections 13 and 14 of the 1934 Act\textsuperscript{18} and applies to tender offers for shares of publicly-held corporations registered under Section 13 of the 1934 Act.\textsuperscript{19} During the almost-twenty years since the Williams Act was enacted, a vast body of law has developed on tender offers. Rules and regulations under the 1934 Act, SEC releases and numerous court decisions have created a legal specialty which cannot be reproduced here.\textsuperscript{20} However, the general regulatory scheme of the Williams Act can be described.

The core of the Williams Act is a set of new subsections added to the 1934 Act. New subsections 13(d) and 13(e) were added to the reporting requirements of Section 13.\textsuperscript{21} New sub-sections 14(d), 14(e) and 14(f) were added to the proxy provisions of Section 14.\textsuperscript{22} In

\begin{itemize}
\item[\textsuperscript{16}] S. 510, 90th Cong., 1st Sess. (1968).
\item[\textsuperscript{18}] See infra notes 21 & 22.
\item[\textsuperscript{19}] The Williams Act was made expressly applicable to companies with a class of equity securities under § 12 of the 1934 Act, 15 U.S.C. of 78e(g). Subsequently, the SEC promulgated Regulation 14E, which is applicable to all tender offers, 17 C.F.R. §§ 240.14e-1 to 240.14e-3, 240.14f-1 (1984).
\item[\textsuperscript{21}] The two new sections added by the Williams Act to § 13 of the 1934 Act are § 13(d), 15 U.S.C. § 78m(d) (1986) (requiring any person attaining beneficial ownership of 5% of a class of registered equity securities to file within 10 days specified information with the issuing corporation, the SEC, and every exchange where the security is traded); and § 13(e), 15 U.S.C. § 78m(e) (1986) (affording the SEC power to regulate corporate stock purchases).
\item[\textsuperscript{22}] The three sections added by the Williams Act to § 14 of the 1934 Act are § 14(d), 15 U.S.C. § 78n(d) (1986) (governing pre-acquisition disclosure where tender offer would result in offeror's owning more than 5% of a class of equity securities, withdrawal rights of offeree, proration of offers for less than all of the target's shares, and increased prices to be paid for shares tendered early); § 14(e), 15 U.S.C. § 78m(e) (1986) (prohibiting fraud in the making of any tender offer); and § 14(f), 15 U.S.C. § 78n(f) (1986) (requiring disclosure where a change in the majority of the Board of Directors would occur subsequent to the tender offer).
\end{itemize}
addition, the SEC has added numerous rules for each of these new subsections.23 Essentially, the Williams Act requires that any person who makes a tender offer for a class of securities which, if successful, would make such person a beneficial owner of more than 5 percent of that class of securities must first file a statement with the Securities and Exchange Commission, and give a copy simultaneously to the target firm.24 Such statements must contain the information required under Section 13(d)(1),25 and include, among other things, the identity and background of the acquirer,26 the source of funds for the purchase,27 the offeror’s current ownership of shares in the target company,28 and the plans for the target firm if acquired.29 Solicitations or recommendations to the target’s shareholders are regulated by the SEC.30

In seeking to insure shareholder protection, the Williams Act was carefully tailored to avoid any favoritism to either the tender offeror or the management of the target company.31 The regulations

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23. 15 U.S.C. §§ 78m(d)(1), 78n(d)(1) authorize the SEC to enact rules and regulations necessary to supplement the provisions of the Williams Act.
   It shall be unlawful for any person . . . to make a tender offer for, or a request or invitation for tenders of, any class of any equity security . . . if, after consummation thereof, such person would, directly or indirectly, be the beneficial owner of more than 5 per centum of such class, unless at the time copies of the offer or request or invitation are first published or sent or given to security holders [and] such person has filed with the Commission a statement containing such of the information [as is] specified in section 78m(d) of this title . . . .

Id.

27. Id. § 78m(d)(1)(B).
28. Id. § 78m(d)(1)(D).
29. Id. § 78m(d)(1)(C).
30. Section 14(d)(4) of the Williams Act requires that any solicitation or recommendation to target shareholders to accept or reject or tender offer must comply with SEC rules and regulations, 15 U.S.C. § 78n(d)(4) (1986).
31. 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 fairly present their case.

not only govern disclosure by an offeror, but also require that management of a target company be subject to the disclosure requirements of the Williams Act. Within ten days of the beginning of the offer, target management must publish or give to its shareholders a statement of its position: recommending acceptance or rejection, or stating that management is neutral, or that it cannot take any position.\textsuperscript{32} Consequently, the federal scheme affords shareholders an opportunity to make an informed decision based on the positions advanced by both the tender offeror and the management of the target company.

The Williams Act also provides tendering shareholders a number of important substantive protections. The object of these provisions is to protect a target company's shareholders by alleviating some of the pressure inherent in determining when and whether to tender their shares. These provisions require that the offeror keep the offer open for at least twenty business days and for ten business days after any change in the percentage of securities being sought, in the price being offered, or in the dealer's solicitation fees.\textsuperscript{33} Tendering shareholders are permitted to withdraw their tendered stock during the first seven days of the offer, or after sixty days if the offeror has not already purchased the tendered shares.\textsuperscript{34} In addition, if the acquirer is successful, then in case of an overacceptance by the target's shareholders, the acquirer must accept tendered stock on a \textit{pro rata} basis, rather than a first-come-first-bought basis.\textsuperscript{35} Finally, when some shareholders tender their stock at an initial price and the offering price is later increased, all tendering shareholders must receive the higher price.\textsuperscript{36}

A few general observations are in order. First, just as Congress did not attempt to prohibit proxy fights with the proxy provisions of the 1934 Act, so it also did not intend to prohibit tender offers. It wished to regulate the process and tried to draft legislation which would be neutral as between incumbent management and the tender offeror.\textsuperscript{37} In most takeover situations, time is on the side of incum-

\begin{footnotes}
  \item[33] \textit{Id.} § 240.14e-1.
  \item[36] \textit{Id.} § 78n(d)(7). The reverse is not true, so that the "first tier" of a tender offer may achieve control at one price and then the acquirer may offer a lower price to obtain the remainder of the stock. However, certain state legislation seeks to regulate this so-called front-end loaded, two-tier tender offer practice. \textit{See infra} Part VIII.
  \item[37] \textit{See supra} note 31; Edgar v. MITE Corp., 457 U.S. 624, 633 (1982).
\end{footnotes}
bent management of the target company. The longer the takeover is delayed, the more chance management has to take defensive action, look for a white knight, and let the arbitrageurs keep their funds tied up in purchased stock. While the Commission’s selection of a minimum offer period of twenty business days is said to be a neutral provision, empirical data is lacking to support the assertion. In any event, most proposals, state or federal, made in support of target company managements are designed to lengthen that twenty-day period. Second, while Federal regulation has increased the legal fees and other expenses of the hostile takeover via the cash tender offer, these expenses have not dampened the enthusiasm of corporate raiders. One reason for the expansion of takeover activity is that pension fund trustees and other fiduciaries switched sides. In the old proxy fight days, bank trust officers and other trustees holding stock tended to vote for incumbent management. But now in the cash tender offer situation, trustees were presented with a clearer choice: cash out the stock now at the higher tender price or miss the opportunity to maximize short-term yield. That choice seems clear to the trust’s beneficiaries who might sue the trustee for breach of fiduciary duties. Thus, fund managers and other trustees are persuaded to sell, rather than to stick with current management. In addition, more stock is now held in trust. One major cause was the passage of ERISA in 1974, which has expanded the size and volume of pension funds. Also, as more and various types of mutual funds place greater amounts of corporate stock in the hands of money managers, their search to maximize short-term yield leads them to cash in on a tender offer. Incumbent management’s best ally is often the individual shareholder who may resist a tender offer through sentiment, confusion or inattention. Third, an entire new vocabulary has developed to delight the press: the “Saturday Night Special”, “poison pills”, the “pac-man” defense, “scorched earth” and “lock-ups”, “shark repellents”, “golden parachutes” (and now “tin parachutes”), “bear-hugs”, “white knights”, “greenmail”, etc. Fourth, the tender offer has provided the context for a recent and explosive expansion of director and officer liability. And fifth, state legislatures have not been happy with the Congressional neutrality behind the Williams Act. It seemed that state legislatures were more a-

