State Competence to Regulate Corporate Takeovers: Lessons from State Takeover Statutes

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It...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.¹

One of the more enduring issues in corporate law scholarship is the question of federalization.² Put simply, the question is whether Congress, exercising its broad authority to regulate interstate commerce,³ should replace the current system of state corporate regulation with a uniform federal system.

Advocates of federalization think such federal intervention necessary because, to their minds, the state law system has produced laws which favor management interests, and not, as it should, the interests of shareholders.⁴ Managers, they argue, seek to incorporate in states with corporate law regimes that favor their own interests; and states, anxious to win chartering business, have responded to this

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2. The debate over federalization of corporate law can be traced as far back as James Madison's proposal at the Constitutional Convention to invest the federal government with the power "[t]o grant charters of incorporation in cases where the Public good may require them, and the authority of a single state may be incompetent." 2 THE RECORDS OF THE FEDERAL CONVENTION OF 1787, at 325 (M. Farrand ed. 1911). For a good historical overview of the federalization debate, see Boyer, FEDERALISM AND CORPORATE LAW: DRAWING THE LINE IN STATE TAKEOVER REGULATION, 47 OHIO ST. L.J. 1037 (1986).
demand by engaging in a "race to the bottom," each outdoing the other in its willingness to allow managers to exploit corporate resources at the shareholders' expense.6 

Opponents of federalization, by contrast, believe just the opposite: that the state chartering system has produced laws which maximize shareholder welfare.7 While these scholars concede that managers typically make the decision as to where to incorporate, they argue that the various markets in which corporations operate compel managers to use their discretion in the best interests of shareholders.8 Consequently, states competing for chartering business have been encouraged, in the words of one scholar, to engage in a "climb to the top."9

5. See Cary, supra note 4, at 665. Cary actually used the phrase "race for the bottom." Id.

6. See generally Cary, supra note 4 (arguing that Delaware law has been historically favorable to corporate management). Some advocates of federalization are not only concerned that state corporate laws are promoting management and not shareholder interests, but also that the laws are not sufficiently sensitive to the concerns of nonshareholder corporate constituencies, such as employees, resident communities, and consumers. See, e.g., R. NADER, M. GREEN & J. SELIGMAN, supra note 4, at 252-63. The propriety of addressing these concerns through corporate law has been addressed by other scholars. See, e.g., Engel, An Approach to Corporate Social Responsibility, 32 Stan. L. Rev. 1 (1979); Friedman, The Social Responsibility of Business Is to Increase Its Profits, N.Y. Times, Sept. 13, 1970, § 6 (Magazine), at 32. See generally Romano, Metapolitics and Corporate Law Reform, 36 Stan. L. Rev. 923 (1984).


  With all due respect both to Professor Cary and to the almost universal academic support for his position, it is implausible on its face. The plausible argument runs in the opposite direction: (1) If Delaware permits corporate management to profit at the expense of shareholders and other states do not, then earnings of Delaware corporations must be less than earnings of comparable corporations chartered in other states and shares in the Delaware corporations must trade at lower prices. (2) Corporations with lower earnings will be at a disadvantage in raising debt or equity capital. (3) Corporations at a disadvantage in the capital market will be at a disadvantage in the product market and their share price will decline, thereby creating a threat of a takeover which may replace management. To avoid this result, corporations must seek out legal systems more attractive to capital. (4) States seeking corporate charters will thus try to provide legal systems which optimize the shareholder-corporation relationship.

  Id. at 256; see also Fischel, The "Race to the Bottom" Revisited: Reflections on Recent Developments in Delaware's Corporation Law, 76 Nw. U.L. Rev. 913 (1982).

8. Fischel, supra note 7, at 919; Winter, supra note 7, at 256, 262-73.

9. Fischel, supra note 7, at 920.

Though the debate over federalization would seem to turn on an easily verifiable empirical question—whether state corporate laws in fact tend to favor management or shareholder interests—a definitive answer to this question has thus far eluded scholars, and the debate therefore continues. See Romano, The State Competition Debate in Corporate Law, 8 Cardozo L.
This Article seeks to contribute to this larger "federalization" debate by considering the competence with which states regulate one particular corporate activity: corporate takeovers. State takeover legislation is particularly suited to such an examination because it has been one of the most active areas of corporate lawmaking in recent years,10 and more importantly, because takeovers themselves are thought to play a critical role in protecting shareholders against management abuse.11 How states have chosen to regulate this phenomenon can provide a good indication of whether the chartering market is promoting management interests or shareholder interests.12

10. See infra notes 129, 131 and accompanying text.
12. State takeover regulation has also, perhaps more than any other area of state corporate law, raised the spectre of federalization. Litigators seeking to invalidate such laws have argued strenuously, and with some success, that federal law already severely limits state corporate lawmaking in this area. See, e.g., Edgar v. MITE Corp., 457 U.S. 624 (1982), discussed infra notes 58-84 and accompanying text. In addition, in recent years Congress has considered preempting state takeover legislation. See, e.g., Witnesses at Takeover Bill Hearing Split on Preemption of State Regulation, 19 Sec. Reg. & L. Rep. (BNA) 851 (June 12, 1987).

This Article begins with the premise that federal intervention to limit state takeover regulation is only justified if the states are not competently regulating takeovers. States, after all, have longstanding experience in regulating corporate affairs, and there would seem to be little reason for the federal government to "fix" this system if it "ain't broke."  

After a brief overview of state takeover legislation in Part I, this Article reveals two very different lessons about state competence to regulate takeovers, with two very different implications for federalization. The first lesson, set forth in Part II, concerns the problem of protectionism. Put simply, some states are abusing their corporate lawmaking powers in an effort to stop takeovers of large local employers.

While such protectionist corporate law is admittedly a problem—protectionist legislation has long been considered anathema in our federal system—that this Article argues that such corporate law warrants only a limited federal response. Most important, unlike most corporate law, protectionist legislation is not a product of the state competition for charters, but rather it occurs because local lawmakers feel pressured to protect their constituents from out-of-

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13. There is much to be said for federal deference to state corporate lawmaking. Most notably, federal intervention into this historic bailiwick of the states might not only prove disruptive for the corporate community, it could also, not having been tested, easily result in a worse system. See Fischel, supra note 7, at 921-23 (arguing that there is no reason to believe, and every reason to doubt that federal regulation would increase shareholders' welfare); Romano, State Competition, supra note 9, at 712-13 (suggesting that there is no reason to think that "diffuse and unorganized" shareholders would be any more capable of communicating their views to Congress than to state legislatures).

14. See infra notes 25-128 and accompanying text.

15. See infra notes 129-228 and accompanying text.

16. See infra notes 136-66 and accompanying text.

17. See Regan, The Supreme Court and State Protectionism: Making Sense of the Dormant Commerce Clause, 84 MICH. L. REV. 1091, 1095 (1986); infra note 135 and accompanying text.
state competition. The appropriate federal response to such legislation, it is argued, is not to invalidate all state takeover regulation, but only that which has been tainted by a protectionist motive. Such limited intervention has been the historic federal response to protectionism through judicial invalidation under the Commerce Clause.

The second lesson, set forth in Part III, directly addresses the effectiveness of the state chartering market in regulating takeovers. While protectionism explains much of the current state takeover legislation, some of the legislation, such as the recently enacted Delaware takeover statute, has been clearly enacted in response to the market for corporate charters.

This latter legislation, it should be noted, is not protectionist. Although it is prompted by a desire to protect a state’s chartering industry, it does so not by stopping the flow of commerce out of a state, but by encouraging it to freely flow in. The legislation, instead, must be evaluated in the context of the larger “race to the bottom” debate. If the chartering market is promoting management interests rather than shareholder interests, then some form of federal intervention is needed.

As will be seen, an examination of the Delaware takeover statute suggests that the chartering market has been engaging in a “race to the bottom”—the legislation appears to be sheltering managers from hostile takeovers without any credible concomitant benefit to shareholders. The appropriate federal response to this type of takeover legislation is not a piecemeal approach. Absent corrective federal intervention, the chartering market will continue to promote management entrenchment legislation. This Article argues, however, that minimal federal intervention may be sufficient to correct any

18. See infra notes 136-38 and accompanying text.
19. See infra notes 187-94 and accompanying text.
20. See infra notes 229-313 and accompanying text.
22. See infra notes 229, 233 and accompanying text.
23. See J. NOWAK, R. ROTUNDA & J. YOUNG, CONSTITUTIONAL LAW 284 (3d ed. 1986). In explaining why a Michigan advertisement campaign promoting Michigan as a vacation spot is not protectionist, one commentator stated:

[We might say that protectionism takes over a market share by force; it is like acquiring territory by armed conquest. Advertising, like product improvement [which is arguably what Delaware is doing in revising its corporate laws] and other standard market ploys, uses no force; it encourages a free transfer of allegiance. It is like acquiring territory by plebiscite of the inhabitants.

Regan, supra note 17, at 1114.
24. See infra notes 240-52 and accompanying text.
management bias in the chartering market.

I. BACKGROUND: OVERVIEW OF STATE TAKEOVER REGULATION

Any overview of state takeover regulation must begin with a recognition that the legislation has not developed in a vacuum. To the contrary, the federal government has, through both legislative and judicial actions, asserted some influence in the takeover area—influence which has naturally affected the development of the state regulation.\(^\text{25}\)

On the legislative side is the Williams Act, a series of amendments to the Securities Exchange Act of 1934,\(^\text{26}\) enacted by Congress in 1968.\(^\text{27}\) The Williams Act, like other federal securities regulations, is for the most part, a disclosure statute.\(^\text{28}\) It requires tender offerors to make disclosures concurrently with their offers,\(^\text{29}\) and requires owners of large blocks of stock to file post-acquisition disclosure statements concerning the nature and purpose of their acquisitions.\(^\text{30}\)

Viewed narrowly, as a statute limited to disclosure requirements, the Williams Act would have little preemptive impact on state takeover regulation. The legislative history behind the Act, however, reveals a strong desire on the part of Congress that takeover battles be fought on a level playing field—one that favors neither management nor acquirors\(^\text{31}\)—and an activist court could use

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25. For an insightful article concerning the interplay of federal and state law in the takeover context, see Thompson, supra note 12.
28. Despite its focus on disclosure, the Williams Act does have more substantive requirements than is typical in securities regulation. The Act, for instance, not only requires that tender offerors file disclosure statements accompanying their offers, it also sets forth a litany of rules regarding the timing and nature of offers themselves. For example, §§ 14(d)(5)-(7) of the Williams Act specify rules concerning shareholder withdrawal rights, the effects of over-subscription in a partial offer, and rules for when an offeror increases its offering price during the pendency of a tender offer. 15 U.S.C. § 78n(d)(5)-(7) (1982). The Securities and Exchange Commission has used its rulemaking authority to supplement these statutory provisions with additional substantive regulation. See, e.g., Rule 14e-1, 17 C.F.R. § 240.14e-1 (1988) (prescribing a minimum tender offer period); Rule 14d-10, 17 C.F.R. § 240.14d-10 (1988) (setting forth tender offer regulations assuring equal treatment of security holders within the same class).
this history to preempt any state legislation which itself did not adopt a neutral stance in takeover battles.\textsuperscript{32} In \textit{Edgar v. MITE Corp.},\textsuperscript{33} the Supreme Court's first major encounter with state takeover legislation,\textsuperscript{34} three Justices endorsed such a broad reading of the Williams Act.\textsuperscript{35} More recently, however, in \textit{CTS Corp. v Dynamics Corp. of America},\textsuperscript{36} the Court, in its second encounter with takeover legislation, largely retreated from this position.\textsuperscript{37}

State regulation of takeovers has also been influenced by what might be called "federal judicial intervention." This term is used to mean judicial use of dormant Commerce Clause theories to limit state takeover regulation,\textsuperscript{38} rather than judicial construction of the Williams Act, which is ultimately simply a matter of construing Congressional intent. As will be seen, the Court's application of Commerce Clause doctrines to state takeover legislation has paralleled its treatment of the Williams Act. At first, the Court in \textit{MITE} broadly applied the Commerce Clause so as to severely restrict state lawmaking powers in the takeover context.\textsuperscript{39} In the subsequent \textit{CTS} decision, however, the Court largely retreated from this position.\textsuperscript{40}

This ebb and flow of federal intervention into the takeover arena has only helped to heighten the importance of the question addressed in this Article—what state takeover regulation teaches about the competence of states to regulate corporate takeovers, and the need, if any, for federal intervention. The \textit{MITE} decision, which represented

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\textsuperscript{32} As the Court noted in \textit{MITE}, a state statute will be preempted by federal legislation when the state "law stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." \textit{MITE}, 457 U.S. at 631 (quoting \textit{Hines v. Davidowitz}, 312 U.S. 52, 67 (1941)).

\textsuperscript{33} 457 U.S. 624 (1982).

\textsuperscript{34} Actually, the Supreme Court had an earlier opportunity to rule on a state takeover statute in \textit{Leroy v. Great Western United Corp.}, 443 U.S. 173 (1979), but the Court disposed of the case on procedural grounds.

\textsuperscript{35} \textit{MITE}, 457 U.S. at 630-40; see infra notes 64-67 and accompanying text (discussing the preemption leg of the \textit{MITE} opinion).

\textsuperscript{36} 481 U.S. 69 (1987).

\textsuperscript{37} See infra notes 117-22 and accompanying text (discussing the preemption leg of the \textit{CTS} opinion).

\textsuperscript{38} Although the Commerce Clause simply provides Congress with the power "[t]o regulate Commerce ... among the several States," \textit{U.S. Const. art. I, § 8, cl. 3}, "it has been settled for more than a century that the Clause prohibits States from taking certain actions respecting interstate commerce even absent congressional action." \textit{CTS}, 481 U.S. at 87 (citing \textit{Cooley v. Board of Wardens}, 53 U.S. (12 How.) 299 (1852)).

\textsuperscript{39} See infra notes 68-84 and accompanying text (discussing the Commerce Clause leg of the \textit{MITE} opinion).

\textsuperscript{40} See infra notes 123-28 and accompanying text (discussing the Commerce Clause leg of the \textit{CTS} opinion).
the pinnacle of federal intervention into the takeover arena, caused a radical reorientation of state takeover laws from laws which tended to be more like securities or blue sky laws to laws which more clearly resembled traditional state corporate law.\textsuperscript{41} The more recent CTS decision, which upheld one of these new statutes, squarely posed the question of whether Congress, in light of the Court's unwillingness to strike the new regulation, should now intervene.

The overview of state takeover legislation proceeds chronologically, beginning with "first generation" statutes—those statutes enacted prior to the Supreme Court's decision in \textit{MITE}, and continuing with "second generation" statutes—those enacted in response to \textit{MITE}.

\textbf{A. State Takeover Regulation in the Pre-\textit{MITE} Period: The "First Generation"}

1. First Generation Takeover Statutes.— Between 1968 and 1982, the year of the Supreme Court's decision in \textit{Edgar v. MITE Corp.},\textsuperscript{42} thirty-seven states enacted what have become known as "first generation" takeover statutes.\textsuperscript{43} These statutes, for the most part, were imitations of the federal Williams Act.\textsuperscript{44} Like the Williams Act, the state legislation established disclosure requirements for tender offers.\textsuperscript{45} Many, in fact, required offerors to disclose essentially the same information required by the Williams Act, though they most typically added at least some additional disclosure items.\textsuperscript{46}

The state legislation, however, also typically had some signifi-

\textsuperscript{41} See infra notes 86-107 and accompanying text.
\textsuperscript{42} 457 U.S. 624 (1982).
\textsuperscript{44} Sargent, \textit{Do the Second-Generation State Takeover Statutes Violate the Commerce Clause?}, 8 CORP. L. REV. 3, 3-4 (1984).
\textsuperscript{45} Langevoort, supra note 43, at 226-33.
significant differences from the Williams Act—differences which for the most part, tended to increase the legislation’s anti-takeover effect. Many of the state statutes, for instance, required offerors to file their disclosure statements far in advance of making their offers, thus providing managers with lead time to implement defensive tactics to thwart unwelcome offers. The Williams Act, by contrast, requires only that disclosures be made simultaneously with offers.

Similarly, many state acts authorized state officials to conduct lengthy public hearings on the adequacy of an offeror’s disclosures, hearings which, again, had the effect of greatly delaying the offering process. By contrast, the Williams Act contains no provision for public hearings on the adequacy of the disclosure documents.

Finally, many of the state acts also authorized state officials to review offers for their substantive fairness to shareholders. This was a requirement wholly absent in the Williams Act, which, according to the legislative history, was intended to leave the decision of fairness to the shareholder/offerees.

It is also worth noting that the state legislation, to the extent it can be considered a form of corporate law, frequently had peculiar jurisdictional limits. Unlike most corporate law statutes which usually apply to entities incorporated in the legislating state, the acts often applied to offers for foreign corporations if the corporations had a substantial presence in the state, such as substantial assets, their principal place of business, or a large number of shareholders.

47. See Langevoort, supra note 43, at 226-28; Profusek & Gompf, supra note 46, at 7.
49. See 15 U.S.C. § 78n(d)(1) (1982). In 1980, the SEC adopted Rule 14d-2, 17 C.F.R. § 240.14d-2 (1988), which provides that a bidder’s public announcement of certain material terms of an offer will constitute the commencement of a tender offer, thus subjecting the party to the disclosure and timing requirements of the Williams Act. See id. Since a bidder’s disclosure pursuant to a state takeover statute would, in most cases, constitute the commencement of a tender offer under this rule, the pre-registration waiting periods of the state statutes, which precluded bidders from commencing their offers until the end of the waiting period, made it impossible for bidders to comply with both state and federal schemes. The SEC recognized that it was creating this conflict in adopting Rule 14d-2 and openly acknowledged that its intent was to preempt state laws. See 44 Fed. Reg. 70,326, 77,329-30 (1979), 17 C.F.R. § 240.14d-2 (1988).
50. See Boehm, supra note 43, at 733; Langevoort, supra note 43, at 232; Profusek & Gompf, supra note 46, at 7-8.
53. MITE, 457 U.S. at 639-40.
54. See Boehm, supra note 43, at 738; Langevoort, supra note 43, at 219-20; Profusek
In theory, the purpose of these statutes, like the Williams Act, was to protect shareholders by insuring that the shareholders, when confronted by a tender offer, had adequate information so as to make an informed decision as to whether to tender.65 Ostensibly, in fact, the first generation statutes even surpassed the Williams Act in terms of their solicitude for shareholders—not only did the statutes require offerors to make disclosures (and many required offerors to disclose even more information than that required by the Williams Act),66 they also authorized state officials to independently evaluate offers for their "fairness" to shareholders.67

2. Edgar v. MITE Corp.: The Death Knell for First Generation Statutes. — Edgar v. MITE Corp.68 was the death knell for first generation statutes.69 In a highly fractionalized decision, five Justices of the Supreme Court held an Illinois first generation statute was unconstitutional since it was an unlawful burden on interstate commerce.70 By implication, MITE portended the demise of all first generation statutes. It also caused a radical reorientation in subsequent state takeover regulation.

The Illinois statute at issue in MITE71 was a typical first generation statute. It required tender offerors to file a disclosure statement

& Gompf, supra note 46, at 7.

55. See Langevoort, supra note 43, at 214-16. The Supreme Court has said of the Williams Act: "The legislative history thus shows that the sole purpose of the Williams Act was the protection of investors who are confronted with a tender offer." Piper v. Chris-Craft Indus., 430 U.S. 1, 35 (1977); see also Rondeau v. Mosinee Paper Corp., 422 U.S. 49, 58 (1975) (noting that the act's purpose is to protect public shareholders who are confronted with a cash tender offer).

56. See supra note 46 and accompanying text.

57. See supra note 52 and accompanying text.


59. See Block, Barton & Roth, State Takeover Statutes: The "Second Generation", 13 SEC. REG. L.J. 332, 332 (1986); Profusek & Gompf, supra note 46, at 3.

60. In essence, Justice White wrote a lead opinion with a smorgasbord of theories for invalidating the Illinois Act, and the remaining Justices, with the exception of three who disagreed on procedural grounds, picked and chose those theories with which they concurred.

Justice Burger and Blackmun joined in Justice White's argument that the Illinois Act was preempted by the Williams Act. See MITE, 457 U.S. at 625-40. Justices Burger, Stevens and O'Connor joined in Justice White's argument that the Illinois Act was an unconstitutional "direct" regulation of interstate commerce. See id. at 625, 640-43. The only theory to garner an additional four votes (Burger, Stevens, O'Connor and Powell), and thus achieve a slim five vote majority, was that the Illinois statute was an unconstitutional "indirect" burden on interstate commerce. See id. at 625, 643-46.

Justice Marshall, joined by Justices Brennan and Rehnquist, dissented on procedural grounds. See id. at 655 (Marshall, J., dissenting); id. at 664 (Rehnquist, J., dissenting).

with the Illinois Secretary of State twenty days prior to making an offer, and commanded the Secretary to evaluate the statement for accuracy as well as to rule on the offer's substantive fairness.

Three Justices found the Illinois Act to be preempted by the Williams Act. The statute, these Justices believed, upset the "careful balance" struck in the Williams Act because its provisions for pre-offer registration and potentially indefinite public hearings delayed the offering process and thus tipped the balance in takeover battles in favor of management.

The only theory to gain a majority of the Court, however, was that the Illinois Act placed an unlawful burden on interstate commerce. Applying the balancing test articulated by the Court in

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62. The Act provided that any takeover offer for a target company, as defined by the Act, must be registered with the Illinois Secretary of State. Id. para. 137.54.A. An offer did not become "registered" until 20 days after a registration statement was filed (and possibly longer if the Secretary were to call for a hearing). Id. para. 137.54E.

63. See id. para. 137.57E. The plurality opinion in MITE noted:
If the Secretary does hold a hearing, he is directed by the statute to deny registration to a tender offer if he finds that it "fails to provide full and fair disclosure to the offerees of all material information concerning the take-over offer, or that the take-over offer is inequitable or would work or tend to work a fraud or deceit upon the offerees . . . ."
MITE, 457 U.S. at 627 (quoting ILL. REV. STAT. ch. 121 ½, psra. 137.57E (1979) (repealed 1983)).

64. See supra note 60.

65. MITE, 457 U.S. at 634-35. The Court stated:
We agree with the Court of Appeals that by providing the target company with additional time within which to take steps to combat the offer, the precommencement notification provisions furnish incumbent management with a powerful tool to combat tender offers, perhaps to the detriment of the stockholders who will not have an offer before them during this period. These consequences are precisely what Congress determined should be avoided, and for this reason, the precommencement notification provision frustrates the objectives of the Williams Act.
Id. at 635 (footnote omitted).

66. Id. at 636-39. The Court agreed with the Court of Appeals "that the hearing provisions of the Illinois Act frustrate the congressional purpose by introducing extended delay into the tender offer process." Id. at 637.

67. Justice White, joined by Justices Burger and Blackmun, specifically noted in a footnote that "[d]elay has been characterized as 'the most potent weapon in a tender-offer fight'" id. at 637 n.12 (quoting Langevoort, supra note 43, at 238), and listed in another footnote potential defensive tactics which can be employed by incumbent management in the event of a delayed offer. Id. at 638 n.13.

These Justices also found the provision in the Illinois Act granting the Secretary of State the right to rule on the substantive fairness of an offer to be in conflict with the purpose of the Williams Act. Id. at 639. Looking to the legislative history of the Williams Act, the Justices concluded that "Congress intended for investors to be free to make their own decisions." Id.

68. Id. at 625, 643-46. The Court's Commerce Clause analysis curiously revived the distinction in Commerce Clause jurisprudence between direct and indirect regulation of com-
Pike v. Bruce Church, Inc., the Court found the Illinois Act to be unconstitutional because the burden it placed on interstate commerce far exceeded any purported state interests furthered by the legislation.

On the burden side of the scale, the majority seemed to assume that an unimpeded market for corporate control was itself an important value embodied in interstate commerce, and the Illinois Act imposed a substantial burden on this market. Citing to the leading advocates of an open market for corporate control, the Court lamented how the Illinois Act, by authorizing a state official to enjoin nationwide tender offers, would deprive shareholders "of the opportunity to sell their shares at a premium," hinder the "reallocation of economic resources to their highest valued use," and reduce the incentive for "incumbent management to perform well."

On the opposite side of the scale, the Court found virtually nothing to weigh in the statute's favor. Illinois, for its part, claimed that the Act was intended to further the state's interests in protecting local shareholders and in regulating the internal affairs of Illi-
nois corporations. Upon examining the Act’s jurisdictional limits, however, the Court found both of these claims to be specious. The Act applied to offers for corporations that had either ten percent of their equity securities owned by Illinois residents, or met any two of the following three requirements: (1) the corporation had its principal executive office in Illinois; (2) was incorporated in Illinois; or (3) had at least ten percent of its stated capital and paid-in surplus in Illinois. With these limits in mind, the Court found that the Illinois Act did little to further either the state’s interests in protecting resident shareholders, since it could apply to offers for companies that did not have a single Illinois shareholder, or its interest in regulating the internal affairs of domestic corporations, since it potentially applied to offers for foreign corporations.

Moreover, the Court noted that the statute did not even regulate internal corporate affairs, which the Court described as “matters peculiar to the relationships among or between [a] corporation and its current officers, directors, and shareholders . . . ” Instead, the Illinois Act attempted to regulate transfers of stock between share-

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78. Id. at 645.
79. Id. at 644-46.
80. ILL. REV. STAT. ch. 121 ½, para. 137.52-10 (1979) (repealed 1983); see also MITE, 457 U.S. at 627 (discussing the provisions of the Illinois Act).
81. The Court stated: “While protecting local investors is plainly a legitimate state objective, the State has no legitimate interest in protecting nonresident shareholders.” MITE, 457 U.S. at 644. Earlier in its decision, the Court had noted that the Illinois Act would apply even if not a single one of [the target’s] shareholders were a resident of Illinois, since the Act applies to every tender offer for a corporation meeting two of the following conditions: the corporation has its principal executive office in Illinois, is organized under Illinois laws, or has at least 10% of its stated capital and paid-in surplus represented in Illinois.

Id. at 642.

The Court also expressed disbelief that the Illinois Act was intended to protect shareholders. See id. at 644-45. The Act, for instance, exempted from its requirements company self-tenders, ILL. REV. STAT. ch. 121 ½, para. 137.52-9(4) (1979) (repealed 1983), even though shareholders would seem to be in equal need of the Act’s protection in that context. As the Court noted, “[t]his distinction is at variance with Illinois’ asserted legislative purpose, and tends to undermine appellant’s justification for the burdens the statute imposes on interstate commerce.” MITE, 457 U.S. at 644.

Finally, the Court also expressed doubt that the disclosure and substantive provisions in the Illinois Act “substantially enhance[d]” shareholder protection since many of the provisions duplicated regulations already found in the federal Williams Act. Id. at 644-45.

82. MITE, 457 U.S. at 645-46. The Court asserted, “[t]he Act thus applies to corporations that are not incorporated in Illinois and have their principal place of business in other States. Illinois has no interest in regulating the internal affairs of foreign corporations.” Id.
83. Id. at 645.
holders and wholly independent third party buyers.  

B. State Takeover Regulation After MITE: The "Second Generation"

*MITE* represents the federal government's furthest incursion into state corporate lawmaking in the takeover context. Read broadly, the Court's Commerce Clause analysis suggests that any state law which interferes with the market for corporate control was potentially unconstitutional. Moreover, the Court's plurality preemption analysis suggests that any state legislation which tips the balance in takeover battles in favor of management would be preempted by the Williams Act.  

*MITE* did not, however, stop state takeover regulation. It only changed its direction. States responded to the Court's criticism that the Illinois Act did not regulate "internal corporate affairs" by devising new statutes which more clearly resembled traditional corporate laws. The result was a variety of statutes, the most prevalent of which focused on such traditional corporate law issues as mergers, appraisal rights, shareholder voting rights and the fiduciary obligations of corporate managers.

1. The Array of Second Generation Statutes.—Six types of second generation statutes are notable. They are best classified by

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84. *Id.*  
85. The decision of the Seventh Circuit in Dynamics Corp. of America v. CTS Corp., 794 F.2d 250 (7th Cir. 1986), rev'd, 481 U.S. 69 (1987), reflects the height of judicial hostility to state takeover legislation. In that decision, Judge Posner, writing for the court, gave what might have been the broadest interpretation of *MITE*. *Id.* In his preemption analysis, for instance, he described the reasoning of the MITE plurality as follows:  

Of course it is a big leap from saying that the Williams Act does not itself exhibit much hostility to tender offers to saying that it implicitly forbids states to adopt more hostile regulations, but this leap was taken by the Supreme Court plurality and us in MITE and by every court to consider the question since. *Id.* at 262. Judge Posner's Commerce Clause discussion also spoke in broad language about the limits placed on state takeover regulation by the Commerce Clause:  

The commerce clause does not allow states to prevent corporations from moving assets and employees to other states. But whether or not an anti-takeover statute is vulnerable to challenge under the commerce clause if it impedes mobility of corporate assets, it is highly vulnerable if it impedes the important commerce in corporate control. Even if a corporation's tangible assets are immovable, the efficiency with which they are employed and the proportions in which the earnings they generate are divided between management and shareholders depends on the market for corporate control—an interstate, indeed international, market that [a state] is not authorized to opt out of . . . .  

*Id.* at 264.  
86. For discussion of second generation statutes, see generally Block, Barton & Roth,
what they purport to do.

Three second generation statutes—fair price, control share cash-out and control share acquisition—purport to protect target shareholders from the coercive effects of two-tiered tender offers. Such offers occur when an acquiror announces that it will pay a high price for shares tendered into a front-end tender offer, while simultaneously threatening to pay a lesser amount to shareholders squeezed out in a subsequent merger. Tender offers of this type are thought to force shareholders to accept the initial offer for fear of being caught in the disadvantageous back-end.88

Fair price statutes, originally developed by Maryland, relieve shareholders from the pressure of two-tiered offers by requiring that any shareholders squeezed out in a second-step merger receive essentially the same price (a "fair price") as that received by the shareholders who tendered into the front-end of the offer.90

90. See Sargent, Do Second-Generation State Takeover Statutes Violate the Commerce Clause? A Preliminary Inquiry, in TENDER OFFERS 75, 82 (M. Steinberg ed. 1985) (stating that "the [Maryland fair price] statute is designed to inhibit front-end-loaded, two-step takeovers, on the ground that such takeover bids are inherently coercive and unfair to nontendering shareholders").
Control share cash-out statutes, first developed by Pennsylvania, basically achieve the same result by giving to shareholders a right of redemption against anyone who acquires more than a certain percentage of the company's stock. Shareholders are typically allowed to redeem their shares for a fair value which takes into consideration any premium paid by the acquiror to gain control.

Finally, control share acquisition statutes, first developed by Ohio, require offerors to receive shareholder approval before pass-
ing certain levels of share ownership. These statutes relieve shareholders of the pressures associated with two-tiered offers by allowing shareholders to decide collectively, before responding to the initial offer, whether the offer combined with a potential back-end price is adequate.

A fourth kind of second generation statute, the modified disclosure statute, is also purportedly aimed at protecting shareholders. These statutes are similar to pre-MITE statutes, but have been modified in an attempt to correct the constitutional infirmities of the earlier legislation. Minnesota, for instance, adopted a new disclosure statute that more clearly emphasizes the state's interest in protecting local shareholders than did most first generation statutes.

Finally, two types of second generation statutes do not purport to protect shareholders, but rather employees and communities from the dislocative effects of takeovers. Business combination statutes, first developed by New York, generally provide that acquirors who

95. Hook, What is Wrong with Takeover Legislation, 8 N. Ill. U.L. Rev. 293, 318 (1988). Failure to receive shareholder approval may bar the acquiror from purchasing the additional shares, as is apparently the case with the Ohio statute, Ohio Rev. Code Ann. § 1701.831 (Anderson 1985), or may simply deny the acquiror voting rights in the acquired stock, as is the case with the Indiana Act, Ind. Code Ann. § 23-1-42-1 to -11 (West 1989). See Hook, supra, at 318-19.

96. CTS Corp. v. Dynamics Corp. of America, 481 U.S. 69, 82-83 (1987). See generally Booth, supra note 12, at 1681-99 (calling control share statutes, standing alone, "a remarkably intelligent approach to the problem of fairness in tender offers" and setting forth their merits).


98. See Minn. Stat. Ann. §§ 80B.01-.13 (West 1986 & Supp. 1989). As originally drafted, the Minnesota Act only applied if 20% of the target's equity shares were held by Minnesota residents and any injunction issued under the statute only enjoined an offeror from buying from the Minnesota shareholders. Id. §§ 80B.01(8), 80B.01(9), 80B.03(5) (1986).

Though modified disclosure statutes sometimes require an offeror to disclose information concerning the potential impact of its acquisition on a state's employees, the legislation still appears to be intended primarily for the benefit of shareholders who will presumably consider such information in making their decision whether to tender. As the Eighth Circuit said in upholding the modified Minnesota statute:

While the state may not use the statute as a protectionist measure, it may require the offeror to inform Minnesota stockholders as to the impacts on the state or its residents of the takeover, so that they can consider these factors as an element in their decision to retain their stock or to sell it.


pass a certain level of share ownership without first getting the approval of a target company's board of directors are forbidden from engaging in any "business combination" with the target, such as a merger, for a certain period of years.100

Governor Cuomo's memorandum in support of the original New York statute suggests that the primary purpose of the legislation was to protect employees and communities from the dislocative effects associated with highly leveraged takeovers.101 The effect of the business combinations statute, the memorandum states, will be "to encourage a potential acquiror to negotiate its proposed acquisition with the board of directors"102 and thus help insure that the "offeror [will] be more likely to have a commitment to the long-term interests of the resident domestic corporation and its employees."103 Curiously, as will be discussed later, when Delaware recently enacted a modified version of the New York statute,104 the proponents of the legislation claimed that its primary purpose was to protect share-

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101. See Memorandum to Governor's Program Bill, 1985 Extraordinary Session, at 6 [hereinafter CUOMO MEMORANDUM] (stating that highly leveraged takeovers "adversely affect employees and communities.... [and] restrict the ability of affected businesses to grow, to invest for long-term return and to provide increased productivity and employment.").

102. Id. at 8.

103. Id. at 9.

holders from coercive offers.\textsuperscript{105}

Furthermore, some states have made explicit in their corporate codes that officers and directors may consider the interests of employees, communities and other nonshareholder corporate constituencies in making decisions, including decisions about how to respond to a takeover bid.\textsuperscript{106}

Finally, it should also be noted that, like their first generation predecessors, second generation statutes in many instances are triggered by acquisitions of companies not incorporated in the legislating state, but which have a substantial presence in the state, such as the principal place of business or a large number of employees.\textsuperscript{107}

\textsuperscript{105.} See infra text accompanying note 263.


In discharging the duties of their respective positions, the board of directors, committees of the board, individual directors may, in considering the best interests of the corporation, 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, and all other pertinent factors. The consideration of those factors shall not constitute a violation of [the director's fiduciary relation to the corporation].