39. L. Loss, supra note 20, at 499-502 (a glossary of this “financial slang” is provided).
nable to pressures from the incumbent management of local companies.

IV. THE FIRST GENERATION STATE ANTI-TAKEOVER STATUTES

The lifespan of the first generation state statutes lasted from March 1968 to June 1982, when the United States Supreme Court decided *Edgar v. MITE Corp.* Virginia enacted the first state anti-takeover statute in March 1968, and was soon followed by Ohio in 1969. By 1982, a vast majority of the states had followed suit, with thirty-seven having enacted some kind of “mini-Williams Act.” While the mechanism adopted by these statutes varied, most seemed to be based upon a desire to protect local incumbent management from hostile tender offers.

It first appeared that the Idaho Takeover Statute would be the vehicle for a determination of the validity of state statutes which seemed to interfere with the operation of the Williams Act. In *Great Western United Corp. v. Kidwell*, a U.S. District Court in Texas held the Idaho statute unconstitutional, under the doctrine of preemption, because the Idaho statute conflicted with the Williams Act “by destroying the careful balance struck in the Williams Act between the offeror and the management of the target company designed to protect the interests of the shareholders.” The court found that under the Commerce Clause the Idaho statute was neither legitimate nor local in its application. The Fifth Circuit affirmed in an opinion by Judge John Miner Wisdom. The U.S. Supreme Court reversed but only on a venue question.

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43. By the date of the MITE decision, the Court would refer to 37 states with takeover statutes. MITE, 457 U.S. at 631 n.6. See also, Warren, Developments in State Takeover Regulation: MITE and Its Aftermath, 40 Bus. Law 671 (1985).
44. For example, Bartell lists 27 state statutes as excluding “friendly” offers if approved by the target company’s board. J. Bartell, State Take-Over Laws: A Survey, Ninth Annual Institute on Securities Regulation, Vol. 1, PLI, Nov. 10-12, 1977, at 361-63.
48. Id. at 437-39.
The fate of the first generation state anti-takeover statutes was later decided in *Edgar v. MITE Corp.*, holding the Illinois Business Take-Over Act\(^2\) (the "Illinois Act") unconstitutional.

The Illinois Act applied to target corporations which met one of the following "nexus" tests. Either 10% of its stock was held by security holders "located in this State" according to postal address or the target met two of the following three criteria: its principal office was in Illinois, or it was incorporated in Illinois, or at least 10% of its stated capital and paid-in surplus was "represented in this State."\(^3\) A takeover offer was unlawful unless registered under the Illinois Act.\(^4\) The registration statement to be filed with the Secretary of State contained much of the same information as required by the Williams Act.\(^5\) A copy of the registration statement needed to be delivered to the target company "not later than the date of filing" of such statement with the Secretary of State.\(^6\) Normally, the offer "shall become registered 20 business days after the date of filing," unless accelerated or delayed by specified procedures.\(^7\) The Act called for hearings to be held by the Secretary of State if "necessary for the protection of offerees in this State" and if the Secretary finds, *inter alia*, "that the take-over offer is inequitable," he can deny registration.\(^8\) Thus, the Illinois Act extended the twenty-day Williams Act period by an additional twenty days or longer, by requiring a pre-offering filing, and also by allowing the Illinois Secretary of State to determine the fairness of the offer.

The United States Supreme Court's decision in *Edgar v. MITE Corp.* was neither clear nor helpful in guiding lower courts as they began to examine the other, different state statutes. There were six written opinions. The lead opinion, by Justice White, had nine subsections, three of which were identified as the "Opinion of the Court."

The offeror, MITE Corporation, was incorporated in Delaware and had its principal offices in Connecticut. The target company,

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53. *Id.* at para. 137.52-10. The last requirement of capital and paid-in surplus "represented in this state" adopts the language of the Illinois corporate franchise tax system, now in the Business Corporation Act.
54. ILL. REV. STAT. ch. 121 1/2, para. 137.54(A) (1982).
55. *Id.* at para. 137.54(C).
56. *Id.* at para. 137.54(B).
57. *Id.* at para. 137.54(E).
58. *Id.* at para. 137.57.
Chicago Rivet & Machine Co., was incorporated in Illinois and conducted most of its business in Pennsylvania. The MITE Corporation made its Williams Act filings, did not make any Illinois filing, and filed suit in Federal District Court in Chicago for a declaratory judgment that the Illinois Act "was preempted by the Williams Act and violated the Commerce Clause." 59 Four of the justices thought the case was moot. Five justices were able to agree on a discussion of the application of the Supremacy Clause. They noted:

There is no evidence in the legislative history that Congress was aware of state takeover laws when it enacted the Williams Act. When the Williams Act was enacted in 1968, only Virginia had a takeover statute. The Virginia statute, Va. Code §13.1-528 (1978), became effective March 5, 1968; the Williams Act was enacted several months later on July 19, 1968. Takeover statutes are now in effect in 37 States. 60

The point on which five justices could agree, subsection V-B of Justice White's opinion, was that the Illinois Act was unconstitutional as a violation of the Commerce Clause, 61 as an undue burden upon interstate commerce. Only four justices thought the Act was also preempted by the Williams Act. 62

The question was now how this opinion would affect the thirty-six other state takeover statutes. To be constitutional after MITE, a state statute would need to be drawn narrowly enough to: 1) be substantially consistent with the Williams Act, 2) be not unduly burdensome to interstate commerce, and 3) preserve the state's legitimate interest in protecting local investors. Several state statutes were found to be unconstitutional and several others were found to be pre-empted. 63

59. MITE, 457 U.S. at 628.
60. Id. at 631 n.6, citing Sargent, On the Validity of State Takeover Regulation: State Responses to MITE and Kidwell, 42 Ohio St. L.J. 689, 690 n.7 (1981).
61. Id. at 636-39.
62. Id. at 639-40.
In the aftermath of MITE, several Circuit Courts applied the Supreme Court's decision to strike down state takeover statutes. Most of the remaining first generation statutes were gutted by the new SEC Rule 14d-2(b) which required that a tender offer be commenced within five days after any public announcement of the identity of bidder and target company. Only the First Circuit refrained from doing so when the takeover provisions of the Massachusetts statute were challenged. These decisions appeared to leave little room for state tender offer regulation.