\textsuperscript{107.} Examples of control share acquisition statutes that apply to foreign corporations include: FLA. STAT. ANN. § 607.109-.110 (West Supp. 1989) (applying to companies which have been granted authority to conduct business in Florida; have 100 or more shareholders; have their principal place of business, principal office or substantial assets within Florida; employ more than 500 Florida residents; and either (a) more than 10% of their shareholders resident in Florida, (b) more than 10% of their share owned by Florida residents or (c) more than 1000 shareholders in Florida); MASS. GEN. LAWS. ANN. chs. 110D, 110E (West Supp. 1989) (applying to companies with 200 or more stockholders; their principal executive office in Massachusetts and more of their employees or assets in Massachusetts than in any other state as of the end of any of the preceding four fiscal quarters; and either (a) more than 10% of their shareholders resident in Massachusetts or (b) more than 10% of their stock owned by Massachusetts residents); N.C. GEN. STAT. §§ 55-90 to -98.1 (Supp. 1988) (applying to companies with, at the end of each of the last two fiscal years, over 40% of their fixed United States assets in North Carolina and 40% of their United States employees in North Carolina; over 500 shareholders; their principal place of business or principal office in North Carolina; and either (a) more than 10% of their shareholders resident in North Carolina or (b) more
2. CTS Corp. v. Dynamics Corp. of America: Giving New Life to State Takeover Regulation.— In CTS Corp. v. Dynamics Corp. of America,\(^{108}\) the Supreme Court upheld an Indiana control share acquisition statute.\(^{108}\) While purporting to follow its earlier decision in MITE, the Court actually signalled a retreat from that decision's broad federal encroachment into state corporate law.\(^{110}\) CTS, in fact, than 10% of their shares owned by North Carolina residents); Okla. Stat. Ann. tit. 18, §§1145-1155 (West Supp. 1989) (declared unconstitutional in TLX Acquisition Corp. v. Telex Corp., 679 F. Supp. 1022 (W.D. Okla. 1987) (applying to companies with 100 or more shareholders; their principal place of business, principal office or substantial assets in Oklahoma; and either (a) more than 10% of their shares owned by Oklahoma residents, (b) more than 10% of their shareholders resident in Oklahoma, or (c) 10,000 shareholders resident in Oklahoma).

Examples of fair price statutes which apply to foreign corporations include: Fla. Stat. Ann. § 607.108 (West Supp. 1989) (employing nexus requirements similar to those for the state's control share acquisition statute discussed above); N.C. Gen. Stat. §§ 55-75 to -79 (Supp. 1988) (employing nexus requirements similar to those for the state's control share acquisition statute discussed above).

For an extended discussion of state takeover statutes which apply to foreign corporations, see Hazen, State Anti-Takeover Legislation: The Second and Third Generations, 23 Wake Forest L. Rev. 77 (1988).

110. See, e.g., Cox, supra note 12, at 337-38 (suggesting that CTS can be read as confining MITE to "questions of extraterritoriality and incompatible state regulation ... "). The issues of extraterritoriality and incompatible state regulatory regimes were raised by the MITE statute because the statute potentially applied to foreign corporations. See Edgar v. MITE Corp., 457 U.S. 624, 642-43 (1982) (plurality opinion). As a result, if the statute was upheld, the possibility existed that other state takeover statutes with similarly broad jurisdictional requirements, but with perhaps incompatible disclosure and registration requirements, could regulate the same tender offer. See id. at 642.

In the years preceding the CTS decision, the lower courts had been liberally applying the free market philosophy reflected in the MITE decision. Following the logic of MITE's Commerce Clause analysis and the plurality's preemption opinion, the lower courts placed severe limitations on state lawmaking powers in the takeover context, striking any legislation which tended to interfere with the market for corporate control (as violative of the Commerce Clause), or which tipped the balance in takeover battles in favor of management (as preempted by the Williams Act). Statutes were not infrequently found to be both preempted and in violation of the Commerce Clause.

Control share acquisitions were the most vulnerable to constitutional attack. In Terry v. Yamashita, 643 F. Supp. 161 (D. Hawi 1986), a United States district court granted a preliminary injunction enjoining enforcement of the Hawaii control share acquisition statute on the ground that it violated the Commerce Clause. Id. at 165-66, 168. The court also suggested that the Act might be preempted by the Williams Act. Id. at 166-68. In APL Ltd. Partnership v. Van Dusen Air, Inc., 622 F. Supp. 1216 (D. Minn. 1985), a district court held an early version of a Minnesota control share acquisition statute unconstitutional on Commerce Clause grounds. Id. at 1225. A Missouri statute was declared unconstitutional on both Commerce Clause and preemption grounds in Icahn v. Blunt, 612 F. Supp. 1400, 1415, 1419-20 (W.D. Mo. 1985).

The Indiana statute, after being declared unconstitutional by the Seventh Circuit, Dy-
resoundingly reaffirmed the right of states to promulgate corporate law, and stressed the hesitancy with which the Court, absent a clear indication from Congress, would interfere with that right. Any extensive federal intervention into the takeover arena, it would seem, was now to be legislative rather than judicial.

The Indiana Act upheld in CTS is a typical control share acquisition statute. The Act provides that an acquirer who passes certain levels of share ownership in a subject corporation will receive voting rights in its shares only "to the extent granted by resolution approved by the shareholders." The acquirer may insist that management call a shareholder meeting for the purpose of voting within fifty days of filing an "acquiring person statement," and will be granted voting rights only if a majority of "disinterested" shareholders (all shares except those owned by the acquirer or by officers or inside directors) vote in favor of the grant.

Dynamics Corporation of America, which was seeking to acquire shares in CTS, an Indiana corporation, challenged this statute on both preemption and Commerce Clause grounds. For its preemption argument, Dynamics argued, inter alia, that the potential fifty day delay imposed by the Indiana Act far exceeded the minimum twenty day tender offer period in the Williams Act, and that the Indiana Act therefore improperly tipped the balance in takeover bat-

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111. See supra notes 94-96 and accompanying text (discussing control share acquisition statutes).

112. The Indiana Act only applies to a company which is incorporated in Indiana, IND. CODE ANN. § 23-1-20-5 (West 1989), and has: (1) 100 or more shareholders; (2) its principal place of business, its principal office, or substantial assets within Indiana; and (3) either (a) more than 10% of its shareholders resident in Indiana, (b) more than 10% of its shares owned by Indiana residents, or (c) 10,000 shareholders resident in Indiana. Id. § 23-1-20-5(a).

113. Id. § 23-1-42-9(a).

114. Id. § 23-1-42-6.

115. Id. § 23-1-42-3.

116. Id. § 23-1-42-9(b).
tles in favor of incumbent managers.\textsuperscript{117}

Though Dynamics’ argument would seem to follow naturally from the Court’s plurality reasoning in \textit{MITE},\textsuperscript{118} the \textit{CTS} Court found the fact that the legislation could delay the tender offer process not to be decisive.\textsuperscript{119} Stressing its hesitancy to preempt state corporate law, the Court remarked, “The longstanding prevalence of state regulation in this area suggests that, if Congress had intended to pre-empt all state laws that delay the acquisition of voting control following a tender offer, it would have said so explicitly.”\textsuperscript{120}

Accepting without critical examination Indiana’s contention that its Act was intended, like most control share acquisition statutes, to protect shareholders from two-tiered offers,\textsuperscript{121} the \textit{CTS} Court found that the Act furthered, rather than frustrated, the purpose of the Williams Act.\textsuperscript{122}

Dynamics’ Commerce Clause argument was no more successful than its preemption argument. The Court, applying a traditional Commerce Clause analysis, first found that the Indiana Act was not \textit{per se} unconstitutional since it did not discriminate against interstate

\begin{footnotes}
\item[117] CTS Corp. v. Dynamics Corp. of America, 481 U.S. 69, 84-85 (1987).
\item[118] \textit{See supra} notes 64-67 and accompanying text. The \textit{CTS} Court was not bound by the broad preemption analysis of the \textit{MITE} plurality. \textit{See CTS}, 481 U.S. at 81. Nevertheless, it applied that reasoning, without expressly adopting or questioning it, since, in the Court’s view, the Indiana statute was lawful even under the broad \textit{MITE} analysis. \textit{Id.} at 80-81.
\item[119] \textit{CTS}, 481 U.S. at 83-86.
\item[120] \textit{Id.} at 86. The Court also questioned whether the Indiana Act actually caused a delay in the tender offer process since an offeror, according to the Court, can simply accept shares on the condition that it receive subsequent shareholder approval for its acquisition. \textit{Id.} at 84-85. Dynamics responded to this argument by noting that even if the offeror makes its offer conditional, management will still be in place for an additional three weeks and would have “‘free rein to take other defensive steps that will diminish the value of the tendered shares.’” \textit{Id.} at 85 n.9 (quoting Brief for Appellee at 37, CTS Corp. v. Dynamics Corp. of America, 481 U.S. 69 (1987) (No. 86-71)). The Court rejected this contention, apparently on the premise that such mismanagement was a subject for state regulation and was not regulated by the Williams Act. \textit{See id.} Again, however, such a narrow reading of the Williams Act would seem to be in conflict with the reasoning of the \textit{MITE} plurality.
\item[121] As the Court explained:
\begin{quote}
[T]he Act protects [shareholders] from the coercive aspects of some tender offers. If, for example, shareholders believe that a successful tender offer will be followed by a purchase of nontendering shares at a depressed price, individual shareholders may tender their shares—even if they doubt the tender offer is in the corporation’s best interest—to protect themselves from being forced to sell their shares at a depressed price. ... In such a situation under the Indiana Act, the shareholders as a group, acting in the corporation’s best interest, could reject the offer, although individual shareholders might be inclined to accept it.
\end{quote}
\textit{Id.} at 83.
\item[122] \textit{Id.}
\end{footnotes}
commerce. Specifically, the Court noted that the Act treated Indiana and non-Indiana acquirors alike.

The Court then appears to have applied a balancing test similar to that employed in MITE. In striking contrast to MITE, however, the CTS Court resoundingly rejected the argument that state legislation may not interfere with an open market for corporate control. Instead, the Court found that, in light of the fact that the entities being traded in the market for corporate control—corporations—are themselves nothing more than creations of state law, states were free to interfere with the market as much as they desired, as long as the state legislation was nondiscriminatory.

II. Lesson #1: State Incompetence to Regulate Corporate Takeovers: Protectionist Takeover Legislation

CTS breathed new life into state takeover regulation. In the aftermath of the decision, numerous states enacted second generation takeover statutes in quick succession. Most significantly, Dela-

123. Id. at 87-88.
124. Id.
125. Id. at 88-89.
126. Id. at 89-90.
127. In reversing the lower court, which had found the Indiana Act to be violative of the Commerce Clause, the Court remarked that "the Court of Appeals failed to appreciate the significance for Commerce Clause analysis of the fact that state regulation of corporate governance is regulation of entities whose very existence and attributes are a product of state law." Id. at 89. Indeed, the majority stressed: "It . . . 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.
128. In the Court's words: The very commodity that is traded in the securities market is one whose characteristics are defined by state law. Similarly, the very commodity that is traded in the "market for corporate control"—the corporation—is one that owes its existence and attributes to state law. Indiana need not define these commodities as other States do; it need only provide that residents and nonresidents have equal access to them. This Indiana has done. Accordingly, even if the Act should decrease the number of successful tender offers for Indiana corporations, this would not offend the Commerce Clause.
ware, the leading corporate law state, 130 adopted a second generation statute. 131 While remnants of the checks placed on state lawmaking by MITE remain, and may still be used to invalidate certain takeover statutes, 132 the larger question of whether state takeover regulation should be permitted has for the most part been shifted by CTS from the courts to Congress.

This Part of the Article and the next consider what, if anything, the federal response to state takeover legislation should be. Starting from the premise that the federal government should defer as much as possible to state regulation, these sections set out to determine how the state system has functioned. Only when it is concluded that the state system is performing inadequately does the Article suggest that some form of federal limitation on state takeover regulation might be appropriate.

As will be seen, a close examination of the phenomenon of state takeover regulation suggests two different ways in which the system of state corporate lawmaking has malfunctioned. This Part explores the first of the problems—the problem of protectionist takeover legislation. Part III considers the problem of a management bias in takeover legislation.

A. Protectionist Motivated Takeover Legislation

On the surface, state takeover legislation seems both well-intentioned and relatively innocuous. In most instances, states appear to be providing protection for shareholders through increased disclosures or protection from coercive offers. 133 In addition, in a few instances, states seem to be providing some limited relief from the dislocative effects of takeovers to nonshareholder corporate


132. See, e.g., Hyde Park Partners v. Connolly, 839 F.2d 837 (1st Cir. 1988) (enjoining enforcement of a Massachusetts takeover statute).

133. See supra notes 87-98 and accompanying text (discussing fair price, control share cash-out, control share acquisition and modified disclosure statutes which purport to protect shareholders).
constituencies. None of this legislation would seem to give cause for federal intervention.

Nevertheless, it is the thesis of this Section that often these arguable legitimate goals of state takeover regulation are in fact simply a facade, and that, in truth, underneath this facade the true motivation for the legislation is protectionism—specifically, to stop takeovers that threaten large local employers. If this thesis is correct, then some form of federal intervention to curb protectionist takeover legislation is appropriate. Indeed, protectionist legislation has long been shunned in our federal system. Before discussing what the federal response to protectionist takeover legislation should be, however, it is first necessary to consider the evidence that such a protectionist motivation exists.

1. Evidence of a Protectionist Motivation.— Though not all scholars would acknowledge that states have enacted takeover legislation for the purpose of trying to thwart takeovers of large local employers, the evidence appears to be overwhelming.

134. See supra notes 99-107 and accompanying text (discussing business combination statutes and modified fiduciary duty).

135. See Regan, supra note 17, at 1094-95. Commercial protectionism between the states under the Articles of Confederation appears to have been the primary impetus for the adoption of the Commerce Clause at the Constitutional Convention. See Eule, Laying the Dormant Commerce Clause to Rest, 91 YALE L.J. 425, 430, 435 (1982); Smith, State Discriminations Against Interstate Commerce, 74 CAL. L. REV. 1203, 1206-08 (1986).

136. Professor Roberta Romano, for example, has expressed doubt as to whether protectionism is actually the moving force behind state takeover legislation. Romano, The Political Economy of Takeover Statutes, 73 VA. L. REV. 111 (1987). Based on a study of the politics underlying a Connecticut takeover statute, she concluded that state takeover regulation was better explained by a “putting out fires” analysis—“that legislators are reacting to the immediate pressure of a firm in a situation in which support for the bill entails no discernible political cost.” Id. at 188. Her conclusion was based on the fact that the Connecticut statute, which sailed through the State Legislature, was not actively supported by a broad based coalition of labor and community groups, and rather received active support only from the management of one large local firm, the Aetna Life & Casualty Insurance Company, which also enlisted the help of Connecticut's most important business association, the Connecticut Business and Industry Association. Id. at 122-23.

Professor Romano is undoubtedly correct in suggesting that state legislators are more likely to pass bills when they are “presented with an immediate constituent demand, and there [is] no opposition . . . .” Id. at 136. This is most likely going to be the case with state takeover legislation since the group that is arguably most adversely affected by the legislation, shareholders, is in most cases too dispersed and disorganized to marshall any kind of active opposition to the legislation.

However, Professor Romano is probably assuming too much, to the extent that she suggests that this theory alone explains the proliferation of state takeover regulation. To begin with, there are many recent examples of takeover legislation which do appear to have been motivated, at least in part, by a desire on the part of legislators to protect a large local employer. See infra notes 137-49 and accompanying text. Second, the absence of lobbying by
To begin with, there is the timing of the legislation. Over and over again, statutes have been enacted during frenzied legislative sessions occurring in the midst of battles for control of large local employers.\textsuperscript{137} Such circumstances usually leave little doubt that the purpose of the legislation is to protect the employers.\textsuperscript{138} Indeed, it is labor or community groups for any given bill does not necessarily imply that legislators are not, nevertheless, considering the interests of these groups in passing the legislation. Indeed, one might question whether the Connecticut legislature would have been so solicitous of Aetna's concerns if Aetna was not a significant local employer and income producer in the state. Moreover, considering the speed with which these bills often race through legislatures, groups with large or dispersed memberships like unions or community organizations might not even have time to organize a lobbying effort. Senior managers of a large local employer obviously need almost no time to organize. In addition, lobbying by labor or community groups often may be unnecessary since, as Professor Romano's theory suggests, the bills are likely to pass given the absence of any active opposition. Romano, \textit{supra}, at 188.

In a similar vein, it is illuminating to note that in perhaps the most important instance in which there was active opposition to the passage of a takeover bill, i.e., the recent enactment of the Delaware second generation statute, labor groups did actively lobby in favor of the legislation. See \textit{Joint Hearings of the House and Senate Judiciary Comms. on House Substitute No. 1 to House Bill 396} (Jan. 20-21, 1988) \textit{[hereinafter Joint Hearings]} (on file at Hofstra Law Review) (statement of OIl, Chemical & Atomic Workers Local \#8-898 President Arthur R. Wilson); \textit{id.} (statement of Independent Federation of Flight Attendants President Victoria Frankovich); \textit{id.} (statement of Delaware State UAW/CAP Council President Ronald E. Queen); \textit{id.} (statement of ConAgra, Inc. Processing Plant Manager Jerry Davis).

Professor Coffee has expressed disagreement with Professor Romano's conclusions. See Coffee, \textit{The Future of Corporate Federalism: State Competition and the New Trend Toward De Facto Federal Minimum Standards}, 8 \textit{CARDOZO L. REV.} 759, 761 (1987). In contrast to Professor Romano, for example, Coffee argues that:

\begin{quote}
\textit{[s]tates within the Rust Belt have been the most aggressive in passing the new second generation of antitakeover laws to respond to powerful internal coalitions of local firms, unions, and their satellite constituencies (including local law firms) that fear management ouster, plant closings, and the firm's physical departure from the state.}
\end{quote}

\textit{Id.} at 770.

Many other scholars have expressed the view that takeover legislation might be motivated by protectionist concerns. See, e.g., Aranow & Einhorn, \textit{State Securities Regulation of Tender Offers}, 46 N.Y.U. L. REV. 767, 768-69 (1971); Langevoort, \textit{supra} note 12; Langevoort, \textit{supra} note 43; Moylan, \textit{supra} note 46; Sargent, \textit{supra} note 44; \textit{accord} Richter, \textit{States Act to Stem Tide of Takeovers}, L.A. Times, Sept. 15, 1987, at 1, col. 1 (stating that “[a]nti-takeover measures have swept through state after state in recent months, propelled by the influence of local companies and the appeal such bills hold for legislators eager to vote for local jobs and businesses.”).  

\begin{itemize}
  \item \textsuperscript{138} See Letter from SEC Commissioner Charles C. Cox to the Council of the Corporation Law Section of the Delaware Bar Association \textit{1-2} (Dec. 10, 1987) \textit{[hereinafter Cox Letter]}; \textit{reprinted in C. SMITH & C. FURLOW, supra} note 130, app. D at 157-58 (commenting that “at least half of the states” that adopted Indiana-type statutes after the \textit{CTS} decision “did so with a clearly protectionist purpose with overnight specials designed to preclude a
even typically obvious exactly which local employer the legislation is intended to protect. The examples are numerous: Washington passed a statute to protect Boeing; Minnesota passed a statute to protect Dayton-Hudson; Massachusetts passed a statute to protect Gillette; Missouri passed a statute to protect TWA; Arizona passed a statute to protect Greyhound; North Carolina passed a statute to protect Burlington Industries; Wisconsin passed a statute to protect G. Heilmann; Florida passed a statute to protect Harcourt Brace Jovanovich; New York passed a statute to protect CBS. This same phenomenon appears to have been true for the earlier first generation statutes as well.


143. See Icahn v. Blunt, 612 F. Supp. 1400, 1405-06 (W.D. Mo. 1985) (describing legislative activities preceeding amendments to the Missouri statute so that it would apply to TWA); Block, Barton & Roth, supra note 59, at 333.


148. Block, Barton & Roth, supra note 59, at 333.

149. See, e.g., Moylan, supra note 46, at 690-91 (stating that "[t]he Ohio Takeover Act is one of the most glaring examples of special interest legislation . . . enacted in response to the bid by Northwest Industries, Inc. for B.F. Goodrich & Co., an Ohio based company."). Aranow & Einhorn similarly assert that the first generation statutes "were not academic exercises in the legislative process. In Ohio, Northwest Industries, Inc. had begun what turned into a hotly contested battle for Ohio-based B.F. Goodrich & Co. . . . In Pennsylvania, attempted takeovers of Sharon Steel Corp., Piper Aircraft Corp. and Westinghouse Air Brake Co. may have influenced the legislature to consider a bill . . . ." Aranow & Einhorn, supra note 136, at 768-69 n.10.

One commentator explained:
Feeling the federal government insufficiently repsonive to their interests, companies
In addition, legislators also frequently admit that they are trying to stop takeovers of local employers, even when the legislation they are enacting purports to protect shareholders. A Pennsylvania state senator, for instance, during a legislative session for what was called the Pennsylvania "Shareholder" Protection Act, remarked that "[t]his bill would basically protect the corporations that are in Pennsylvania." Similarly, Governor Celeste of Ohio, while signing into law new takeover legislation, lamented how hostile takeovers have cost Ohio millions of dollars and hundreds of jobs.

On occasion, even the legislation itself suggests a protectionist purpose. The preamble to a Utah takeover statute, for example, describes the legislators' concern that takeovers "in many instances threaten jobs and careers of Utah citizens." Perhaps the best clue of a protectionist purpose, however, comes from the jurisdictional reach of many takeover statutes. Though

Corporations provide states with jobs for their citizens, tax revenues for their budgets and prestige for their public images. In return, many states have been willing to provide corporations with legal and regulatory environments conducive to conducting their businesses. By 1982, 37 states had heeded the corporate cry for protection and had enacted laws that required greater disclosure than the Williams Act did. S. PAMEPINTO, supra note 46, at 3. Another commentator similarly noted:

Potential targets seeking further protection began to turn to the states. They pointed out the potential deleterious effects that a change to out-of-state ownership or control could have on state economies. States feared that a change in control could result in less attention to local concerns and needs, or possibly the removal of investment and jobs. Some corporations hinted that they might consider relocation or reincorporation in a state more solicitous of their needs. By the mid-1970s many of the states had responded by enacting takeover statutes.


152. UTAH CODE ANN. § 61-5-1(1)(c) (Supp. 1988) (repealed 1987). The statutory codification of the legislative intent also reflects the legislature's recognition that takeovers "can result in plant closings or consolidations that damage communities dependent on the jobs and taxes provided by these plants." Id. § 61-5-1(1)(d); see also MINN. STAT. ANN. § 80B.01 (West 1986 & Supp. 1989) (providing a similar description of legislative intent).
most statutes purport to protect shareholders, many of these same statutes nevertheless are drafted so as to apply to acquisitions of target companies that are neither incorporated in the legislating state nor have a large percentage of local shareholders.\footnote{See supra notes 54, 107 and accompanying text.}

Such broad jurisdictional reach seems puzzling: Why would states want to protect the shareholders of these target companies? The only credible explanation, it is suggested, is that they do not. Rather, the statutes contain these broad jurisdictional limits because they were actually enacted for the purpose of protecting large local employers.\footnote{See Boehm, supra note 43, at 746; Langevoort, supra note 43, at 219-26.} Thus, in those cases where a large employer was not incorporated in the state, the legislators simply stretched the jurisdictional boundaries of their "shareholder" legislation to make sure that the company was covered.

The Illinois statute at issue in \textit{MITE} exemplifies this situation.\footnote{Illinois Business Take-Over Act, ILL. REV. STAT. Ch. 121 ½ paras. 137.51-137.70 (1979) (repealed 1983).} The statute was a disclosure provision, presumably intended to benefit shareholders.\footnote{See supra notes 62, 77 and accompanying text.} Nevertheless, the statute potentially applied to target companies whose only contact with the state was that they had their principal place of business and substantial assets in the state.\footnote{See supra note 80 and accompanying text.}

This same phenomenon is true for some second generation statutes. When Carl Icahn made overtures for TWA, a Delaware corporation but a significant Missouri employer, Missouri amended its control share acquisition statute so as to apply to foreign common carriers financed by Missouri subdivisions that have over 7,500 employees in Missouri.\footnote{See Icahn v. Blunt, 612 F. Supp. 1400, 1406 n.2 (W.D. Mo. 1985) (indicating that counsel for the defendant conceded that TWA was the only known company to meet the statute's new jurisdictional requirement); see also supra note 143 and accompanying text (noting that Missouri's statute was apparently enacted primarily to protect TWA). Similarly, when Revlon approached Gillette, a large Massachusetts employer but a Delaware corporation, Massachusetts enacted a control share acquisition statute that applied to targets having a substantial presence in the state, including a large number of employees. See supra note 142 and accompanying text.}

Of course, it is not surprising that protectionism underlies many state takeover statutes. From the perspective of state legislators, anyone threatening to disrupt the business of a large local employer would naturally be considered a threat, and any legislation that

\footnote{See supra note 80 and accompanying text.}
would repel such an acquiror would undoubtedly be welcome. This is all the more true in the takeover context, where the cost of the legislation can be spread outside the state to the typically nationwide group of shareholders who are denied the opportunity to sell their shares at a premium, and to the group of out-of-state employees that may have stood to benefit from a change in corporate policy.\footnote{159. R. Gilson, The Law and Finance of Corporate Acquisitions 1059-60 (1986); see also Langevoort, supra note 12, at 96. It is precisely because protectionist legislation attempts to benefit a state's local constituents at the expense of out-of-state parties, who have no recourse to the state's legislature, that federal intervention to invalidate protectionist legislation has been thought necessary. See infra note 184 and accompanying text. 160. See supra notes 153-58 and accompanying text. 161. See supra notes 140-49 and accompanying text. 162. See supra notes 137-49 and accompanying text. 163. See Comment, Third-Generation Anti-Takeover Statutes in Oregon and Indiana After Dynamics: Target Corporations Control the Ship and Raiders are Foiled, 24 Williamette L. Rev. 73, 98 (1988) (authored by Russel D. Garrett). 164. See supra notes 54, 107 and accompanying text.}

Protectionism, in fact, can help explain some of the oddities about takeover legislation which distinguish it from other forms of corporate law. First, as already discussed, it can explain why states sometimes try to stretch their corporate lawmaking powers to cover corporations that are not incorporated in their state—the states might simply be trying to use their corporate laws for the purpose of protecting a large local (but foreign incorporated) employer.\footnote{160. See supra notes 153-58 and accompanying text.}

Second, a protectionist purpose helps explain why many states, which have not otherwise been on the cutting edge of corporate law, have been so quick to enact takeover legislation.\footnote{161. See supra notes 140-49 and accompanying text.} Quite simply, the legislators may have been pushed into action by the threatened takeover of a local employer.\footnote{162. See supra notes 137-49 and accompanying text.}

Conversely, protectionism can help explain why Delaware, traditionally the leading corporate law state, was slow to pass a second generation statute. Tiny Delaware, which has few large local employers, might simply not have had a crisis situation arise in which its legislature would have felt compelled to help protect a large local employer.\footnote{163. See Comment, Third-Generation Anti-Takeover Statutes in Oregon and Indiana After Dynamics: Target Corporations Control the Ship and Raiders are Foiled, 24 Williamette L. Rev. 73, 98 (1988) (authored by Russel D. Garrett).} Moreover, it might have felt less pressure to enact such legislation to protect its chartering business because many states were willing to pass statutes to protect corporations even if they were not the state of incorporation.\footnote{164. See supra notes 54, 107 and accompanying text.}

Lastly, a protectionist purpose helps explain the odd medley of state takeover legislation which has developed—some of which purports to protect shareholders while some openly admits to protecting
employees and communities.\textsuperscript{165} It can also explain why legislatures are frequently able to consider these seemingly quite different statutes in unison, and even in the alternative, since ultimately all of the legislation has the same goal in mind—to impede takeovers.\textsuperscript{166}

2. How Takeover Legislation Can Effectuate A Protectionist Purpose.— Looming behind this entire discussion are two pestering questions: why do states try to disguise their protectionist motivated legislation in the form of shareholder protection legislation and how could such shareholder-oriented legislation effectuate a protectionist purpose?

The answers are clear. As to the first question, it need only be recognized that an openly protectionist statute, such as a statute forbidding outright the acquisition of a local company, would invite federal intervention—specifically through judicial application of a dormant Commerce Clause analysis.\textsuperscript{167} By contrast, if a state can disguise its protectionist legislation in the form of shareholder protection legislation, then the legislation becomes eminently more palatable.\textsuperscript{168} Indeed, by casting their protectionist legislation as corporate law, states can lend to this otherwise unlawful legislation the air of legitimacy which attaches to this traditional realm of state lawmaking.

The facts in \textit{CTS}\textsuperscript{169} may very well provide a good example. In that case, the dissent forcefully argued that Indiana admitted in its brief that “at least one of the [Act’s] goals is to protect Indiana corporations,”\textsuperscript{170} and that such legislation was “the archetype of the

\textsuperscript{165} \textit{See supra} notes 150-52 and accompanying text.

\textsuperscript{166} Pennsylvania takeover legislation, for instance, included both a control share cash-out statute and a modified fiduciary duty provision. \textit{See} Newlin \& Gilmer, \textit{supra} note 93, at 113-16.

\textsuperscript{167} \textit{See} Regan, \textit{supra} note 17, at 1092 (arguing that dormant Commerce Clause jurisprudence should be concerned almost exclusively with “preventing states from engaging in purposeful economic protectionism.”).

\textsuperscript{168} \textit{See} Eule, \textit{supra} note 135, at 460. In discussing the difficulty in ascertaining an unlawful discriminatory or protectionist intent in state legislation, Professor Eule remarks that “[f]ew statutes are so inartfully drafted that they boldly reveal an intent to discriminate against non-citizens. The fact that the discrimination has non-residents, rather than a racial or religious minority, as its target may make it more socially acceptable, but legislatures are seldom less secretive in their efforts to carry it out.” \textit{Id.; cf.} Hunt v. Washington State Apple Advertising Comm’n, 432 U.S. 333 (1977) (involving a state statute regulating grading on apples which was purportedly intended to protect consumers but which may have served an ulterior purpose of protecting local apple growers from competition by out-of-state growers).

\textsuperscript{169} \textit{CTS Corp. v. Dynamics Corp. of America}, 481 U.S. 69 (1987).

\textsuperscript{170} \textit{Id.} at 100 (White, J., dissenting).
kind of state law that the Commerce Clause forbids." The majority, however, without inquiring into the factual history of the legislation, uncritically accepted the argument that the Act, like most control share acquisition statutes, was intended to protect shareholders from two-tiered offers.

As to the second question—whether shareholder-oriented legislation could effectuate a protectionist purpose—the answer is again clear. Quite simply, to the extent that these “shareholder” statutes can make takeovers more costly or difficult, or even simply delay takeovers so that managers can implement defensive tactics, they can help accomplish the protectionist goal of discouraging unwanted takeovers of large local employers.

First generation statutes, for instance, through their provisions for pre-registration of offers and lengthy public hearings, could greatly delay the offering process. Moreover, and much less subtly, the statutes provided a powerful weapon for stopping unwanted takeovers by granting state officials broad discretion to enjoin nationwide tender offers when the offers were found to be “unfair” or the disclosure inadequate.

Similarly, second generation statutes also make takeovers more difficult. Fair price, control share acquisition, and control share cash-out statutes, for instance, make acquisitions more expensive by eliminating the ability of offerors to use two-tiered offers. In addition, control share cash-out and control share acquisition models threaten

171. Id. at 101.
172. See supra note 121 and accompanying text.
173. Of course, some takeover legislation might be more effective than others in effectuating a protectionist purpose and some, regardless of the legislative intent, may even backfire by making takeovers easier. Some scholars have contended, for example, that control share acquisition provisions actually make takeovers easier because shareholders tend to vote in favor of the acquisitions. See R. Gilson, supra note 159, at 308-12 (Supp. 1988) (arguing that control share acquisition statutes “actually may work in favor of the acquirer.”); C. Smith & C. Furlow, supra note 130, at 8 (describing the concern of the Council of the Corporation Law Section of the Delaware State Bar Association that a statute modeled after the Indiana statute in CTS would “turn every offer into a plebiscite that by its nature would favor the bidder, and could actually promote takeovers.”). Nevertheless, many states have enacted such statutes for apparently protectionist reasons. See Cox Letter, supra note 138, at 2, reprinted in C. Smith & C. Furlow, supra note 130, app. D at 158 n.2 (suggesting that North Carolina, Washington, Minnesota, Massachusetts and Florida all adopted Indiana-style control share acquisition statutes after the CTS decision in efforts to protect large local employers).
175. See supra notes 50-53 and accompanying text.
176. See supra notes 87-88 and accompanying text.
acquirors with the ominous possibility of either having to accomplish a second-step transaction against their will, or more ominously, of acquiring a control interest in a company without the accompanying voting rights.¹⁷⁷

Likewise, freeze-out statutes will discourage any hostile acquiror that wants to, or needs to, engage in a business combination with the target corporation any time soon after acquiring control.¹⁷⁸ The statutes will discourage leveraged acquisitions in particular because acquirors in such instances frequently need to sell off target assets soon after the acquisition in order to satisfy their debt obligations.¹⁷⁹

Finally, modified fiduciary statutes simply give corporate managers additional discretion to be used in a takeover fight.¹⁸⁰

B. Federal Limitations on Corporate Law: Responding to Protectionist Takeover Legislation

If states are enacting takeover legislation for a protectionist purpose, what, if anything, should be the federal response? Protectionist legislation, after all, has long been considered unlawful in our federal system.¹⁸¹ That it would take the form of corporate law should not seem to matter.

Indeed, protectionist takeover legislation would seem to have all the hallmarks of traditional protectionist legislation. It is inefficient¹⁸²—the legislating state is trying to keep a business’ operations

¹⁷⁷. See generally Sargent, supra note 44, at 27 (analyzing the burden on interstate commerce created by second generation statutes); Note, Antitakeover Legislation: Not Necessary, Not Wise, 35 CLEV. ST. L. REV. 303, 332 (1987) (authored by Jeffrey A. Johnson) (arguing that a requirement of shareholder approval would reduce the possibility of takeovers); see also Gilson, The Case Against Shark Repellant Amendments: Structural Limitations on the Enabling Concept, 34 STAN. L. REV. 775, 801 (1982) (discussing the effectiveness of similar charter amendments).

¹⁷⁸. See supra notes 99-100 and accompanying text (discussing business combination statutes).


¹八十. Steinberg, supra note 150, at 186 (commenting that “[b]y expressly authorizing officers and directors to consider noninvestor interests, the [Pennsylvania modified fiduciary duty statute], in practical effect, may expand the presumption of the business judgment rule, thereby rendering it nearly impossible for a complainant to overcome.”); see also infra note 280.

¹⁸¹. See supra note 135 and accompanying text.

¹⁸². The point is not that states may not pass any law which interferes with the movement of productive resources from higher to lower cost producers, but that states may not do so when the primary purpose is to protect local producers from interstate competition. See Regan, supra note 17, at 1115-25. See generally Levmore, Interstate Exploitation and Judi-
within the state even when those operations might be performed more efficiently elsewhere.\textsuperscript{183} It raises political process problems\textsuperscript{184}—specifically, those adversely impacted by the legislation (the nationwide group of shareholders who are deprived of a premium for their shares and out-of-state employees who might benefit from takeovers) are outside the legislating state and thus lack political recourse to the state’s legislators.\textsuperscript{185} Finally, it is hostile to the concept of “unionism” which binds our country together\textsuperscript{186}—the legislation is deliberately aimed at benefitting one state’s economy even when that benefit might come at the expense of the other states.