V. THE SECOND GENERATION STATUTES

The next attempts to assist local managements took several forms. Some were statutes whose operation kicked in after completion of the tender offer. Some purported to regulate only the internal affairs of a corporation. The major types became known as "business combination," "fair price" and "control share acquisition" statutes.

The New York statute is a "business combination" statute which has excited interest in Illinois and other states. It applies to "resi-
dent domestic corporations" which are defined as those incorporated in New York, have their main office and significant business operations there and at least 10 percent of the voting stock is owned by New York residents. For such target corporations, any person who buys 20 percent or more of its stock may not subsequently "engage in any business combination" with it for five years unless such person had the target board's approval before such person's purchase of stock. There are other provisions, including an authorization for new corporations to "opt out" of the statute and for existing corporations to opt out before March 31, 1986.

An example of a "fair price" statute is a 1985 amendment to the Illinois Business Corporation Act. The new section requires two shareholder votes to ratify any of a list of business combinations: a vote of 80 percent of the shareholders and a majority of disinterested shareholders. This higher vote is not required if either of the following conditions are met: two-thirds of the disinterested directors approve of the business combination or the shareholders receive a fair price for their shares under a complicated formula.

A different approach was started by an Ohio statute. Ohio was the first state to act after the MITE decision. The Ohio statute applied to any "issuing public corporation," defined as a "domestic corporation with fifty or more shareholders that has its principal place of business, principal executive offices or substantial assets within this state and as to which no valid close corporation agreement exists ...." What was regulated was a "control share acquisition," defined as the acquisition of any shares which would push the acquirer over any one of three thresholds: one-fifth, one-third or a majority of the voting power. The basic provision then prohibited any such "control share acquisition" unless made with

68. Id. § 912(a)(13).
69. Id. § 912(b). There is a six-part definition of "business combination" in § 912(a)(5).
70. Id. § 912(d)(3).
72. Id. at para. 7.85(A)(1).
73. Id. at para. 7.85(B).
74. OHIO REV. CODE § 1701.831 (Page 1985) (effective Nov. 19, 1982).
76. OHIO REV. CODE ANN. § 1701.01(Y) (Page 1985).
77. Id. § 1701.01(Z).
the prior authorization of the shareholders of the corporation.\textsuperscript{78} Any person proposing to make such a control share acquisition needed to deliver an "acquiring person statement" to the corporation.\textsuperscript{79} A special meeting of the shareholders is then called and the control share acquisition may be made if both of two votes are obtained: a majority of all shareholders and a majority of disinterested shareholders.\textsuperscript{80}

The Ohio statute was soon tested and found wanting. In \textit{Fleet Aerospace Corp. v. Holderman},\textsuperscript{81} the Sixth Circuit held the statute unconstitutional on two grounds. First, the Ohio statute frustrated the objectives of the Williams Act and thus violated the Supremacy Clause.\textsuperscript{82} In addition, its burden on interstate commerce violated the Commerce Clause.\textsuperscript{83} Meanwhile, other state statutes were also being tested.\textsuperscript{84}

No matter how interesting the Ohio statute would have become, attention turned to the variation adopted in Indiana as the Control Share Acquisition Chapter of the Indiana Business Corporation Law.\textsuperscript{85} That was the statute upheld by the U.S. Supreme Court, in April 1987, in \textit{CTS Corp. v. Dynamics Corp. of America}.\textsuperscript{86} Since a statute with the Supreme Court's imprimatur has become \textit{the} statute to copy, a brief analysis of the Indiana scheme should be given.

\section{VI. The Indiana Statute}

The Indiana Chapter is very similar to the Ohio statute. The "nexus" with Indiana is provided by the definition of the target company affected, the "issuing public corporation." First, it is a "corporation," which is defined in the general definitions for the entire Indiana Business Corporation Law as "any corporation formed

\begin{itemize}
\item 78. \textit{Id.} § 1701.831(A).
\item 79. \textit{Id.} § 1701.831(B).
\item 80. \textit{Id.} § 1701.831(E).
\item 82. \textit{Fleet Aerospace}, 796 F.2d at 139.
\item 83. \textit{Id.}
\item 86. 107 S. Ct. 1637 (1987).
\end{itemize}
under this Act.'\textsuperscript{87} In addition to being a domestic Indiana corporation the target must meet three other tests: it must have one hundred or more shareholders, it must have its principal place of business or its principal office or substantial assets in Indiana and third, it must meet one of three shareholder tests. The three shareholder tests are: more than ten percent of its shareholders reside in Indiana, more than ten percent of its shares are owned by Indiana residents or there are ten thousand shareholder residents in Indiana.\textsuperscript{88}

"Control shares" are the items whose purchase is regulated. They are defined as whatever shares a person would acquire and which would have the effect of placing such person's voting strength "within any of the following ranges of voting power:" one-fifth to one-third; or one-third or more but less than a majority; or a majority or more.\textsuperscript{89}

Whenever "control shares" are acquired in a "control share acquisition,\textsuperscript{90}" those shares retain their previous voting right only if a proper resolution is voted upon and approved by the shareholders.\textsuperscript{91} That resolution must pass two votes: a majority of all shares and a majority of all shares which are not "interested shares."\textsuperscript{92} Interested shares are those involved in a "control share acquisition," those voted by an officer of the target corporation and those voted by inside directors of the target company.\textsuperscript{93} A person who has made or proposes to make a control share acquisition may deliver an "acquiring person statement" to the target company and request a special meeting of the shareholders with the hope of enfranchising such person's shares.\textsuperscript{94} The entire scheme has an opt-out provision: the target company's articles or by-laws may provide that chapter 42 does not apply provided such article or by-law was in place before the control share acquisition in question.\textsuperscript{95}

\textsuperscript{87} Ind. Code Ann. § 23-1-1-1(a) (West Supp. 1987). The new Indiana Bus. Corp. Law. § 23-1-20-5 defines "corporation" as "a corporation for profit that is not a foreign corporation, incorporated under or subject to the provisions of this article." The old Act was repealed as of August 1, 1987, after the CTS opinion. The new definitions chapter went into effect on April 1, 1986. Chapter 42, the Control Share Acquisition Chapter, also went into effect on April 1, 1986.


\textsuperscript{90} "Control share acquisition" is defined in § 23-1-42-1, which also exempts a number of transactions. See infra Appendix 2 at pp. 359-65.

\textsuperscript{91} Id. § 23-1-42-9(a).

\textsuperscript{92} Id. § 23-1-42-9(b).

\textsuperscript{93} Id. § 23-1-42-3.

\textsuperscript{94} Id. §§ 23-1-42-6, 42-1-42-7.

\textsuperscript{95} Id. § 23-1-42-5.
The Indiana Statute has some ambiguities and raises some concerns for states proposing to imitate that scheme. Many of these concerns relate to perceived loopholes or inconsistencies with what may have been the basic intent of the legislation. Whether the following comments could be characterized as pro management or as pro acquiror, the purpose is to highlight problems with the legislation. Examples and scenarios are included to illustrate the issues, and reference is also hereby made to the complete text of the Indiana Control Share Acquisition Chapter which is appended to this Symposium. 96

A. "CONTROL SHARES"

The statute's language states that only those shares which push shareholdings within the enumerated ranges would be control shares and thus subject to voting disenfranchisement. It may have been intended that all shares purchased in a control share acquisition, as defined, would constitute control shares. If so, clarifying language would be necessary. For example, if a 10% shareholder acquires another 12% and thus exceeds the 20% level set forth in the statute, the language can be interpreted to mean that only the 2% within the range constitutes "control shares." It is believed that the intent was to include the entire 12% acquisition within the definition of control shares, but the language is not clear.

It would seem that, once shareholder approval is received for shareholdings within a certain range and the shares are re-enfranchised, further acquisitions within that range can be made without the need of further approval. Otherwise, the concept of several ranges makes no sense. The language is ambiguous on this point and should be clarified. For example: If the 22% shareholder in the previous example acquires another 2% (the upper limit of the range being 33 1/3%), further approval (re-enfranchisement) should not be required.

The definition of control shares focuses on "person" and does not contemplate concerted action by a group. A provision closing this gap would be in order. For example, each of 3 people acting as a group acquire 15%. Since none of them are within the enumerated ranges, no shareholder approval is necessary even though the practical effect of their joint holdings is the same as that where one individual purchases 45% of the shares.

96. See infra Appendix 2 at pp. 359-65.
B. "CONTROL SHARE ACQUISITION"

If any of the changes discussed in A above were made, then corresponding changes in Section 23-1-42-2 would be necessary.

The exclusions in subsection (d) from acquisitions of shares constituting control share acquisitions should be significantly expanded. For example, intra-family transfers, transfers for estate or tax planning and other legitimate planning are not covered.

The current language would include the normal solicitation of proxies ("in respect to which a person may exercise or direct the exercise of voting power . . .") within the coverage of the statute.

Such situations were probably not intended to fall within the acquisition of control shares and should be excepted.

Subsection (e) provides that once a person has received shareholder approval the shares can be transferred without the need for further approval. It is the person owning the shares rather than the shares themselves that should be scrutinized. For example, Shareholder A has received shareholder approval with respect to his or her position. He or she transfers this position to a person who shareholders do not approve. The statute seems to allow this transfer to occur.

Note that changing the language in subsection (e) to clarify that the focus is on the holder rather than on the shares themselves makes the exclusions in subsection (d) all the more critical.

Consistent with the position that disenfranchisement should follow the person and not the shares, a person who does not receive the requisite shareholder approval to vote the control shares should be allowed to transfer these shares without having the shares remain disenfranchised. For example, a 25% shareholder not receiving shareholder approval should be able to transfer shares without restriction. However, if a transferee acquires control shares in his or her own right due to his or her shareholdings falling within an enumerated range, shareholder approval is necessary as to these acquisitions.

C. "ISSUING PUBLIC CORPORATION"

This section establishes the constitutional nexus with the state that the Supreme Court found important in CTS. While one could agree that the constitutional nexus must be established, problems may arise with the practical application of the nexus parameters. For instance, since shares held by banks, brokers or nominees are excluded for purposes of calculating the numbers and percentages, a publicly held corporation with a number of shares held in street name may not meet the 100 shareholder requirement.
D. APPLICATION UNDER SECTION 5

Section 23-1-42-5 permits a corporation to opt-out from the application of the control share provisions. The opt-out can be through the Articles of Incorporation or By-Laws. A problem may arise with manipulation by the board (opting out through amendment of the By-laws) without vote of the shareholders. While the directors have fiduciary duties to the shareholders, manipulation can occur with the timing of the opt-out and, by implication, a subsequent opt-in by again amending the Articles or By-Laws.

For example, assume a bidding war for control of a corporation is in progress. One person acquires control shares but does not receive the requisite shareholder vote. It appears that the other bidder could not receive shareholder approval either but the board supports the bid and opts out of the control share provisions so as to avoid a shareholder vote on the voting rights of the control shares.

E. "ACQUIRING PERSON STATEMENT"

Some questions exist as to exactly what is presented to the shareholders at the meeting of approval of the control share acquisition. It would be better if the acquiring person statement must contain the form of resolution to be voted on at the meeting.

F. "SPECIAL MEETING OF SHAREHOLDERS"

The acquiring person must give an undertaking to the corporation to pay its expenses if a special meeting of shareholders is requested. Anyone intending to acquire control shares can request a meeting for approval to vote the shares without the necessity of having actually bought the shares. Therefore actual deposit of funds with the corporation may be necessary to ensure that only those serious about the acquisition request the meeting. Otherwise, disgruntled and impecunious parties not actually intending to acquire shares, in spite of their declared intentions, may harass corporations into calling special shareholder meetings.

G. VOTING RIGHTS

If the requisite shareholder approval is not obtained, the control shares have no vote. Aside from the issue of disenfranchisement and inability to vote the shares on any matters (e.g., voting on fundamental corporate changes and changes peculiar to that class of shares such as reduction of mandatory dividends), there is a concern about the control shares being unable to vote regardless of subsequent dilution or other changes in the corporation. For example, a person
has a 25% control share position which has not received shareholder approval. Subsequent issuances of stock by the corporation reduce the shareholdings to 10% but, because of the original characterization of the shares as control shares, they continue to be unable to vote.

As presently worded, the resolution as to voting control shares must be approved by:

i) a majority of all votes entitled to be cast by a “voting group” entitled to vote separately on the proposal and

ii) a majority of all disinterested shares.

“Voting group” is a term in the Indiana statute that has no counterpart in other state corporation statutes, such as Illinois. Furthermore, the focal point of the vote should be the majority of the disinterested shares and a majority of all the shares of a class should vote only if the proposed control share acquisition would result in certain fundamental changes to that class.

H. REDEMPTION

If control shares are not able to vote, the corporation has the ability to redeem the shares at fair market value pursuant to procedures adopted by the corporation. Fair value is defined in Section 23-1-42-11 (dissenters’ rights) as not less than the highest price per share paid by the acquiring person in the control share acquisition. This concept could also be applied to Section 23-1-42-10. While it may result in a premium being paid to the acquiring person, the redemption is at the corporation’s election without the consent of the acquiring person. One could become concerned about the ability to redeem shares ex parte, but the acquiring person does know beforehand that the shares are callable if the shareholder approval is not obtained.

The preceding discussion points out perceived defects in the Indiana statute97 but one cannot overlook its greatest strength: it was held constitutional by the United States Supreme Court. In the

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97. A joint task force composed of members of the American Bar Association and the North American Securities Administrators Association has drafted a model “control share” statute which addresses many of the ambiguities of the Indiana Control Acquisitions Chapter and considers other substantive issues involving the concepts behind “control share” legislation. A public exposure draft of the model “control share” statute has been released and the deadline for submitting public comments expired March 15, 1988.
CTS decision, Justice Powell found that the Williams Act did not pre-empt the Indiana statute. He also found that the Indiana statute was not such a burden on interstate commerce as to violate the Commerce Clause. It was in this discussion in which he made the now famous "moreover" statement:

We agree that Indiana has no interest in protecting non-resident shareholders of nonresident corporations. But this Act applies only to corporations incorporated in Indiana. We reject the contention that Indiana has no interest in providing for the shareholders of its corporations the voting autonomy granted by the Act. Indiana has a substantial interest in preventing the corporate form from becoming a shield for unfair business dealing. Moreover, unlike the Illinois statute invalidated in MITE, the Indiana Act applies only to corporations that have a substantial number of shareholders in Indiana. See Ind. Code § 23-1-42-4(a)(3) (Supp. 1986). Thus, every application of the Indiana Act will affect a substantial number of Indiana residents, whom Indiana indisputably has an interest in protecting.