If protectionist takeover legislation is thought harmful, the question turns from whether the federal government should intervene to the manner by which it should intervene.

1. Fashioning a Response: Using the Commerce Clause to Strike Takeover Legislation.— Historically, the federal response to protectionist state legislation has not been to invalidate entire areas of state law, but rather to strike, through judicial interpretation of

\textit{c}hal Intervention, 69 Va. L. Rev. 563 (1983). Protectionist legislation, as Justice Cardozo once observed, attempts to “neutralize the economic consequences of free trade among the states.” Baldwin v. G.A.F. Seelig, Inc., 294 U.S. 511, 526 (1935). States may seek to accomplish this either by keeping out interstate competition through vehicles such as tariffs or embargoes, or by forcing an industry to remain in the state, such as requiring production to occur within the state. See Regan, \textit{supra} note 17, at 1112.

183. Such legislation has traditionally been unfavorably received by the Courts. The Supreme Court “has viewed with particular suspicion state statutes requiring business operations to be performed in the home State that could more efficiently be performed elsewhere.” Pike v. Bruce Church, Inc., 397 U.S. 137, 145 (1970).


State regulations affecting interstate commerce, whose purpose or effect is to gain for those within the state an advantage at the expense of those without, or to burden those out of the state without any corresponding advantage to those within, have been thought to impinge upon the constitutional prohibition even though Congress has not acted. . . .

Underlying the stated rule has been the thought, often expressed in judicial opinion, that 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 those political restraints which are normally exerted on legislation where it affects adversely some interests within the state.

\textit{Id.} at 184 n.2 (citations omitted).

185. R. Gilson, \textit{supra} note 159, at 1059-60; Langevoort, \textit{supra} note 12, at 96.

186. See Regan, \textit{supra} note 17, at 1114 (arguing that protectionist legislation “generate[s] a cycle of escalating animosity and isolation” among the states, imperilling the union). As Justice Cardozo observed: “[The Constitution] was framed upon the theory that the peoples of the several states must sink or swim together, and that in the long run prosperity and salvation are in union and not division.” \textit{Baldwin}, 294 U.S. at 523.
the Commerce Clause, that legislation which has been enacted for an unlawful protectionist purpose. The Commerce Clause grants to Congress the power "[t]o regulate Commerce . . . among the several States . . . ." Nevertheless, it has long been established that the Clause also implicitly prohibits the states from taking certain actions which interfere with interstate commerce. Of those actions, none has been considered to be more hostile to the values embodied in the Commerce Clause than economic protectionism.

The primary advantage of using a Commerce Clause approach to strike improperly motivated takeover legislation is that such approach would not preclude legitimate state regulation of takeovers. This surgical approach seems appropriate since protectionist legislation says little about whether the market for corporate charters, in the absence of distorting protectionist motivations, will cause states to properly regulate the takeover phenomenon.

Protectionist takeover legislation is not a product of the market for corporate charters, but rather, like all protectionist state law, occurs because state legislators feel pressured to protect their local constituents from the forces of interstate competition. Such protectionist corporate law is no more likely to occur than protectionist state regulation of milk prices. In both cases, the legislation is simply symptomatic of the tension and natural structural bias inherent in local lawmaking within a federal system. As Professor Tribe observed, "the proper structural role of state lawmakers is to protect and promote the interests of their own constituents," and "[t]hat role is one that they will inevitably try to fulfill even at the expense of citizens of other states."

Since protectionist takeover legislation is not a product of the state competition for charters, the appropriate federal response to such corporate legislation should not be to invalidate all state corporate lawmaking in the takeover context, but only that which has

189. See, e.g., Lewis v. BT Investment Managers, Inc., 447 U.S. 27, 36 (1980); City of Philadelphia v. New Jersey, 437 U.S. 617, 624 (1978); Regan, supra note 17, at 1092 (arguing that dormant Commerce Clause jurisprudence should be concerned almost exclusively with "preventing states from engaging in purposeful economic protectionism.").
190. See L. Tribe, supra note 68, § 6-5, at 409.
192. L. Tribe, supra note 68, § 6-5, at 409.
193. Id. (emphasis in original).
been tainted by a protectionist motivation. Unfortunately, however, the Supreme Court in both MITE and CTS failed to adequately address the issue of protectionism. To the contrary, the only Justices to directly discuss the issue were the dissenters in CTS, who argued that the Indiana control share acquisition statute had been enacted for the unlawful purpose of protecting Indiana corporations. 194

2. Rethinking the MITE and CTS Decisions.—When evaluating state legislation under a dormant Commerce Clause analysis, courts generally use a two-tiered approach. 195 First, the court examines whether the legislation discriminates against interstate commerce. 196 A law which discriminates for the primary purpose of protecting local residents from out-of-state competition is typically found to be per se unlawful. 197 Conversely, a law which has a legitimate, i.e., non-protectionist, purpose but a discriminatory impact, will be upheld if the state can "justify it both in terms of the local benefits flowing from the statute and the unavailability of nondiscriminatory alternatives . . . ." 198

Legislation which is not discriminatory is then subject to the second-tier balancing analysis, in which the burden which the legislation imposes on interstate commerce is weighed against any local benefits furthered by the legislation. 199 The state legislation will be held invalid if the burden on interstate commerce "is clearly excessive in relation to the putative local benefits." 200

Protectionist legislation would typically fall under the first tier

195. See, e.g., Brown-Forman Distillers Corp. v. New York State Liquor Auth., 476 U.S. 573, 578-79 (1986). As the Supreme Court stated in Brown-Forman:
This Court has adopted what amounts to a two-tiered approach to analyzing state economic regulation under the Commerce Clause. When a state statute directly regulates or discriminates against interstate commerce, or when its effect is to favor in-state economic interests over out-of-state interests, we have generally struck down the statute without further inquiry. When, however, a statute has only indirect effects on interstate commerce and regulates evenhandedly, we have examined whether the State's interest is legitimate and whether the burden on interstate commerce clearly exceeds the local benefits.
Id. (citations omitted).
196. Id.
197. See, e.g., Lewis v. BT Investment Managers, Inc., 447 U.S. 27, 36 (1980) (stating that "where simple economic protectionism is effected by state legislation, a virtually per se rule of invalidity has been erected." (quoting City of Philadelphia v. New Jersey, 437 U.S. 617, 624 (1978))).
199. See supra note 69 (setting forth the Pike balancing test).
of this analysis. Indeed, protectionist legislation—which seeks to benefit in-state economic actors at the expense of the citizens of the other states—is precisely the kind of discriminatory legislation which the Commerce Clause is intended to prevent.footnote{201}

In *MITE*, however, the Court never addressed this discrimination issue. Instead, the Court struck down the Illinois statute under a balancing analysis because it placed an undue burden on interstate commerce.footnote{202} Nevertheless, as previously pointed out, the jurisdictional reach of the Illinois Act gave at least some indication that the legislation might have been enacted for a protectionist purpose.footnote{203}

In *CTS*, the majority did analyze the Indiana statute under a discrimination test, but concluded that the statute was lawful because it applied equally to in-state and out-of-state acquirors.footnote{204} Arguably, however, this analysis missed the point. If, as the dissent believed, the legislation was enacted for protectionist reasons,footnote{205} the relevant unlawful discrimination would not have been between in-state and out-of-state acquirors, but between those whom the state legislators assumed would favor the continued in-state operations of a company (current managers) and those whom the legislators assumed might disrupt or remove such operations (any hostile acquiror).footnote{206} It would be through this latter discrimination that the state legislators would have tried to shelter their local industry from interstate competition and thus benefit the local employees, suppliers, and communities at the expense of citizens of other states who might have benefited from takeovers.footnote{207}

footnote{201. See generally Regan, supra note 17, at 1094-95.; Smith, supra note 135.}

footnote{202. See supra notes 68-84 and accompanying text (setting forth the Court's burden analysis). Justice Powell's concurring opinion in *MITE*, which provided the necessary fifth vote to find the Illinois statute an unlawful burden on interstate commerce, curiously seems to suggest that states might lawfully enact legislation intended to block the movement of corporate assets out of a state. Edgar v. *MITE* Corp., 457 U.S. 624, 646 n.8 (1982) (Powell, J., concurring). Such reasoning, however, seems to be entirely irreconcilable with traditional Commerce Clause doctrine. See Cox, supra note 12, at 343.}

footnote{203. See supra notes 68-84 and accompanying text (discussing the purpose of the Illinois statute).}

footnote{204. *CTS* Corp. v. Dynamics Corp. of America, 481 U.S. 69, 87-88 (1987).}

footnote{205. *Id.* at 99-100 (White, J., dissenting).}

footnote{206. See *Cox, supra* note 12, at 340-41.}

footnote{207. See generally *id.* at 340-43 (suggesting that takeover legislation enacted to protect local industry violates the Commerce Clause); *Langevoort, supra* note 12, at 107; *Levmore, supra* note 182, at 623-24; *Note, The Tender Offer Regulation Battle Continues: Should States Regulate Only Local Companies?*, 60 IND. L.J. 721, 736 (1985) (authored by Phyllis E. Grimm).}

Perhaps most notably, Professor Regan, whose recent article on Commerce Clause juris-
How, it might be asked, could the Court in CTS have detected such an unlawful protectionist motivation? A careful exploration of the facts might have revealed that the statute was enacted for a protectionist purpose. The Wall Street Journal, for instance, in an article subsequent to the CTS decision, suggested that the statute had been enacted to help protect Arvin Industries, a large local employer in Columbus, Indiana, from a takeover attempt by the Belzburgs.

In fairness to the Court, the Justices did inquire as to the legislative purpose of the Indiana Act during oral argument. Almost immediately after questioning began, Justice O'Connor engaged in the following exchange with James A. Strain, counsel for CTS Corporation, who was seeking to have the statute upheld:

QUESTION: Mr. Strain, may I inquire what you think the purpose of the statute is?
MR. STRAIN: Of course.
QUESTION: Do you think, at least in part, it is to try to keep jobs and corporate headquarters and so forth within the State of Indiana.
MR. STRAIN: No, I do not.
QUESTION: It is not a purpose at all?
MR. STRAIN: It is my belief that is not the purpose.
QUESTION: We should in making our findings and decision here conclude that that has no part for consideration in this case, is that right?
MR. STRAIN: Based on the theory that we argue, Justice O'Connor, it makes no difference.
QUESTION: Well, is it a purpose then to provide protection to stockholders of public corporations incorporated in Indiana?
MR. STRAIN: Ultimately, that has to be the purpose.
QUESTION: You think that is the purpose?
MR. STRAIN: Yes, ma'am.


Curiously, Mr. Strain had earlier been quoted as giving a strikingly different explanation for the statute: "We don't like having all our companies taken over by East Coast firms." New York Takeover Statute's First Progeny, CORP. CONTROL ALERT, Mar. 1986, at 10. The report continued: "On further consideration, Strain says Mid-western and West Coast acquirers are no better." Id.

The article gives the following depiction of what occurred in Indiana:

One day in December 1985, James K. Baker, the chairman of Arvin Industries, Inc., summoned his friend Robert Garton to lunch and let him in on a startling secret. Arvin Industries, an autoparts giant, had received a letter from Canada's Belzberg family threatening a takeover.

Jim Baker and Bob Garton, the president of the Indiana Senate, went back a long way together in Columbus. . . . Now, Mr. Baker asked his old friend to help
In addition, the majority could have seized upon, as did the dissent, an admission in Indiana's brief that one of the Act's purposes was to protect Indiana corporations.\textsuperscript{210} As the dissent argued, such a purpose would make the Act “the archetype of the kind of state law that the Commerce Clause forbids.”\textsuperscript{211}

And finally, the Indiana Act’s jurisdictional reach, like the jurisdictional reach of the statute in \textit{MITE}, also provided evidence of the statute’s protectionist purpose.\textsuperscript{212} Though the Act requires target corporations to be incorporated in the state and have a substantial number of shareholders in the state, both of which could justify the state’s concern in protecting shareholders, the Act also requires that target corporations have either their principal place of business, principal office, or substantial assets in Indiana.\textsuperscript{213} Why this additional prerequisite if Indiana is simply trying to protect shareholders? As one commentator stated, these “preconditions add strength to the argument that Indiana was seeking to protect ‘Indiana management’ and Indiana communities and Indiana residents from foreign competition for target assets.”\textsuperscript{214}

\begin{itemize}
  \item stop the takeover and save Arvin Industries and Columbus from wrenching change.
  \item Mr. Garton didn’t let him down.
\end{itemize}

\textit{Id.}

Thomas J. Bamonte, one of the attorneys who represented Dynamics Corporation of America in \textit{CTS}, wrote, after the Supreme Court issued its decision, that the Indiana statute at issue in \textit{CTS} was “a thinly veiled piece of protectionist legislation designed to shield Indiana corporations from so-called hostile tender offers.” Bamonte, \textit{The Dynamics of State Protectionism: A Short Critique of the CTS Decision}, 8 N. ILL. U.L. REV. 259, 259 (1988).

\textsuperscript{210} \textit{CTS}, 481 U.S. at 100 (White, J., dissenting); \textit{see also} Cox, supra note 12, at 343.

\textsuperscript{211} \textit{CTS}, 481 U.S. at 101 (White, J., dissenting).

\textsuperscript{212} \textit{See supra} notes 76-82 and accompanying text (discussing how the jurisdictional reach of the Illinois statute in \textit{MITE} indicated a protectionist purpose).

\textsuperscript{213} IND. CODE ANN. § 23-1-42-4(a) (West 1989).

\textsuperscript{214} Cox, supra note 12, at 341; \textit{see also} Langevoort, supra note 12, at 106-07.

It should be noted, however, that even if the Court could not find a protectionist motive for the legislation, it could still have invalidated the legislation if it concluded the legislation had a discriminatory impact on interstate commerce and the legislators had not employed the least restrictive alternative for accomplishing their desired purpose of protecting shareholders from two-tiered offers. See, \textit{e.g.}, Dean Milk Co. v. Madison, 340 U.S. 349, 354 (1951) (holding that a state may not discriminate against interstate commerce “if reasonable nondiscriminatory alternatives, adequate to conserve legitimate local interests, are available.”). Professor Langevoort, for example, has suggested that whenever a corporate law relates directly to a shift in corporate control and the law is potentially motivated by a protectionist purpose, the law must be the least restrictive means of implementing the legitimate legislative goal. Langevoort, \textit{ supra} note 12, at 108. Here, of course, there was a less restrictive alternative. The state, rather than imposing the legislation on shareholders, could have passed an enabling statute that would have allowed shareholders to protect themselves by adopting anti-takeover provisions as part of their charter. Coffee, \textit{Shareholders Versus Managers: The Strain in the
Two final points of clarification are in order. First, it should be noted that while neither MITE nor CTS adequately addressed the issue of protectionism, neither decision would seem to preclude the lower courts from invalidating other takeover legislation (even control share acquisition statutes modeled after the Indiana Act) if the courts were presented with strong evidence of a protectionist motivation.

Lastly, the above discussion is not intended to suggest that states may not do anything to protect their local employees and communities from takeover-related dislocation. To the contrary, Commerce Clause jurisprudence would seem to suggest that states may interfere with interstate commerce, for the purpose of furthering a legitimate state end, as long as the legislation is not purposefully discriminatory and does not overly burden interstate commerce.215 State severance pay laws or plant closing laws, for instance, might pass Commerce Clause muster.216 Protectionist takeover regulation, however, does not try to indirectly regulate takeovers to ease their dislocative effect—it tries to stop takeovers.217 Such legislation,

215. See, e.g., American Can Co. v. Oregon Liquor Control Comm’n, 15 Or. App. 618, 517 P.2d 691 (1973) (upholding an Oregon statute which forbade the use of nonreturnable, nonrefundable beverage containers for the legitimate purpose of protecting the Oregon environment, even though the statute indirectly tended to favor Oregon bottlers over foreign bottlers).
216. See Buxbaum, Federalism and Company Law, 82 Mich. L. Rev. 1163, 1176 (1984) (suggesting that "[a] workplace protection control generally imposed upon all enterprises in a given state... and operating directly on a managerial, operational decision to close down a workbench, an assembly line or a plant" would not be per se unconstitutional but rather would be evaluated under the Pike balancing test). But see Arnold, Existing and Proposed Regulation of Business Dislocations, 57 U. Det. J. Urb. L. 209, 251-53 (1980) (suggesting that a proposed Ohio law which required, inter alia, two years notice of a proposed shutdown or relocation would not pass constitutional muster); Note, A Legal, Economic, and Normative Analysis of National Plant Closing Legislation, 11 J. LEGis. 348, 354-55 (1984) (authored by James M. Cline) (arguing that state plant closing legislation would constitute unlawful protectionism).

Severance pay or plant closing legislation, however, might run into preemption problems with the National Labor Relations Act or Employee Retirement Income Security Act. See generally Note, NLRA Preemption of State and Local Plant Relocation Laws, 86 Col. L Rev. 407 (1986) (authored by Kyle B. Hettinger). However, the Supreme Court recently upheld a Maine severance pay law against a preemption attack. Fort Halifax Packing Co. v. Coyne, 482 U.S. 1 (1987).
217. Probably the best indication that takeover legislation is aimed at stopping takeovers and not just regulating for dislocation is that the statutes are all one-sided; that is, they only try to regulate against dislocation when it occurs at the hands of an acquirer. They do nothing to prevent current managers from engaging in the very same activity, which is not at all uncommon.