Taking their cue from this observation, commentators predict that any other state anti-takeover must meet both tests: it must apply only to target companies incorporated in that state and there must be sufficient other nexus to warrant the burden on interstate commerce. For example, Delaware has many major corporations incorporated there but few have a major commercial nexus with Delaware. Thus, difficulties are encountered in drafting a Delaware takeover statute which would be constitutional.

VII. THE DELAWARE STATUTE

A response different from the Indiana "control share" approach has been taken in Delaware. On February 2, 1988 the Governor of the State of Delaware signed into law legislation which adds a new Section 203 to the Delaware General Corporation Law. Section 203 is a "business combination" statute intended to regulate

98. CTS, 107 S. Ct. at 1644-47.
99. Id. at 1648-52.
100. Id. at 1651-52 (emphasis in original).
102. See supra Section IV, and infra Section VIII, for a description and comparison of the three dominant forms of state anti-takeover legislation: "control share," "business combination," and "fair price".
takeovers of companies incorporated in Delaware. Immediately after Section 203 became effective, Campeau Corp. (which was bidding for Federated Department Stores) and The Black & Decker Corporation (which is bidding for American Standard, Inc.) each filed suit seeking to enjoin enforcement of Section 203 on various grounds including its unconstitutionality under the federal Supremacy and Commerce Clauses.\textsuperscript{103}

The precipitating cause of the Delaware legislation was \textit{CTS},\textsuperscript{104} in which the United States Supreme Court upheld the constitutionality of the Indiana Control Share Acquisitions Chapter.\textsuperscript{105} Since the Supreme Court had invalidated the Illinois Business Takeover Act\textsuperscript{106} in \textit{MITE}\textsuperscript{107} in 1982, the status of state takeover legislation had been in a state of flux. However, since \textit{CTS}, a number of states have enacted control share legislation\textsuperscript{108} and others have pending bills contemplating enactment of such legislation.\textsuperscript{109} Delaware also considered enactment of a control share type statute similar to that

\begin{itemize}
  \item Section IX \textit{infra} for a discussion of these constitutional issues. Black & Decker Corporation's motion for a preliminary injunction was subsequently denied without the court reaching the constitutional issues. Civil Action No. 88-50-CON (D. Del. Feb. 2, 1988). Also Campeau Corp. has apparently emerged as the winner in a bidding war with Macy's for control of Federated Department Stores. A contrary result was rendered in RTE Corp. v. Mark IV Indus., Inc., Civil Action No. 88-C-378 (E.D. Wis. May 7, 1988), where the United States District Court for the Eastern District of Wisconsin found Wisconsin's "business combination" statute to be unconstitutional on Supremacy Clause grounds. The court did not reach the Commerce Clause arguments. However, the United States District Court for the District of Delaware denied an offeror's request for preliminary injunctive relief seeking to enjoin the application of Section 203, finding that it was probably constitutional. BNS Inc. v. Koppers Co., Civil Action No. 88-130-MMS, (D. Del. April 1, 1988). A different offeror has also been denied preliminary injunctive relief by the United States District Court for the District of Delaware in a finding that "the facts adduced are insufficient to support a determination that Section 203 is most likely unconstitutional." RP Acquisition Corp. v. Staley Continental, Inc., Civil Action No. 88-190-JRR (D. Del. May 9, 1988). In both cases, and in other recent cases challenging other state "business combination" statutes, the Securities and Exchange Commission has filed \textit{amicus curiae} briefs urging that these statutes be held unconstitutional on Supremacy and Commerce Clause grounds.
  \item \textit{CTS}, 107 S. Ct. 1637.
  \item \textit{IND. CODE ANN.} § 23-1-42 (West Supp. 1987).
  \item \textit{ILL. REV. STAT.} ch. 121-1/2, para. 137.51 to 137.70 (1985).
  \item \textit{MITE}, 457 U.S. 624.
  \item Thirteen states have enacted anti-takeover statutes since \textit{CTS}. See Sontag, \textit{Takeovers Are on the Rise Again}, Nat'l. L.J., Feb. 1, 1988, at 1, col. 4.
  \item For instance, Illinois has several pending bills which are verbatim copies of the Indiana Control Share Acquisition Chapter. \textit{See supra} Section VI.
\end{itemize}
adopted by Indiana prior to the conclusion of the Delaware 1987 legislative session in June of 1987. However, the Corporation Law Section of the Delaware Bar Association elected not to propose such legislation to the Delaware legislature at that time. Among the reasons were the concerns of hastily enacting legislation prior to the end of the 1987 legislative session without a reasonable opportunity to analyze the consequences of the application of such legislation and the belief that control share legislation would not adequately act as a deterrent to hostile takeovers. After further review and debate, the Corporation Law Committee of the Delaware Bar Association formulated and submitted a bill that ultimately was adopted as Section 203 on February 2, 1988.

The following description is a summary of the pertinent provisions of Section 203 and reference is hereby made to the complete text of Section 203 as appended to this symposium.

Basically, Section 203 provides that a corporation shall not engage in any business combination with an interested stockholder (as described in the following paragraph) for a period of 3 years after such person becomes an interested stockholder except in one of the following situations:

1) prior to the date the stockholder becomes an interested stockholder, the board had approved either:

   a) the business combination or

   b) the transaction in which the stockholder became an interested stockholder, or

2) upon consummation of the transaction in which the stockholder became an interested stockholder, the interested stockholder owned at least 85% of the voting stock of the corporation excluding in determining the issued and outstanding shares those shares owned by:

   a) those persons who are both directors and officers (hereinafter referred to as "inside directors") and

   b) employee stock plans in which employee participants do not have the right to determine confidentially whether shares under the plan will be tendered in a tender or exchange offer, or

3) on or after such date, the business combination is approved by the board and authorized at a special or annual stockholder meeting (not by written consent) by at least two-
thirds of the outstanding voting stock not owned by the
interested stockholder.

An “interested stockholder” is a person who:

1) owns 15% or more of the corporation’s outstanding
voting stock, or

2) is an affiliate or associate of the corporation and was
the owner of 15% or more of the outstanding voting stock
at any time within the 3 year period immediately prior to the
date when the determination as to interested stockholder
status is to be made, or

3) the affiliates or associates of the foregoing persons.

There is a grandfather provision excepting out those who:

1) owned shares prior to December 23, 1987, or

2) acquired shares from such a person by gift, inheritance
or without consideration, or

3) who were bumped over 15% as a result of action on the
corporation’s part, not action on the person’s part.

A “business combination” is extensively defined in Section
203(c)(3). The basic intent of the legislation is to prohibit transactions
such as mergers, considerations, sales, leases, exchanges, mortgages,
issuances of securities and the like between a corporation or its
subsidiaries and an interested stockholder or which would dispro-
portionately favor an interested stockholder over other stockholders.
A sale of assets to an unaffiliated entity would be permissible as
would a merger or consolidation with an unaffiliated entity, even if
caused by the interested stockholder unless the result of the merger
or consolidation is that the protections of Section 203 are no longer
available to the surviving corporation (e.g., a going private trans-
action whereby the surviving corporation would no longer be publicly
traded).

Section 203 will not apply to a corporation under a number of
situations:

1) a corporation can opt out by a provision in its original
Certificate of Incorporation.

2) within 90 days of the effective date of Section 203, the
board can amend the By-Laws to opt out.

3) the stockholders can amend the Certificate of Incorpo-
ration or By-Laws to opt out but such action will not be effective for 12 months and shall not apply to any business combination with an interested stockholder who becomes such on or prior to the adoption of the amendment.

4) a corporation does not have a class of stock:

a) listed on a national stock exchange;

b) NASDAQ listed or

c) held of record by at least 2,000 stockholders unless the corporation cannot meet any of these tests due to action taken by an interested stockholder.

5) a stockholder becomes an interested stockholder inadvertently, was not an interested stockholder within the last three years and divests shares as soon as practicable to fall below the 15% level.

6) a business combination with another party is proposed which is approved or not opposed by a majority of the then directors who were directors before any person became an interested stockholder within the last three years or were elected or recommended for election to succeed such directors by a majority of such directors (a so-called “white knight” scenario) and an interested stockholder counters with his or her own proposal after the date the first proposal is announced but before it is consummated or abandoned.

A corporation can opt in by amending its certificate of incorporation, but the opt in cannot restrict a business combination between the corporation and an interested stockholder if he or she became such prior to the adoption of the amendment.

One practical problem that arises under the definition of “business combination” occurs when a corporation extends a rights offering to its stockholders or otherwise attempts to raise capital through the stockholders. The concept of the “business combination” definition is to cover those transactions in which an interested stockholder obtains preferential treatment over other stockholders. In the context of a rights offering, it is likely that not all of the stockholders will exercise their rights resulting in an increase in proportionate share of the securities by an interested stockholder who exercises. Thus, a prohibited business combination is the result. Similarly, a ready avenue of funds for a corporation which is financially troubled would be through loans or other accommoda-
tions from its stockholders. However, the ability of the corporation to give adequate security may be jeopardized if doing so gives an interested stockholder a disproportionate benefit. In these types of situations, it is arguable that it is the corporation receiving a benefit more than an interested stockholder receiving preferential treatment. Nonetheless, Section 203 as presently drafted would include these transactions within the scope of a business combination which cannot take place unless there is compliance with Section 203.\footnote{110}

VIII. COMPARISON OF STATE ANTI-TAKEOVER LEGISLATION

State legislatures today are facing a situation in which the first tier of state takeover statutes were struck down by \textit{MITE}, one of the newer types (control share) has been upheld in \textit{CTS}, and the two other major new types (business combination and fair price) have yet to be conclusively tested.\footnote{111} These major types and their variations will now be briefly compared.

The “control share” statutes, as upheld in \textit{CTS}, generally provide that shareholders in excess of any one of three thresholds—20\%, 33 1/3\% and 50\%—must receive the approval of a majority of shares of the “disinterested” shareholders before such shares are allowed to vote. The definition of “disinterested” excludes the shares held by \textit{both} an acquiror and incumbent management. The practical effect of a “control share” statute is that a bidder for a corporation will condition purchase of shares exceeding a threshold upon prior approval of a majority of the “disinterested” shareholders.

States incorporating “fair price” provisions into their corporation statutes\footnote{112} attempt to regulate the abuses of front-end loaded, two-

\footnote{110. If the corporation is in dire need of the funds and can only obtain such funds through a prohibited business combination, the stockholders presumably would cooperate in opting out of § 203 coverage by amending the corporation’s certificate of incorporation, but such action would not be effective for 12 months and will not apply to any business combination with a pre-existing interested stockholder \textit{unless} the business combination is approved by the board and authorized by at least two-thirds of the outstanding shares (excluding those shares held by the interested stockholder). Another possibility would be where the interested stockholder gained control of the board of directors and the board subsequently opted out of § 203. However, such action must be taken by May 2, 1988, so this provision will be of limited use.

\footnote{111. However, see \textit{supra} note 102 in which two Delaware federal district court decisions have denied motions for preliminary injunctions seeking to enjoin the application of Section 203.

\footnote{112. See, \textit{e.g.}, Section 7.85 of the Illinois Business Corporation Act of 1983, \textsc{I.l. Rev. Stat.}, ch. 32, para. 7.85 (1985). See \textit{supra} note 60 and accompanying text.}
tier tender offers where shareholders are induced to tender their shares in an initial tender offer for fear that, if they do not tender, they will be merged out at a lower price in the second phase of the transaction following a successful tender offer. "Fair price" provisions are to assure shareholders that the same price must be paid in the second freeze-out phase as in the initial tender offer. This would close a perceived gap in the Williams Act.\(^{113}\)

"Business combination" statutes regulate takeovers by preventing, unless certain conditions are met, follow up mergers or other specified transactions that an acquiror often desires to effectuate following acquisition of control of a corporation. As distinguished from the "control share" statutes, shares owned by an "interested stockholder" under a "business combination" statute remain able to vote.

These three basic forms of state anti-takeover legislation are not mutually exclusive. Many states have combined the protections of these forms.\(^{114}\) Also, each form of legislation varies from state to state.\(^{115}\)

\(^{113}\) See supra note 22.


\(^{115}\) For example, Ohio's "control share" statute does not allow purchase of shares unless the articles or the regulations of the corporation provide that the "control share" provision does not apply, or the requisite vote is obtained, OHIO REV. CODE ANN. § 1701.831 (Page 1985), whereas Indiana allows purchase but disenfranchises voting rights unless the articles of incorporation or the bylaws provide that the "control share" chapter does not apply, or the requisite disinterested shareholder vote is obtained. Also, while Delaware modeled § 203 after the New York "business combination" statute, § 203 was purposely made less restrictive in a number of respects:

1) three years rather than five is used for the freeze out period;
2) an interested shareholder is able to compete with a "white knight" without the constraints of § 203 if a business combination with such "white knight" is proposed;
3) the freeze can be avoided by acquiring 85% of the outstanding shares (excluding inside director shares in making the determination); and
4) New York has fair price provisions after the freeze; Delaware does not regulate the pricing of the transactions.
“Control share” statutes purport to emphasize the right of shareholders not associated with an acquiror or incumbent management to determine the voting rights of a person reaching the specified shareholding thresholds. On the other hand, “business combination” statutes give a corporation’s board of directors a more active voice (and, as a practical matter, a veto power in some situations) in determining the fate of the corporation. Under Delaware’s Section 203, it is possible for a business combination to occur within the three year period if at least two-thirds of the stockholders (excluding the shares owned by the interested stockholder) approve it, but the board of directors also must approve the transaction. Furthermore, in calculating the two-thirds majority, shares owned by incumbent management are able to vote; only those of the acquiror are excluded. Stockholders of an existing corporation may also opt out of the applicability of Delaware’s Section 203 by amending the corporation’s certificate of incorporation or by-laws, but such action is not effective for 12 months and does not apply to any business combination with an interested stockholder who becomes such on or prior to such amendment. Thus, an argument can be made that a “business combination” statute impermissibly favors management over an acquiror and violates the balance that is intended by the Williams Act.\textsuperscript{116} However, directors remain liable for breaches of their fiduciary duties of care and loyalty to the corporation so they do not have unfettered discretion.\textsuperscript{117}

On the other hand, Section 203 does not prohibit an acquiror’s purchase of shares or disenfranchise the vote of those shares, and allows an interested stockholder to seek board representation and even control.\textsuperscript{118} Also, as soon as another party proposes a business combination and the terms of Section 203(b)(6) are otherwise met,

\textsuperscript{116} See supra Section III and also the federal preemption discussion in Section IX infra as to the Supremacy Clause argument.