States are undoubtedly wary of passing across-the-board legislation (such as plant closing laws or severance pay laws) that would help ease corporate dislocation, whether by an acquirer
which attempts to stop dislocation by stopping interstate competition, is simply intolerable in our federal system.\textsuperscript{218}

3. Corporate Law as Immune from Commerce Clause Scrutiny: Private Action versus State Action.—The one argument against using a Commerce Clause analysis to strike protectionist takeover legislation would be that the legislation is viewed as private action and not state action, thus immunizing it from constitutional attack.\textsuperscript{219}

or by current managers, because such legislation would be poorly received by the local business community and might discourage new business from coming to the state. R. GILSON, supra note 159, at 1060 n.122. In contrast, legislation which tries to stop takeovers of local companies can at least stop acquiror-motivated dislocation and will be warmly received, if not heavily lobbied for, by the current business community.

Business combination statutes are a perfect example of one-sided statutes. While the New York statute, for instance, purports to be concerned with protecting the long-term employment interests of New York employees, it serves to protect the employees only by discouraging hostile takeovers. Takeovers approved by current managers are not affected by the statute. Moreover, the statute will not stop current managers from heavily leveraging a company (just as an acquiror might) and then laying off employees.

Another good example of a one-sided statute is the Hawaii Environmental Disclosure Law, HAW. REV. STAT. §§ 343D-1 to -11 (1985). The statute, which is a variant of a modified pre-MITE statute, forbids a 10% shareholder of a Hawaii corporation from purchasing an additional 5% within a 12-month period unless the shareholder first files a statement with the Hawaiian Office of Environmental Control, disclosing, among other things, whether the acquiror has ever been charged with violations of state or federal environmental laws. \textit{id.} § 343D-3. While the statute seems reasonable at first glance, one must still wonder why, if Hawaii is so concerned with its environment, the state doesn't simply pass tough environmental laws with stiff penalties rather than regulating who owns shares of Hawaiian corporations. This indirect regulatory approach seems less a way of dealing with Hawaii's environmental concerns than a way of stopping takeovers of local companies. \textit{See generally} Goelzer & Cohen, \textit{The Empire Strikes Back—Post-MITE Developments in State Antitakeover Regulation}, in \textit{TENDER OFFERS} 49, 64-66 (M. Steinberg ed. 1985).

218. The Supreme Court has asserted:

\begin{quote}
Economic welfare is always related to health, for there can be no health if men are starving. Let such an exception be admitted, and all that a state will have to do in times of stress and strain is to say that its farmers and merchants and workmen must be protected against competition from without, lest they go upon the poor relief lists or perish altogether. To give entrance to that excuse would be to invite a speedy end of our national solidarity.
\end{quote}

\textit{Baldwin v. G.A.F. Seelig, Inc.}, 294 U.S. 511, 523 (1935); \textit{see also} \textit{Lewis v. BT Investment Managers, Inc.}, 447 U.S. 27, 43-44 (1980). In \textit{Lewis}, the Court made the following observation:

\begin{quote}
[In almost any Commerce Clause case it would be possible for a State to argue that it has an interest in bolstering local ownership, or wealth, or control of business enterprise. Yet these arguments are at odds with the general principle that the Commerce Clause prohibits a State from using its regulatory power to protect its own citizens from outside competition.]
\end{quote}

\textit{Id. See also} \textit{Langevoort, supra} note 12, at 107 (stating that "[t]he motivation of protecting local businesses... flies in the face of a core commerce clause value: avoiding local protectionism with respect to the interstate movement of economic resources.").

This argument can be approached from several angles. First, it can be argued that the choice of corporate law is a private decision since corporations are generally free to move in and out of corporate regulatory regimes, or, even short of reincorporation, often can opt out from coverage by a specific piece of legislation. Second, it can be argued that takeover legislation is immune from Commerce Clause scrutiny because it does not absolutely shelter a state's local industry from interstate competition. Indeed, protectionist takeover legislation only attempts to stop potential acquirors who legislators fear will move corporate assets or jobs out of a state. It does not in any way preclude current managers, who are presumably still sensitive to the forces of interstate competition, from doing the very same thing.

Without having to answer this question, it should at least be recognized that the same way in which corporate law could be considered "private" action, private actions might also be able to correct for the problem of protectionism. Specifically, if market forces, as advocates of state corporate lawmaking claim, are successful in eliminating the agency costs associated with the separation of ownership and control, then the state competition for charters would logically correct for protectionism.

Protectionist legislation is almost certainly hostile to shareholder...
State takeover statutes prevent the movement of corporate assets to their highest valued use and entrenches managers. One would expect, therefore, in an efficient corporate law regime, that firms would reincorporate away from states with such statutes. Moreover, states with takeover statutes would eventually feel pressure to eliminate the legislation in order to protect their chartering business.

Such a focus on the effectiveness of the current corporate law system provides a perfect transition into Part III of this Article, which focuses directly on this issue. Specifically, Part III examines the politics of takeover regulation in an effort to determine whether the market for corporate charters, in the takeover context, is in fact promoting efficient, shareholder-oriented legislation, or is actually promoting inefficient laws that cater to the concerns of corporate managers. As discussed, such an analysis may help to determine whether the federal government can rely on the state competition for charters to correct for the problem of protectionism.

III. Lesson #2: State Incompetence to Regulate Corporate Takeovers: The Management Bias in the Chartering Market

While protectionism explains much of the phenomenon of state takeover regulation, it does not explain all. To the contrary, some of the same takeover statutes which have been enacted in one context to stop takeovers of local employers, have, in another context, been just as clearly enacted by states in response to pressures from the market for corporate charters.

Again, it should be noted that this latter motivation is not protectionism. Though prompted by a desire to protect a local industry...
(a state’s chartering business), the legislation seeks to further its goal not by stopping the flow of commerce out of a state, but by encouraging commerce to freely flow in. States are simply trying to maintain the attractiveness of their corporate laws in order to attract chartering business in the same way that states offer tax incentives or run advertising promotions to draw business into their state.230

This Part of the Article focuses on the politics of takeover legislation enacted in this new context by focusing primarily on a second generation statute recently enacted by Delaware.231 Delaware, of course, has long been the leading corporate law state,232 and the legislative history of its Act makes clear that the primary motivation for the legislation was to preserve the state’s preeminence in the chartering market.233

The thesis of this Part is that the market for corporate charters, in choosing to promote takeover legislation, has malfunctioned and thus justifies some form of federal corrective action. The legislation being promoted by the market does not further shareholder welfare as corporate law should. To the contrary, it is management entrenchment legislation—legislation which will only serve to decrease manager accountability and exacerbate the agency costs associated with the separation of ownership and control. In the vernacular of the

230. See supra note 23 and accompanying text (explaining why state actions attempting to draw business into a state do not constitute protectionism).


232. Delaware has every reason to be sensitive to pressures from the chartering market. Corporate franchise tax and fees currently generate $170 million annually for the tiny state, which amounts to 17% of the state’s total income. Joint Hearings, supra note 136, at 1 (testimony of Delaware Secretary of State Michael E. Harkins), reprinted in C. Smith & C. Furlow, supra note 130, app. Q at 257. These figures do not even include the lucrative legal practice which has developed in Wilmington to serve the corporate community. Macey & Miller, supra note 9, at 472.

233. See, e.g., Joint Hearings, supra note 136, at 6 (testimony of Delaware Secretary of State Michael E. Harkins), reprinted in C. Smith & C. Furlow, supra note 130, app. Q at 259 (stating that “I distributed to each of you the correspondence I have received from over 170 corporations, all of whom have paid a maximum franchise tax of $130,000. Each of them supports this statute and at least a half a dozen have stated that they would look seriously at the question of changing their Delaware incorporation.”); Montgomery, House Votes 39-0 for Takeover Bill, Wilmington Morning News, Jan. 27, 1988, at A1, col. 1 - A8, col. 1 (reporting that “[t]he Castle administration said that, because 27 other states have passed takeover controls, local efforts to attract new firms could be undermined and an exodus could occur among Delaware-chartered companies.”).
federalization debate, the market has engaged in a “race to the bottom.”

Such a conclusion is hardly surprising in light of the fact that the legislation being enacted in response to the chartering market is the same type of legislation being enacted by other states for protectionist reasons. After all, legislators enacting protectionist corporate laws certainly do not have shareholder welfare at the forefront of their agendas. To the contrary, the legislators’ primary goal is to block the free movement of corporate assets for the purpose of protecting their state’s economy.

Conversely, a “management entrenchment” characterization of takeover legislation enacted in response to the chartering market is perfectly consistent with the secondary protectionist explanation for such legislation. In both cases, the primary ulterior goal of the legislation is the same—to keep current management in power. In the protectionist context, the legislators simply seek this end not so much for the sake of the managers but out of the hope that by preserving current managers they will be able to preserve current management policies, including the current deployment of corporate assets and jobs.

If the market for corporate charters is in fact prompting states to enact management entrenchment legislation, then some form of federal intervention might be warranted. Such legislation not only poorly serves the interests of shareholders, it also poorly serves the interests of the nation at large by removing the incentive which takeovers create for managers to operate their companies efficiently.

Before addressing what the federal response should be, however, it is necessary to look at the evidence of the management bias in takeover legislation. The next section does this by closely examining the politics underlying the most important statute enacted in response to pressures from the chartering market, the Delaware takeover statute.

234. See supra notes 4-6 and accompanying text (discussing the concept of the “race to the bottom”).

235. See Aranow & Einhorn, supra note 136, at 768 (observing that state tender offer legislation “is unique in that it was apparently inspired by the legislature’s concern for the issuer rather than the investor.”).

236. See supra notes 173-80 and accompanying text.

237. See supra notes 136-52 and accompanying text.

238. See Easterbrook & Fischel, supra note 11, at 1164.

A. Takeover Legislation as Promoting Management Interests: A Case Study of the Delaware Takeover Statute

In examining the impact of the takeover phenomenon on the market for corporate charters, the question is not whether the market will respond, but rather, how it has responded. Given Delaware’s uncontested position as the leading corporate law state, its enactment of a takeover statute can be viewed as a definitive indication that the market tends to promote the adoption of takeover legislation.

At the same time, however, if the market for charters is promoting takeover legislation, it remains uncertain why Delaware was so slow to pass a statute. Indeed, at least twenty-seven other states had adopted takeover legislation before the traditional leader of the corporate world finally adopted its own.

As previously explained, the speed with which many of these states acted may be attributable to a protectionist motivation; that the enacting states simply may have felt compelled to protect a large local employer. Delaware, by contrast, may never have faced a comparable situation.

But why, if the chartering market eventually compelled Delaware to adopt a statute, did the market not do so earlier? The answer, it seems, has two parts. One part concerns the market for corporate charters. The other part concerns the unique position of Delaware as the leader in that market.

As to the first point, a strong argument can be made that, until the Supreme Court issued its decision in CTS, there was probably little pressure in the market for corporate charters to enact takeover legislation. The reasons for this are twofold. First, prior to CTS, takeover legislation was being routinely invalidated by courts under the reasoning of the earlier MITE decision. Thus, it seems un-
likely that corporations would have been making decisions as to where to incorporate based upon legislation of such dubious legality.

Second, and as previously mentioned, some states, compelled by a motivation to protect local employers, were willing to enact legislation that applied to foreign corporations. Such legislation would also take pressure off the market for corporate charters since companies could get takeover protection even without reincorporating.

As to the second point, concerning Delaware’s unique position as the leading corporate law state, takeover legislation may simply have been one instance in which a piece of corporate law was so politically explosive that, even if the market for corporate charters was to encourage its enactment, as indeed it ultimately did, the sensitivity of the legislation would cause Delaware to put off its adoption as long as possible (in other words, as long as it seemed that it was not likely to lose much of its chartering business by not acting).

From Delaware’s standpoint, takeover legislation could be “explosive” in two respects. First, as the leading corporate law state, it is likely to be the state of incorporation not only for corporations seeking protection from takeovers, but also for acquiring corporations. Deciding whether to adopt a statute, therefore, would ultimately have to upset one of these constituencies.

More important, however, is that given Delaware’s position as the state of incorporation for many of the nation’s leading corporations, the adoption of takeover legislation could spawn preemptive legislation by a federal government unsympathetic to such legislation. Federal intervention into the arena of corporate law, of course, poses the greatest single threat to Delaware’s chartering business. Delaware, therefore, would have every incentive to delay adoption of a takeover statute, at least until the pressures in the market for corporate charters became so great that failure to adopt a statute posed an even greater threat to the state’s chartering business.

This is apparently what occurred once the Supreme Court issued its decision in CTS. The reasons are obvious. First, by upholding a second generation statute, CTS suddenly gave credibility to

244. See supra notes 54, 107, 153-58, 160 and accompanying text (discussing the jurisdictional reach of some state takeover statutes to foreign corporations).
245. See Romano, supra note 12, at 141.
246. See infra notes 290-92 and accompanying text.
247. For another possible example of Delaware corporate law responding to the threat of federal preemption, see R. Gilson, supra note 159, at 870-83 (suggesting that the Delaware Supreme Court’s decision in Singer v. Magnavox Co., 380 A.2d 969 (Del. 1977), may have been intended to quell a strengthening movement to federalize corporate law).
such legislation and thus made it a matter which corporations could reasonably consider in their incorporation decisions.\(^2\)\(^4\) Second, for all of the deference which the \textit{CTS} decision gave to state corporate lawmaking, that deference appears to have been limited to lawmaking involving a state's domestic corporations.\(^2\)\(^4\)\(^9\) Thus, the decision made highly suspect any takeover legislation which extended its jurisdiction to foreign corporations.\(^2\)\(^5\)\(^0\) This also reinforced the importance of takeover legislation in deciding where to incorporate.

In fact, Delaware began to show interest in adopting a takeover statute almost immediately after the \textit{CTS} decision was handed down.\(^2\)\(^5\)\(^1\) At first, a Committee of the State Bar Association, which was responsible for developing a proposed bill for the legislature, considered the adoption of a control share acquisition statute modeled after the Indiana Act that was upheld in \textit{CTS}.\(^2\)\(^5\)\(^2\) Eventually, however, the Committee rejected such a bill, and, after several more months of deliberation, settled on a modified version of the New York business combination statute, which was ultimately enacted into law.$^2\)\(^5\)\(^3\)

1. The Delaware Business Combination Statute.— Like the New York business combination statute,\(^2\)\(^8\)\(^4\) the Delaware statute provides that an acquiror who obtains a certain percentage of ownership of a domestic corporation is prohibited from engaging in a "business combination" with the corporation, such as a merger, for a certain period of years.\(^2\)\(^5\)\(^5\) As is true with the New York statute, this prohibition will not apply if the acquiror, prior to making its acquisition, obtains approval from the target's board for either the acquisition or the anticipated business combination.\(^2\)\(^5\)\(^6\)

While similar in form, the two statutes vary slightly in both

\(^{248}\) See supra note 233 (describing the concern after the \textit{CTS} decision that corporations would reincorporate outside of Delaware if the state did not adopt a second generation statute).

\(^{249}\) See supra note 220.

\(^{250}\) See supra note 220.

\(^{251}\) C. Smith & C. Furlow, supra note 130, at 8.

\(^{252}\) Id.

\(^{253}\) Id. at 8-10.


their triggering requirements and prohibitions. The New York statute, for instance, is only triggered by a purchase of twenty percent of a target company's stock,\textsuperscript{257} whereas the Delaware statute is triggered by a purchase of fifteen percent.\textsuperscript{258} The Delaware statute, however, only bars an acquiror from engaging in a business combination with the target for a period of three years,\textsuperscript{259} whereas the prohibition under the New York statute is five years.\textsuperscript{260}

The most significant difference between the two statutes, however, is that the Delaware statute provides several important exceptions whereby an acquiror can avoid the prohibition on business combinations, without having to obtain prior approval from the target's board. Two exceptions are particularly noteworthy. First, if the acquiror obtains eighty-five percent of the target's outstanding voting stock (exclusive of management stock) in the same transaction in which it passes the fifteen percent mark, then the statute's prohibitions do not apply.\textsuperscript{261} Second, an exception is triggered if the business combination is approved by the target's board of directors and by shareholders owning two-thirds of the shares not owned by the acquiror any time after the acquiror passes the fifteen percent threshold.\textsuperscript{262}

2. Evidence of a Management Entrenchment Motivation.— The view that the Delaware statute should be perceived as management entrenchment legislation and not shareholder protection is suggested by the legislative history underlying the Act. Virtually every “shareholder protection” rationale put forward for the legislation is belied

\begin{itemize}
\item \textsuperscript{257} N.Y. BUS. CORP. LAW § 912(a)(10)(A) (McKinney 1986).
\item \textsuperscript{258} DEL. CODE ANN. tit. 8, § 203(c)(5) (Supp. 1988).
\item \textsuperscript{259} Id. § 203(a).
\item \textsuperscript{260} N.Y. BUS. CORP. LAW § 912(b) (McKinney 1986).
\item \textsuperscript{261} DEL. CODE ANN. tit. 8, § 203(a)(2) (Supp. 1988). Also excluded in determining whether an acquiror has obtained 85% of the voting stock are shares owned by “employee stock plans in which employee participants do not have the right to determine confidentially whether shares held subject to the plan will be tendered in a tender or exchange offer.” Id.
\item While management counsel Martin Lipton of New York's Wachtell, Lipton, Rosen & Katz described this as a “barn-door size” exception, see Grundfest Letter, supra note 130, at 7, \textit{reprinted in} C. SMITH & C. FURLOW, supra note 130, app. E at 167 (quoting Memorandum from Martin Lipton to Clients (Nov. 23, 1987)), it is not clear exactly how important it will be in practice. When the statute was first proposed, for instance, the exception would only apply if an acquiror obtained 90% of the target's outstanding stock. At that time, the Securities and Exchange Commission reviewed all hostile tender offers between 1982 and 1987 and discovered that no offeror had ever achieved such a large majority in its initial acquisition. See Grundfest Letter, supra note 130 at 7-8, \textit{reprinted in} C. SMITH & C. FURLOW, supra note 130, app. E at 167-68; R. GILSON, supra note 159, at 322-23 (Supp. 1988).
\item \textsuperscript{262} DEL. CODE ANN. tit. 8, § 203(a)(3) (Supp. 1988).
\end{itemize}
by the legislation itself, which goes far beyond what is necessary to accomplish any of the stated goals. Such overkill, with its concomitant effect of discouraging hostile takeovers, suggests that the real object of the legislation is management entrenchment.