\textsuperscript{117} One possible consequence of the “business combination” type statute is a return to proxy fights by a potential acquiror prior to becoming an interested stockholder. After a successful proxy fight in which an acquiror obtains control of a board, the board would then approve a business combination prior to the person becoming an interested stockholder.

\textsuperscript{118} The business judgment rule governing the actions of directors in takeover situations may ultimately be more important than the scheme of Delaware’s Section 203. The explosion of that field of law beginning with Smith v. Van Gorkam, 488 A.2d 858 (Del. 1985), may result in there being two sets of laws regarding a director’s duty of care: one for ordinary times and another for takeover situations.

\textsuperscript{118} Such representation would, of course, depend on the number of shares owned and be subject to staggered board and other defensive provisions.
an interested stockholder is able to counter with his or her own proposal subsequent to the first proposal's announcement but prior to its consummation or abandonment.

IX. CONSTITUTIONAL ISSUES

In general, the inquiries into the constitutionality of state anti-takeover legislation have focused on two aspects: the Supremacy Clause\textsuperscript{119} and the Commerce Clause\textsuperscript{120} of the United States Constitution. The Supremacy Clause has given rise to the doctrine of federal preemption. As to state anti-takeover statutes, the Illinois Business Takeover Act was struck down in \textit{MITE} in part because it impermissibly deviated from the concept of neutrality under the Williams Act as between management and an acquirer. On the other hand, the Indiana Control Share Acquisitions Chapter was held in \textit{CTS} to protect the independent shareholders from both management and acquirers\textsuperscript{121} and did not frustrate the purposes of the federal law. The Commerce Clause, where a state law indirectly affects interstate commerce, involves a balancing of the statewide benefits against the burdens on interstate commerce in determining constitutionality. Direct regulation is per se invalid.\textsuperscript{122} In upholding the Indiana Control Share Acquisitions Chapter as not violative of the Commerce Clause, \textit{CTS} reaffirmed the internal affairs doctrine which provides that a state has the ability to regulate the internal affairs of corporations organized within its boundaries.

Under a Supremacy Clause analysis, it is arguable that Section 203 frustrates the goal of neutrality under the Williams Act by unduly favoring corporate management over an offeror or acquiror of that corporation's stock.\textsuperscript{123} If so, Section 203 would violate the

\textsuperscript{119} "This Constitution, and the Law of the United States which shall be made in pursuance thereof...shall be the supreme Law of the Land...anything in the Constitution or Laws of any State to the contrary notwithstanding." U.S. Const. art. IV, cl. 2.

\textsuperscript{120} The Commerce Clause gives Congress the authority "(t)o regulate commerce among the several States..." U.S. Const. art. I, § 8, cl. 3.

\textsuperscript{121} \textit{CTS}, 107 S. Ct. at 1645.

\textsuperscript{122} \textit{MITE}, 457 U.S. at 643.

\textsuperscript{123} See supra the discussion in Section VIII. On the other hand, the Williams Act governs tender offers while § 203 governs business combinations and not the purchase of shares pursuant to a tender offer. It is possible to comply with both the Williams Act and § 203. However, § 203 does indirectly affect the tender offer process by regulating the steps that can be taken after a successful tender offer and thus serving to discourage takeovers not supported by management.
Supremacy Clause and be preempted by the Williams Act. Justice Powell, in the CTS majority opinion, stated that:

. . . [T]he overriding concern of the MITE plurality was that the Illinois statute considered in that case operated to favor management against offerors, to the detriment of shareholders. By contrast, the statute now before the Court protects the independent shareholder against both of the contending parties. Thus, the Act furthers a basic purpose of the Williams Act. . . .124

Also, from a federal preemption standpoint, it is arguable that the three year freeze period on business combinations imposes an impermissible delay that conflicts with the Williams Act tender offer time period. The statute in MITE was held to impermissibly delay consummation of tender offers because it gave the Illinois Secretary of State the right to hold hearings to determine fairness and thus introduced the potential for indefinite delays in an offeror consuming the tender offers.125 The Indiana statute upheld in CTS provides that a shareholder meeting to determine voting rights must be held within 50 days after a acquiror has filed an “acquiring person statement” with the corporation. This period was held in CTS not to be an unreasonably delay in the tender offer process.

Since Section 203 does not delay the tender offer process, this latter federal preemption argument is not compelling. However, the federal preemption argument based upon the neutrality of legislation as between corporate management and an acquiror, while not conclusive, is more compelling in that Section 203 arguably tips the balance too far in favor of management.126


125. The plurality opinion in MITE stated that an offeror should be “free to go forward without unreasonable delay.” 457 U.S. at 639. The Illinois statute also involved a 20-day precommencement notice period which gave management time to erect defensive positions prior to commencement of the tender offer. See supra Section IV.

126. The Delaware district court in RP Acquisition Corp. v. Staley Continental, Inc., Civil Action No. 88-190-JRR (D. Del. May 9, 1988), stated that Section 203 protects the independent shareholder and, while hostile tender offers are deterred by Section 203 tha it does not preclude those hostile offers that are beneficial to shareholders. Staley Continental, Civil Action No. 88-190-JRR, at 24. See also supra note 103. The balance, in the view of the court, is not tipped too far in favor of management under Section 203. Id. On the other hand, the Wisconsin district court, in RTE Corp. v. Mark IV Indus., Inc., Civil Action No. 88-C-378 (E.D. Wis. May 7, 1988), distinguished the “business combination” approach from the “control
Section 203 also raises interstate commerce questions. The jurisdictional nexus of a corporation seeking the protections of Section 203 to Delaware is that it be incorporated in Delaware. The Indiana Control Share Acquisition Chapter required not only that a corporation be incorporated in Indiana\textsuperscript{127} but also that it have:

1) one hundred (100) or more shareholders;

2) its principal place of business, its principal office, or substantial assets within Indiana; and

3) either;

(A) more than ten percent (10\%) of its shareholders resident in Indiana;

(B) more than ten percent (10\%) of its shares owned by Indiana residents; or

(C) ten thousand (10,000) shareholders resident in Indiana.\textsuperscript{128}

\textit{CTS} made it clear that state legislation, to be constitutional, must apply only to corporations incorporated in that state.\textsuperscript{129} Furthermore, the decision went on to state that:

Moreover, unlike the Illinois statute invalidated in \textit{MITE}, the Indiana Act applies only to corporations that have a substantial number of shareholders in Indiana . . . Thus, every application on the Indiana Act will effect a substantial number of Indiana residents, whom Indiana indisputably has an interest in protecting.\textsuperscript{130}

Due to the language in \textit{CTS}, it is debatable whether the statewide benefits of Section 203 sufficiently outweigh the burdens on interstate commerce to render it constitutional.\textsuperscript{131}

\textsuperscript{127} \textsc{Ind. Code Ann.} § 23-1-20-5 (West Supp. 1988).

\textsuperscript{128} \textsc{Ind. Code Ann.} § 23-1-42-4(a) (West Supp. 1988).

\textsuperscript{129} \textit{CTS}, 107 S. Ct. at 1653. \textit{See also} Telex Acquisition Corp. v. Telex Corp., No. Civ-87-2056-R (W.D. Okla. Nov. 3, 1987) where the federal district court held an Oklahoma takeover statute unconstitutional as it applied to corporations organized outside of the state.

\textsuperscript{130} \textit{CTS}, 107 S. Ct. at 1652.

\textsuperscript{131} In response to the "moreover" statement in \textit{CTS}, the district court in
X. Conclusion

Due to Delaware's importance as a corporate domicile,132 the cases challenging the constitutionality of Section 203 will be followed with interest. Section 203 suffers potential constitutional infirmities from both a federal preemption and an interstate commerce standpoint. However, the Corporation Law Section of the Delaware State Bar Association and the Delaware legislatures believes that a "control share" response does not adequately act as a deterrent in hostile takeovers. In adopting the "business combination" approach, the Delaware legislature mitigated much of the harshness of the New York statute133 in an attempt to avoid legislation that would be characterized as unduly and impermissibly pro-management and, thus, a violation of the balance intended by the Williams Act. From an interstate commerce standpoint, Delaware had little choice in establishing that the sole jurisdictional nexus in Section 203 would be incorporation in Delaware. In order to enact legislation that would apply to the vast majority of corporations organized within its boundaries, it could not adopt the minimum shareholder and business contacts found in the Indiana Control Share Acquisition Chapter. However, finding Section 203 unconstitutional from an interstate commerce standpoint would result in a very significant number of corporations not being able to enjoy the protections of this type of state legislation merely due to where they chose to incorporate. If Section 203 is unconstitutional from an interstate commerce standpoint, one possible response by the corporate community would be a flood of reincorporations to states where corpo-

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Staley Continental stated that the existence of these additional contacts vel non is not constitutionally determinative and that "Delaware realizes an important local benefit when it protects the shareholders of Delaware corporations, wheresoever the shareholders reside." Staley Continental, Civil Action No. 88-190-JRR, at 30. Furthermore, the court noted that, by regulating only Delaware corporations, Section 203 does not impose inconsistent regulations on interstate commerce. The Staley Continental court quoted CTS stating that "[s]o long as each State regulates voting rights [or business combinations] only in corporations it has created, each corporation will be subject to the law of only one State." CTS, 107 S. Ct. at 1649. In addition, the Staley Continental court stated that Section 203 does not discriminate against interstate commerce because it does not favor Delawarean offerors over non-Delawarean offerors nor does it favor Delawarean shareholders over non-Delawarean shareholders. Staley Continental, No. 88-190-JRR, at 26.


133. See supra note 103.
rations could establish the minimum contacts. It is debatable whether the prospect of such massive reincorporations and concomitant dislocations is economically justified on a macro-economic level even though it may be the logical response by individual corporations to a conclusive finding that Section 203 is unconstitutional. Because of Delaware's importance as a corporate domicile, predicting the constitutionality of Section 203 is not a risk free proposition and, while not openly holding Delaware to be sui generis, the constitutional infirmities of Section 203, especially those concerning interstate commerce, may more likely to be upheld for Delaware than they would if these issues would be litigated in the context of another state anti-takeover statute.

Due to the constitutional questions concerning Section 203 and the importance of Delaware as a corporate domicile, the most appropriate resolution in the area of state anti-takeover legislation may be federal congressional action amending the Williams Act and preempting state law at least as to the large, publicly traded corporations that have a demonstrable impact on interstate commerce. Until CTS, most securities law attorneys and other observers had assumed that state responses to the takeover battles in recent years would be unconstitutional. CTS corrected that assumption but has raised questions of its own which will not be resolved in the near future. Delaware's legislative response is indicative of the new uncertainty. The new legal uncertainty is set in a context of major philosophical, ideological and economic disagreements over basic policy.

134. Delaware has traditionally been favorably viewed as a state with a progressive corporation statute. While many other states have adopted provisions similar to those contained in the Delaware General Corporation Law, Delaware remains in many ways the state of choice for organizations seeking to incorporate due to its established body of case law supporting the corporation statute and the level of judicial competence that has developed in interpreting the statute.

135. See supra note 103 in which two Delaware district court decisions have held in preliminary injunction actions that plaintiffs did not sustain their burden of proof in demonstrating that Section 203 was unconstitutional.

136. Several bills are pending in Congress which would amend the Williams Act. While Chairman Ruder of the Securities and Exchange Commission has frequently advocated federal preemption with respect to nationally traded corporations, Representative Dingell, Chairman of the House Energy and Commerce Committee, has just as frequently asserted his opposition to such preemption. In any event, it would appear that a role would continue to exist for states as to companies that do not have securities registered under the Securities and Exchange Act of 1934 and are not subject to the Williams Act.

137. See Karjala, Federalism, Full Disclosure, and the National Markets in the
Further, it is difficult to draft solutions to the hostile takeover problems without affecting other areas of corporation law. For example, two other interrelated issues are those of the close corporation and the question: who are really the shareholders? With rare exceptions, hostile takeovers are undertaken only with respect to target companies whose stock is publicly held or at least very widely held. Statutes like Indiana's Control Share Acquisition Chapter attempt a definition of target companies with at least one hundred shareholders. In trying to separate "close corporations" from others, drafters have found that in the world of business there is a continuum of corporations from the mom and pop store to General Motors. That continuum has no clear gaps in which to draw definitional lines. Thus, an Indiana corporation might have two resident brothers who each held twenty percent of the stock and the remainder is widely held by 120 persons. A majority of the shareholders may not want to opt out of the statute and the shares held by either brother may be disenfranchised upon transfer. Whatever tests a state might use for defining its target companies to be protected, medium-sized corporations in that state may find themselves on the uncomfortable side of the line.

The continuum from close corporation to publicly-held corporation forces attention on the shareholder of the corporation. The traditional images of local investors, widows and pensioners come to mind. As long as one has such types in mind, it seems sensible to protect their interests and to let the fate of the corporation rest with a vote of disinterested shareholders. But it bears pointing out that a majority of publicized hostile takeovers involves stock which rapidly drifts into the hands of large institutions and arbitrageurs speculating on further increases in the stock price. Should a goal of takeover legislation be to protect stock market speculators?

Before a state legislature feels forced to adopt one of the types of takeover legislation now available, it should also keep in mind the simple alternate of doing nothing. There are two quite different reasons for selecting inaction. The first reason is based upon the economic viewpoint that all antitakeover legislation impedes the flow of capital from inefficient use toward more efficient uses, prevents shareholders from finally realizing their rightful value and protects

inefficient or inept incumbent managers. These views can be strongly held and strongly argued. The second reason is based upon the realization that shareholders of a publicly-held company are usually dispersed nationally and the public markets in securities are national markets. National, uniform federal regulation of this interstate commerce is preferable to a patchwork of state regulating schemes. This second argument leads toward the view that whatever reforms are needed, they need to be done by Congress to the Williams Act. It is only because the policy decision at the federal level has been that the law of takeover should be neutral that the losers of that political fight have turned to state legislation for aid.\(^{138}\)

\(^{138}\) Those who have turned to state legislation would respond and the recent spat of hostile takeover activity and varying forms of financing for such takeover attempts have indicated that the balance of the Williams Act is actually tipped in favor of acquirors, and that target companies cannot wait for Congress to restore neutrality in the Williams Act.