The official justification given for the Delaware legislation is to protect shareholders from coercive two-tiered offers. A spokesperson for the Delaware Bar Association, which was responsible for drafting the Delaware legislation, described the legislation’s purpose as follows:

I believe we have succeeded in bringing to the General Assembly for your consideration a balanced proposal which, rather than inhibiting legitimate takeover activity as some other states have done, is narrowly targeted to address a limited category of takeover abuses which have been repeatedly recognized both by the U.S. Supreme Court and as recently as three months ago by our Delaware Supreme Court. Transactions in which offerors seek to take advantage of the power that we have given to them under our law of a bare majority stockholder to cash out the minority to coerce stockholders into selling their stock at a price which is less than that which stockholders would receive in a free and uncoerced market.²⁶³

The Delaware legislation, however, goes far beyond what is necessary to accomplish this goal. If the purpose of the legislation is to protect shareholders from two-tiered offers, a fair price statute would seem to easily suffice, while at the same time having much less of an anti-takeover effect.²⁶⁴ Why, it must be asked, is it necessary, in or-

²⁶³ Joint Hearings, supra note 136, at 2-3 (statement of Delaware State Bar Association Corporation Law Section Chairman A. Gilchrist Sparks III), reprinted in C. Smith & C. Furlow, supra note 130, app. Y at 298. This rationale was echoed in the testimony of many corporate managers who testified before the Delaware legislature. See, e.g., Joint Hearings supra note 136 (statement of Household International Senior Vice President and General Counsel J. Richard Hull); Joint Hearings, supra note 136 (statement of General Mills Chairman and Chief Executive Officer Bruce Atwater). Shareholder protection was also assumed to be the legislature’s rationale by a federal district court in Delaware which refused to enjoin the application of the statute. BNS Inc. v. Koppers Co., 683 F. Supp. 458, 468 (D. Del. 1988) (stating that “[t]he purpose of the Delaware legislation, as presented in the synopsis to the act and in certain testimony during the hearings, is to protect shareholders from the coercive aspects of some tender offers.”). See generally C. Smith & C. Furlow, supra note 130, at 3 (stating that “[t]he particular evil to which the statute is directed is the use of two-tiered, highly leveraged takeovers.”).

²⁶⁴ See Joint Hearings, supra note 136 (testimony of Fidelity Investments Senior Vice President and General Counsel Robert C. Pozen). Mr. Pozen testified:

The bill appears to be a response to concerns that “two-tier” tender offers may be coercive. If so, the focus of the bill should be sharpened: much less sweeping
order to protect shareholders in this context, to prevent an acquiror from being able to accomplish a variety of business combinations for a period of three years?265 Moreover, as a number of commentators have pointed out, if shareholders feel that they need protection from coercive offers, they are able to protect themselves through appropriate charter amendments.266 Fair price provisions, for example, have been enacted by numerous corporations.267 The fact that Delaware chose to protect shareholders in an instance when shareholders could have protected provisions could protect shareholders during two-tier offers. As drafted, the bill is so broad that management may block shareholders from accepting even offers favorable to all shareholders.

For example, the bill should not impose restrictions on a bidder that acquires 51% of the company's outstanding stock if the bidder undertakes to pay equivalent consideration to the remaining shareholders in a second-step merger. There is nothing coercive about such an offer.

Id. at 6. SEC Commissioner Charles C. Cox similarly stated:

The focus of Delaware's concern in proposing this legislation at issue appears to be "coercive" takeovers, where minority shareholders are "squeezed out" on unfavorable terms. Although the incidence of third-party two-tier tender offers is limited and their adverse or coercive effects open to debate, if Delaware believes that they present shareholder protection concerns, then the legislation should specifically restrict two-tier offers and not restrict offers which do not present these concerns. If legislation were to eliminate the coercive nature of front-end loaded bids by providing that shareholders in a second step takeout would be assured of receiving the same compensation, then shareholders would be in a position to reasonably assess the economic merits of an offer and could accept it or reject it accordingly.


265. A perfect example of how the Delaware statute can serve to discourage takeovers even when there is no threat of coercion is shown in BNS Inc. v. Koppers Co., 683 F. Supp. 458 (D. Del. 1988), where a federal district court upheld the constitutionality of the Delaware statute. In that case, the statute would bar the acquiror, BNS, from engaging in a business combination with Koppers for a period of three years. This three-year moratorium was held to be valid, although the BNS offer for Koppers stock was not a two-tiered offer, see id. at 461 (noting that BNS's offer was for "all" of Koppers' outstanding securities), and even though under BNS's proposed business combination, any shareholders who did not tender and were squeezed out in a second step merger were to "receive the same cash price paid pursuant to the tender offer." Id.; see also RP Acquisition Corp. v. Staley Continental, Inc., 686 F. Supp. 476, 477 (D. Del. 1988). In RP Acquisition, the court refused to enjoin application of the Delaware statute even though the acquiror, RP Acquisition Corp., was making a tender offer for "any or all" of Staley's common stock and "[u]nder the terms of the anticipated merger, each Staley common share would be converted into the right to receive the same cash price paid pursuant to the tender offer."

266. See, e.g., Langevoort, supra note 12, at 105; Romano, supra note 12, at 188-89. See generally 1 A. Fleischer, Tender Offers: Defenses, Responses, and Planning 33-38 (Supp. 1987) (discussing various charter amendments).

themselves raises the possibility that the shareholders may not have wanted the legislation being foisted on them "for their benefit."268

Indeed, Delaware compounded this problem by providing that corporations must opt out of its takeover legislation, rather than requiring them to opt in.269 This again results in foisting the legislation on shareholders who may be too disorganized and dispersed to exercise their right to opt out.270 Moreover, if the legislation is in fact intended to protect managers from hostile takeovers, managers will not likely take the initiative themselves to sponsor an opt-out amendment.

Though other rationales for the Delaware legislation surfaced during the legislative hearings for the bill, once again the legislation belies the credibility of these explanations. One such rationale, for instance, was to protect shareholders from partial offers by insuring that an acquiror could not buy a controlling interest in a company and then exploit the company's assets for its own benefit and at the expense of the remaining minority shareholders.271

Again, however, there would seem to be less burdensome means for accomplishing the stated purpose. Most obviously, a control share cash-out statute, which compels acquirors to redeem the shares of the minority shareholders at a fair price, would adequately protect

268. See Langevoort, supra note 12, at 105-06; see also Romano, supra note 12, at 180-81 (suggesting that managers will turn to state legislators for takeover legislation only when they think they would not receive a favorable shareholder vote for a charter provision).

269. Del. Code Ann. tit 8, § 203(b)(2) (Supp. 1988). There was a bill before the Delaware legislature which would have made the takeover statute an enabling "opt-in" statute, but the Delaware State Bar Association fervently opposed it. See Joint Hearings, supra note 136, at 4-7 (statement of Delaware State Bar Association Corporation Law Section Chairman A. Gilchrist Sparks III), reprinted in C. Smith & C. Furlow, supra note 130, app. Y at 299-300. One argument against an "opt-in" provision was that a management request that shareholders vote to opt in would signal to the marketplace that their company was a target and raiders would move in before shareholders could even approve the provision. Id. SEC Commissioner Joseph A. Grundfest argued, however, that corporations had long been going to their shareholders for bylaw and charter provisions which would impede takeovers (such as staggered board provisions) and this had not triggered attacks by raiders. See Joint Hearings, supra note 136, at 8-10 (statement of SEC Commissioner Joseph A. Grundfest), reprinted in Practising Law Inst., The New Delaware Takeover Statute 133, 150-51 (1988) [hereinafter The New Delaware Takeover Statute].


271. See Joint Hearings, supra note 136, at 3-5 (statement of General Mills Chairman and Chief Executive Officer Bruce Atwater). See generally Booth, supra note 12, at 1641-42 (discussing the coercive effect of partial offers).
shareholders from partial offers. At the same time, it would not prevent acquirors from engaging in possibly needed business combinations for three years.

Similarly, a control share acquisition statute would eliminate the coerciveness of partial offers by allowing the shareholders to decide collectively, before approving the acquiror's initial acquisition, whether the acquiror's front-end price was sufficiently high so as to justify any loss shareholders might endure as continuing minority shareholders. The primary advantage of this approach, as at least one commentator has noted, is that it leaves the decision as to what is best for the shareholders in the shareholders' hands.

By contrast, the Delaware statute leaves the decision as to what is best for the shareholders in the hands of management. Indeed, press reports suggested that Delaware initially decided to reject a control share acquisition model precisely because of speculation that such legislation actually makes takeovers easier, since shareholders tend to benefit from takeovers and are likely to vote in favor of an acquiror's purchases. By taking the decision away from shareholders and placing it in the hands of management, the Delaware legislation again seems biased in favor of management.

272. See supra notes 91-93 and accompanying text (discussing control share cash-out statutes).

273. See supra notes 94-96 and accompanying text (discussing control share acquisition statutes).

274. See Booth, supra note 12, at 1682-85 (noting the benefits of shareholder voting in takeover statutes). Professor Booth argues that business combination statutes do not "directly address partial offers," id. at 1675, and worse yet, "prohibit[] some bids which clearly are noncoercive and beneficial." Id. at 1676.


276. See, e.g., Black, Why Delaware is Wary of Anti-Takeover Law, Wall St. J., July 10, 1987, at 18, col. 3. Mr. Black, a member of the Delaware State Bar Association's Corporation Law Section, expressed the concern as follows:

[W]ouldn't the result [of a control share acquisition statute] be a stockholder plebiscite on every offer, and wouldn't the stockholder vote always favor the bidder or any new bidder that offered a greater premium? It did not seem to the committee to matter that the Indiana law precluded the bidder (as well as management) from voting. It seemed likely that institutions would vote for a short-term profit. So would arbitragers who could acquire shares before the record date for the stockholders meeting or purchase shares with proxies attached.

Id. See generally R. Gilson, supra note 159, at 308-12 (Supp. 1988) (discussing the effectiveness of control share acquisition provisions).

277. The statute does permit an acquiror to sell assets to third parties during the three year waiting period, as long as receipts from those sales are distributed to all shareholders proportionately. DEL. CODE ANN. tit. 8, § 203(c)(3)(ii) (Supp. 1988). Although this might seem an appropriate method for insuring that shareholders receive the full value of their shares in the corporation, while at the same time allowing acquirors to make use of their acquisition,
Lastly, a much more provocative rationale given for the Delaware legislation was that it was needed to further much broader public policy interests in promoting long-term corporate planning, and in protecting employees and their communities from the dislocative effects of takeovers. Several unions, for instance, testified in favor of the statute.

While such concerns are indeed important and deserve considerably more attention, it is questionable whether they can or should be addressed by states in the context of corporate law. Specifically, there would seem to be no credible explanation, under any theory of state corporate lawmaking, as to why states competing for chartering business would be likely to properly consider the interests of non-shareholder corporate constituencies or the national economy.

Most important, if those who favor state regulation of corporate law are correct, then that would mean the market for charters promotes corporate laws which maximize shareholder welfare. What it arguably goes far beyond what is necessary for shareholder protection by encouraging shareholders to freely ride on the efficiencies achieved through the efforts of acquirors. See Grundfest Letter, supra note 130, at 12-13, reprinted in C. Smith & C. Furlow, supra note 130, app. E at 172-73. For a general discussion of the free rider problem facing corporate acquirors, see R. Gilson, supra note 159, at 854-932.

278. See, e.g., Joint Hearings, supra note 136, at 4-6 (testimony of Delaware Secretary of State Michael E. Harkins), reprinted in C. Smith & C. Furlow, supra note 130, app. Q at 259; Joint Hearings, supra note 136, at 1-8 (testimony of Irving S. Shapiro), reprinted in C. Smith & C. Furlow, supra note 130, app. R at 262; Statement by Governor Michael N. Castle Regarding House Substitute 1 for House Bill 396 (Feb. 2, 1988), reprinted in C Smith & C. Furlow, supra note 130, app. CC at 339-40.

279. See supra note 136 (noting that labor groups actively lobbied for antitakeover legislation).

280. See Fischel, supra note 7, at 919-20; Romano, supra note 9, at 711; Winter, supra note 7.

If the "race to the bottom" theorists are correct, that fact, in and of itself, would give cause for federal intervention. Nevertheless, one might suggest that even if the market for charters has a management bias, that bias is good since the extra leeway the law would afford managers would allow managers to act as proxies to protect the interests of nonshareholder corporate constituencies or society at large. Such a broad investment of power into the hands of management, however, would seem unjustifiable. See 3 F. HAYEK, LAW, LEGISLATION AND LIBERTY: THE POLITICAL ORDER OF A FREE PEOPLE 82 (1982). Hayek states:

So long as the management has the one overriding duty of administering the resources under its control as trustees for the shareholders and for their benefit, its hands are largely tied; and it will have no arbitrary power to benefit this or that particular interest. But once the management of a big enterprise is regarded as not only entitled but even obliged to consider in its decisions whatever is regarded as the public or social interest, or to support good causes and generally to act for the public benefit, it gains indeed an uncontrolable power—a power which could not long be left in the hands of private managers but would inevitably be made the subject of increasing public control.
is best for shareholders, however, is not necessarily what is best for nonshareholder corporate constituencies such as employees and resident communities, or for that matter, what is best for the economy at large. Indeed, at the same time that employees have been hurt by the takeover phenomenon, shareholders have often enjoyed fabulously high premiums. If there is a need to protect these nonshareholder constituencies, it is best done through labor, contract or pension laws, or through severance pay or plant closing laws, rather than through corporate law.

Id.; see also R. Gilson, supra note 159, at 758; Karmel, Will Takeover Abuses Lead to Federal Corporation Law?, N.Y.L.J., Feb. 19, 1987, at 1, col. 1 n.43 (noting that although the business community vigorously fought the corporate social responsibility movement of the 1970s, it is now fervently arguing that managers must have a right to protect nonshareholder constituencies from corporate raiders). Commissioner Grundfest has similarly observed:

Management's position on the job loss and takeover issue is quite intriguing. On one hand, managements opposed to takeovers often point to the spectre of job loss and local plant shutdowns or headquarters moves as a reason to fight takeover activity. On the other hand, managements vigorously protest legislative efforts that would restrain their ability to lay off workers, shut down plants, or move headquarters when and as management likes.

Address by SEC Commissioner Joseph A. Grundfest, University of Toledo College of Law 5 (Mar. 11, 1988) (transcript on file at Hofstra Law Review). The Delaware statute is actually better explained as management entrenchment legislation (which would comport with the "race to the bottom" theory) than as legislation designed to consider the needs of employees or communities, or the economy at large. See infra text accompanying notes 284-87.

281. In fact, shareholders are frequently considered the culprits for many of the problems associated with takeovers. Institutional shareholders, for instance, are often accused of concentrating solely on short term price maximization, and consequently for fueling "merger mania." See, e.g., Lipton, supra note 88, at 7-9; CUOMO MEMORANDUM, supra note 101, at 7.

282. After Texaco's acquisition of Getty Oil, for instance, 2,000 workers (26% of Getty's workforce) were dismissed. See Schmitt, Depleted Field: Despite Raider's Lust, Oil Industry is Facing Retrenchment Period, Wall St. J., June 7, 1985, at 1, col. 6, 15, col. 3. By contrast, the shareholders who sold to Texaco received a very substantial premium for their shares. Gelfand, "Pun's Oil Sues Toxico": A Comedy of Errors in (At Least) Four Acts, 11 DEL. J. CORP. L. 345, 349 (1986).

Similarly, Owens Corning dismissed 46 percent of its workforce (including 480 research employees) after engaging in a "frantic recapitalization" to fend off the Wickes Companies. Willoughby, What a Raider Hath Wrought, FORBES, Mar. 23, 1987, at 56. As part of the recapitalization, however, shareholders, whose shares had been selling for approximately $40 per share, received a combination of cash and bonds valued at over $70. Id.; Aristof, Wickes Drops Owen-Corning Offer, N.Y. Times, Aug. 30, 1986, § 1, at 31, col. 3.

283. The above discussion is not intended to deny the importance of such issues as takeover-related dislocation, or the effects of leveraging on the national economy. See Impact on Workers of Takeovers, Leveraged Buyouts, Corporate Restructuring, and Greenmail: Hearings Before a Subcomm. of the Comm. on Gov't Operations, House of Representatives, 100th Cong., 1st Sess. 80 (1987) [hereinafter House Hearings] (testimony of Dr. Richard S. Belous) (testifying that "increased merger and acquisition activity has tended to lower compensation trends . . . and reduce employment levels" (emphasis in original)); Id. at 42 (statement of...
More to the point, however, these broader public policy rationales for the Delaware statute ring hollow when one considers that the legislation only discourages hostile acquirors from engaging in leveraging or dislocative conduct, but does nothing to insure that


The question, instead, is how these concerns should be addressed. It has been suggested that state corporate law is not the proper forum, primarily because the current system, in which corporations can opt in and out of corporate law regimes and in which states compete for chartering business, is not likely to produce laws which will properly address these concerns. Even if the system operates efficiently, it will only serve to maximize shareholder wealth, and not to properly consider the interests of other corporate constituencies or the economy at large. See supra note 280 and accompanying text.

Nevertheless, these issues still can be addressed by legislators both on federal and state levels. On the federal level, for instance, Congress could consider limits on leveraging if leveraging is thought to encourage harmful short-term business planning or dislocative conduct. See, e.g., 12 C.F.R. pt. 207 (1986) (setting forth the Federal Reserve Board's interpretation that its existing margin requirements are applicable to junk bond financing); Lipton, supra note 88, at 9-11 (discussing how the tax laws have encouraged leveraged acquisitions). Similarly, in an effort to help ease the dislocation of corporate employees, Congress could consider, inter alia, amendments to the National Labor Relations Act, such as making the decision to close a plant a mandatory subject of collective bargaining. Cf. First Nat'l Maintenance Corp. v. NLRB, 452 U.S. 666 (1981) (holding that an employer's decision to close part of its operations is not a mandatory subject of bargaining). Additionally, Congress could enact changes in pension laws, or, for those with more radical tastes, require employee representation on corporate boards. See Bonanno, Employee Codetermination: Origins in Germany, Present Practice in Europe, and Applicability to the United States, 14 Harv. J. on Legis. 947 (1977); Summers, Codetermination in the United States: A Projection of Problems and Potentials, 4 J. Comp. Corp. L. & Sec. Reg. 155 (1982); Note, Employee Representative on the Corporate Board of Directors: Implications Under Labor, Antitrust and Corporate Law, 27 Wayne L. Rev. 367 (1980) (authored by Barbara A. Zelle). Congress recently enacted legislation requiring advance notice of plant closings. Worker Adjustment and Retraining Notification Act, Pub. L. No. 100-379, 102 Stat. 890 (1988) (to be codified at 29 U.S.C. §§ 2101-2109).

On the state level but outside the corporate law context, state legislatures could consider a variety of means of easing dislocation, such as plant closing or severance pay laws. See generally Douglas, State and Local Plant Closing Laws: The Case Against Preemption, 21 Gonz. L. Rev. 603 (1986) (advocating plant closing regulations to ease the impact of plant closings on workers); Note, supra note 216, at 253-55 (proposing and analyzing state plant closing legislation as an alternative to federal legislation). One commentator has suggested that a state's tort of wrongful discharge could be construed so as to require notice of layoffs or plant closings. See Rhine, Business Closings and Their Effects on Employees—Adaptation of the Tort of Wrongful Discharge, 8 Indus. Rel. L.J. 362 (1986).
current management does not engage in the same behavior. Would it be likely, for instance, under the Delaware statute, that a company's board would not approve a management-led leveraged buyout, even though it could just as easily as a third-party acquisition, result in employee layoffs and short-term business planning? Similarly, the statute would not even apply if current managers simply decided to leverage their company through a recapitalization. This is a very common phenomenon, which also can have the effect of encouraging short-term business planning and employee layoffs. This one-sided bias of the Delaware statute again supports the management entrenchment explanation for the legislation.

Finally, the testimony submitted to the Delaware state legislature when it was considering the takeover statute also suggests that the statute was intended to benefit managers rather than shareholders. Virtually every shareholder group opposed adoption of the legislation, and vociferously opposed the requirement that companies must opt-out of the legislation. The testimony of Steven Cohen on behalf of New York City Comptroller Harrison J. Goldin, the trus-

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284. For example, in response to a hostile bid by the Haft family, the Safeway management engineered a management-led buy-out with the help of Kohlberg, Kravis, Roberts & Co. *House Hearings*, *supra* note 283, at 45 (statement of AFL-CIO representative). After the acquisition, Safeway closed numerous stores resulting in layoffs of 3,000 to 4,000 employees. *Id.; see also* Bernstein, *Labor: Workers May Pay the Price in Safeway Sale*, L.A. Times, Dec. 15, 1987, pt. 4, at 1, col. 1 (noting that "[m]ore than 8,500 Safeway workers lost their jobs after [Kohlberg, Kravis, Roberts & Co.] first moved in last year to save Safeway from the clutches of the father-son team of Herbert H. Haft and Robert M. Haft of Landover, Md.").

285. See *Hearings Before a Subcomm. on Employment and Housing of the House Comm. on Gov't Operations*, 100th Cong., 1st Sess. 28-29 (1987) (statement of President James E. Hatfield of the International Glass, Pottery, Plastics & Allied Workers Union) (testifying that the restructuring by Owens-Corning management resulted in layoffs of over 1000 employees); *see also* Coffee, *supra* note 214, at 6 (stating that "between January 1984 and mid-July 1985, 398 of North America's 850 largest corporations engaged in . . . restructurings . . ."); Thackray, *Restructuring is the Name of the Hurricane*, *EUROMONEY*, Feb. 1987, at 106 (noting that "well over half of the top 800 corporations have restructured significantly in the past four years.").

286. *See, e.g., Joint Hearings*, *supra* note 136 (testimony of Office of the Comptroller of the City of New York Deputy Counsel Steven A. Cohen); *id.* (testimony of Robert A.G. Monks on behalf of Institutional Shareholder Services, Inc., on behalf of Alliance Capital Management, California Public Employees Retirement System, FMR Corporation, New Jersey Division of Investment, Pension Reserves Investment Management Board, California State Teachers Retirement System, Wells Fargo Bank, College Retirement Equities Fund and the California Senate Commission on Corporate Governance, Shareholders Rights and Securities Transactions); *id.* (testimony of Bruce O. Kallos as Trustee for the Delaware state pension system); *id.* (testimony of United Shareholders Association Executive Director James E. Heard); *id.* (testimony of Fidelity Investments Senior Vice President and General Counsel Robert C. Pozen).
tee of five New York City public employee pension funds and the co-chairman of the Council of Institutional Investors, is exemplary:

There is no evidence that stockholders fare worse in hostile takeovers than in mergers arranged by management. Quite to the contrary, available data suggests the value of their holdings increase by as much as 40%.

Nor is there evidence that hostile takeovers are rampant. Or that they cut research and development or any of the other horrible outcomes about which you have been warned.

Clearly, though, they do pose a threat to corporate management. Management says they need protection from that threat. But why? Certainly not to protect us stockholders, which should be their primary job. As stockholders, we reject the notion that we need protection from ourselves. But we do need protection of our basic rights. And that is why we oppose this legislation.287

While it has been argued that the politics of the Delaware statute tend to suggest that the legislation is better characterized as management entrenchment rather than shareholder protection, it should be noted how restrained the Delaware legislature was in pursuing the former objective. Most notably, the Delaware statute poses much less of a burden on takeovers, and is thus much less effective as a management entrenchment tool, than the New York statute after which it was modeled. As previously noted, the New York statute bars business combinations for five years, whereas the Delaware statute only bars such activity for three years.288 Even more significantly, the Delaware statute, unlike the New York statute, has many significant exceptions by which an acquiror can avoid the statute's prohibitions, without having to get prior approval from the target company's board of directors.289

Delaware's restraint should not be construed as an indication that the market for corporate charters does not lean in favor of management interests. Rather, its restraint is probably best explained by Delaware's concern with a federal preemptive response should its legislation be deemed too protective of management. Such federal action, in fact, seemed perfectly plausible at the time Delaware was considering its statute—Congress had recently considered a bill that

287. Id. at 2-3 (testimony of Office of the Comptroller of the City of New York Deputy Counsel Steven A. Cohen).

288. See supra notes 259-60 and accompanying text.

289. See supra notes 261-62 and accompanying text.
would preempt state takeover legislation, the Reagan Administration voiced its opposition to the Delaware statute, and prominent members of the Securities and Exchange Commission suggested that Delaware's adoption of a statute might provoke preemptive action. Indeed, the fact that Delaware enacted a takeover statute despite this very tangible threat of federal preemption is a good indication of how powerfully the forces in the market for corporate charters pushed for such legislation.

B. Federal Limitations on Corporate Law: Responding to the Management Bias in the Chartering Market

If the market for corporate charters is, in fact, promoting management entrenchment legislation, then some form of federal corrective action would seem appropriate. Such legislation is both in conflict with the very raison d'être of corporate law—to minimize the agency costs resulting from the separation of ownership and control—and with the interests of the nation at large. By sheltering managers from corporate takeovers, the legislation takes away what many commentators believe is the primary check on management behavior, and additionally, the primary incentive for managers to run their companies efficiently.

291. See Joint Hearings, supra note 136, at 6 (statement of SEC Commissioner Joseph A. Grundfest) (including a letter to the Delaware legislature from Chairman Berryl Sprinkle expressing the views of the Council of Economic Advisors), reprinted in The New Delaware Takeover Statute, supra note 269, at 142-43.
292. See Grundfest Letter, supra note 130, at 5, reprinted in C. Smith & C. Furlow, supra note 130, app. E at 165 (stating that “[i]t is clear . . . that a decision by Delaware to adopt an antitakeover statute will be subject to far greater scrutiny and debate, and is more likely to provoke a federal response . . . .”). SEC Commissioner David S. Ruder also stated: Limitations on the free transferability of securities of corporations which are owned by 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.


293. Delaware's restraint in enacting the takeover statute should not be exaggerated, however. Most important, while Delaware's statute might be restrained by comparison to the New York business combination statute, it is still probably more likely to discourage takeovers than many of the other types of second generation takeover legislation, any of which could have been chosen by the Delaware legislature.

294. See generally Easterbrook & Fischel, supra note 11; Gilson, supra note 11.
How, then, should the federal government respond to such legislation? To begin with, it must be recognized that surgical removal of specific statutes, as suggested for protectionist takeover legislation, is not appropriate. To the contrary, the lesson of management entrenchment takeover legislation is that the system of state corporate lawmaking itself is not properly regulating the takeover phenomenon. Absent some federal remedial action, the market for corporate charters will continue to prompt states to adopt takeover laws which are adverse to shareholders' interests.

The more difficult question, however, is how extensive federal action should be. Admittedly, some commentators might consider the management bias in takeover legislation as simply more proof of the “race to the bottom” theory, and thus merely additional evidence of the need for extensive federalization of corporate law. But while such a reading has surface appeal, it may be inferring too much from the legislation. Most important, it ignores the argument that minimal federal intervention in the takeover context might be sufficient to remedy any other management bias problems in the chartering market.

Specifically, the primary distinction between those who favor and those who oppose federalization of corporate law is a belief in the effectiveness of market forces in compelling managers to act in the best interests of shareholders. Opponents of federalization generally concede that managers typically make the decision as to where to incorporate. Their distinguishing characteristic is that they believe that market forces compel managers to choose a state of incorporation which best serves the interests of shareholders.

Commentators opposing federalization rely in large part on the market for corporate control. Stated succinctly, the scholars believe that if managers select corporate laws which promote their own interests at the expense of shareholders, their company's stock price will decline and their company will become a takeover target.

Such a belief suggests that the federal government might be

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296. See supra notes 4-13 and accompanying text (discussing the debate over federalization of corporate law).
297. See, e.g., Winter, supra note 7, at 252.
298. See supra note 9 and accompanying text.
299. See Fischel, supra note 7, at 919; Winter, supra note 7, at 264-70.
300. Winter, supra note 7, at 256.
able to remedy the management bias in the chartering market simply by restricting state takeover regulation. If the federal government preserves a relatively unimpeded market for corporate control, that market itself might eliminate any other management bias in the chartering market. Indeed, even the proponents of state regulation have argued that federal regulation of takeovers might be necessary. 301

If such minimal federal intervention would be sufficient, it would seem preferable. States, after all, have longstanding experience as corporate lawmakers. Absent more convincing evidence that the state system as a whole is malfunctioning, the federal government should defer as much as possible to state regulation.

What, however, should be the nature of this "minimal" federal intervention? Simply requiring that takeover legislation assume an "opt-in" format instead of an "opt-out" format should be sufficient to correct for any problems. 302 If states enact legislation that promotes management and not shareholder interests, then shareholders will not likely opt into the legislation. 303 Moreover, if the legislation does in fact properly promote shareholder welfare, then shareholders would happily vote to opt-in. 304 Most importantly, such an enabling format avoids the problem of having takeover legislation foisted upon shareholders against their will. 305

1. Fashioning a Response: Judicial versus Legislative Action.—The simplest and most obvious choice for federal intervention to correct for the management bias in takeover legislation would be for Congress to enact legislation which would require that state takeover legislation adopt an enabling format. Before doing this, however, Congress should wait to see whether the new takeover legislation,

301. See, e.g., id. at 289.

302. See Joint Hearings, supra note 136, at 8-11 (statement of SEC Commissioner Joseph A. Grundfest) (discussing the merits of an “opt-in” or enabling approach over an “opt-out” approach); see also Note, supra note 12, at 221 (arguing that “implementation of antitakeover legislation by a corporation should require the concurrence of a majority of the shareholders since it materially alters the factors upon which shareholders relied when they invested in the corporation.”).

303. See Joint Hearings, supra note 136, at 10 (statement of SEC Commissioner Joseph A. Grundfest).

304. See id. SEC Commissioner Joseph A. Grundfest reasoned that: “[i]f the proposed [Delaware] antitakeover measures are beneficial for stockholders, then stockholders will support those measures and they will be adopted, just as hundreds of corporations have gained stockholder approval for fair price amendments, staggered boards, and numerous other takeover protections.” Id.

305. Id. at 8-11; see supra notes 269-70 and accompanying text.
and in particular the Delaware statute, actually interferes significantly with takeover activity. As already noted, the mere threat of federal preemption went a long way toward ameliorating the anti-takeover effect of the Delaware statute, and market forces may prove sufficiently powerful to overcome any obstacles which the legislation continues to create.

Even in the absence of federal legislative action, however, courts could conceivably play a role in correcting for the management bias in state takeover regulation. While it has already been seen how the Commerce Clause could be used to correct for the problem of protectionist legislation, the Clause could also be used to invalidate state legislation which is not protectionist, but which is intended to entrench management.

Quite simply, courts could revive the Commerce Clause balancing test which the Supreme Court employed in *Edgar v. MITE Corp.* As previously noted, in the *MITE* decision, Justice White assumed that an open market for corporate control was itself an important national interest, and that any state legislation which interfered with that market would be considered a heavy burden on interstate commerce. Under this approach, takeover legislation which tended to entrench managers would fall under a Commerce Clause balancing analysis unless the legislating state could prove that its legislation furthered significant state interests.

There are, however, two potential problems with using such an approach, one practical and one theoretical. On the practical side, there is the simple fact that the *CTS* Court appears to have rejected *MITE*‘s broad construction of the Commerce Clause. Under the logic of *CTS*, it would seem that states may freely burden the market for corporate control as long as that interference does not discriminate against interstate commerce.

On the theoretical side, the question is not whether the *CTS* or the *MITE* analysis is correct, but whether courts should engage in an interest balancing approach at all. Many scholars, for instance, have suggested that such balancing of interests is a purely legislative function, for which courts are ill-suited, and that judicial scrutiny of state law under the Commerce Clause should therefore be restricted

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309. *See supra* notes 71-75 and accompanying text.
310. *See supra* notes 125-28 and accompanying text.
to policing for purposeful economic protectionism.\textsuperscript{311}

Without trying to resolve this academic debate, it can at least be noted that, in the context of state takeover regulation, a broader judicial role in Commerce Clause analysis can help to compensate for a failure of the legislative process which may be as likely to occur on the federal level as on the state level. Specifically, the very mechanism which causes the market for corporate charters to promote management and not shareholder interests—that shareholders are too disorganized and dispersed to adequately defend their rights in either the internal corporate governance structure or in state legislatures—is just as likely to be a problem on the federal level.\textsuperscript{312} Courts, being free from management lobbying pressures, could thus serve a valuable role through the use of a balancing analysis, to correct for this deficiency in the legislative process.\textsuperscript{313}

\textbf{CONCLUSION}

One of the perennial issues looming behind all of corporate law is the extent to which such law should be "federalized." This Article has attempted to shed light on that issue through an examination of

\textsuperscript{311} See, e.g., Maltz, \textit{How Much Regulation is Too Much—An Examination of Commerce Clause Jurisprudence}, 50 Geo. Wash. L. Rev. 47 (1981); Regan, supra note 17; Selder, \textit{The Negative Commerce Clause as a Restriction on State Regulation and Taxation: An Analysis in Terms of Constitutional Structure}, 31 Wayne L. Rev. 885 (1985). See generally Regan, supra note 17 (citing other scholars advocating this position). Justice Scalia also advocated this position in his concurrence in \textit{CTS}. CTS Corp. v. Dynamics Corp. of America, 481 U.S. 69, 94-95 (1987) (Scalia, J., concurring).

\textsuperscript{312} See Fischel, supra note 7, at 921-23 (arguing that "[t]here is no reason to believe, and every reason to doubt, that the elimination of the market for corporate charters will increase shareholders’ welfare."); Romano, \textit{State Competition}, supra note 9, at 712-13 (suggesting that there is no reason to think that “diffuse and unorganized” shareholders would be any more capable of communicating their views to Congress than to state legislatures).

\textsuperscript{313} Scholars have described two alternative theories for justifying judicial intervention under the Commerce Clause. Under one theory, judicial intervention should be limited to correcting for failures in the legislative process. See Eule, supra note 135, at 438. Judicial invalidation of protectionist legislation is the prime example, since, as mentioned earlier, in that situation the parties adversely affected by the legislation are by definition outside the legislat- ing state and thus have no legislative recourse. See supra notes 159, 185 and accompanying text.

Under the second theory, judicial intervention is thought appropriate to preserve fundamental values inherent in our system. See Eule, supra note 13, at 438-40. In the Commerce Clause context, this value-oriented approach is reflected by the Court's striking of legislation which interferes with the fundamental value of free trade. The MITE decision would appear to reflect this latter approach.

The striking of management entrenchment takeover legislation might not only be appropriate on a value-oriented approach, as was used in MITE, but also from a process approach, since there is likely to be a legislative failure at all levels of governance.
what one area of state corporate lawmaking—state takeover statutes—can teach about state competence to make corporate law.

The examination has shown that all is not well in state corporate lawmaking, at least in the takeover context. Some states are abusing their corporate lawmaking powers to enact protectionist legislation; others to enact management entrenchment legislation. Nevertheless, having isolated the motivations underlying this legislation, the Article has hopefully been able to prescribe a coherent and comprehensive federal response.