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STATE TAKEOVER LEGISLATION: THE EXTENT OF THE STATES’ RIGHTS IN THE CREATION OF CONTROL SHARE ACQUISITION STATUTES

by Mark S. Howard

In recent years corporate America has experienced an evolution that has changed the thinking of both management and shareholders. Increasing shareholder wealth appears to have a greater emphasis today than in the past. Takeover activity has increased significantly throughout the last twenty-five years. Congress reacted to the evolution of takeover related investment by passing legislation in 1968 designed to protect investors and put the target company and the offeror on an equal footing.1 Because the states felt that the federal legislation was inadequate, state legislators attempted to regulate takeover activity under their respective corporate laws. Litigation regarding the constitutionality of these statutes increases daily. Last year the United States Supreme Court held an Indiana anti-takeover statute constitutional.2 This ruling triggered many states to enact takeover legislation that may exceed the bounds of constitutionality.3

This Comment analyzes the extent to which states may enact control share takeover legislation. The first section provides background information regarding federal legislation governing corporate acquisitions. The second section presents a brief history of state takeover legislation through three different stages. The third section specifically addresses control share acquisition statutes, including an analysis of the Supreme Court's ruling in *CTS Corp. v. Dynamics Corp. of America.* The fourth section proposes a solution that provides for federal takeover legislation superseding much current state takeover legislation, while leaving to the states the limited role of enforcing the enacted federal legislation.

I. Federal Regulation and Constitutional Challenges

Litigants attack state takeover regulation daily in lawsuits filed in the federal courts alleging conflicts with the United States Constitution. Opposition to the state statutes centers upon two constitutional grounds. First, opponents challenge whether the Williams Act, an amendment to the Securities Exchange Act of 1934, should supersede state takeover legislation based on the supremacy clause of the Constitution. Second, opponents claim that state takeover legislation inhibits the exchange of shares in a national securities market in violation of the commerce clause. For a state takeover statute to stand, it must surmount these two constitutional challenges.

A. The Williams Act and the Supremacy Clause

1. The Williams Act

In 1968 Congress enacted the Williams Act in an attempt to provide investor protection. In addition, the Act strives to provide a balance be-
tween tender offerors and the target company. By increasing disclosure requirements to both the public and the management of the target company, the Act requires tender offerors to provide sufficient information to shareholders so they can make educated decisions regarding whether to tender their shares.

The Williams Act covers three different situations. First, the Act applies to the investor or group of investors attempting to acquire control of a corporation through a tender offer. Second, the Act pertains to the investor or group of investors attempting to acquire control of a corporation through open market or privately negotiated purchases. Third, the Act applies to a corporation that wishes to repurchase its own stock. Two circumstances activate the Act’s requirement that purchasers disclose additional information. The first is when the investor acquires securities in a corporation such that the investor’s ownership interest in the corporation exceeds five percent of the class of stock acquired. At that point the Act requires the investor or investors to send a statement to the issuer, the stock exchange on which the corporation’s shares are traded, and the Securities and Exchange Commission (the SEC or the Commission). This statement

CONG. & ADMIN. NEWS 2811. The stated purpose of the bill, referred to as S. 510, reads as follows:

S. 510 amends the Securities Exchange Act of 1934 by requiring the disclosure of pertinent information and would afford other protections to stockholders (1) when a person or group of persons seeks to acquire a substantial block of equity securities of a corporation by a cash tender offer, alternately called a “takeover bid” . . . .

Id.

11. Id. at 2813 (“The bill avoids tipping the balance of regulation either in favor of management or in favor of the person making the takeover bid.”).
A public offer or solicitation by a company, an individual or a group of persons to purchase during a fixed period of time all or a portion of a class or classes of securities of a publicly held corporation at a specified price or upon specified terms for cash [cash tender offer] and/or securities [exchange offer].
16. Id.
17. Id. § 78m(d)(1). The statute states its purpose within its language:
Any person who, after acquiring directly or indirectly the beneficial ownership of any equity security of a class . . . . is directly or indirectly the beneficial owner of more than 5 per centum of such class shall, within ten days after such acquisition, send to the issuer of the security . . . . send to each exchange where the security is traded, and file with the Commission, a statement containing such of the following information, and such additional information, as the Commission may by rules and regulations, prescribe as necessary or appropriate in the public interest or for the protection of investors.
Id.
18. Id.
should include the background of all investors, the investors' source of funds, and any subsequent plans to liquidate, merge, or make any other major change in its corporate structure. The statement should also contain the number of shares owned by each investor, and any information regarding contracts, arrangements, or understandings with anyone regarding the target corporation's securities.

The other situation triggering the Act concerns the investor who makes a tender offer such that after the purchase of shares pursuant to the offer the investor owns more than five percent of the class of equity securities acquired. In this situation the investor must file a statement with the SEC containing information necessary in the public interest to protect investors. The investor must send this statement simultaneously with the copies of the tender offer that are sent to the shareholders.

Other aspects of the Act include time provisions designed to protect investors against fraudulent acts as well as unreasonable delay. Tender offerors must keep their offers open for a minimum of twenty business days. Shareholders who deposit their shares in response to tender offers may withdraw their shares at any time while the offer remains open, provided the share-

19. Id. § 78m(d)(1)(A) (requires "the background, and identity, residence, and citizenship of, and the nature of such beneficial ownership by, such person and all other persons by whom or on whose behalf the purchases have been or are to be effected").

20. Id. § 78m(d)(1)(B). If the purchaser borrows funds to acquire, hold, or trade a security, he must disclose the nature of the transaction and the names of the parties involved. The only exception involves a loan received from a bank in the ordinary course of business. The purchaser may request in his statement that the Commission withhold the identity of the bank from the public. Id.

21. Id. § 78m(d)(1)(C).

22. Id. § 78m(d)(1)(D) (requires disclosure of "the number of shares of such security which are beneficially owned, and the number of shares concerning which there is a right to acquire, directly or indirectly, by (i) such person, and (ii) by each associate of such person, giving the background, identity, residence, and citizenship of each such associate").

23. Id. § 78m(d)(1)(E). This section requires very broad disclosure regarding any information involving:

[Transfer of any of the securities, joint ventures, loan or option agreements, puts or calls, guaranties of loans, guaranties against loss or guaranties of profits, division of losses or profits, or the giving or withholding of proxies, naming the persons with whom such contracts, arrangements, or understandings have been entered into, and giving the details thereof.]

Id.

24. Id. § 78n(d)(1). This provision parallels that of the investor acquiring more than 5% found in id. § 78m(d)(1):

It shall be unlawful for any person, directly or indirectly . . . to make a tender offer for . . . any class of equity security . . . if, after consummation thereof, such person would, directly or indirectly, be the beneficial owner of more than 5 per centum of such class, unless at the time copies of the offer or request or invitation are first published or sent or given to security holders such person has filed with the Commission a statement containing such of the information . . . as the Commission may by rules and regulations prescribe as necessary or appropriate in the public interest or for the protection of investors. Id. § 78n(d)(1).

25. Id. § 78n(d)(1).

26. Id.

27. 17 C.F.R. § 240.14e-1(a) (1988) (time period begins the date the "offer is first published or sent or given to security holders").

28. Id. § 240.14d-7(a).
holder submits a written notice of withdrawal. Shareholders may also withdraw their deposited shares any time after sixty days from the date of the original tender offer if the offeror has not purchased the tendered shares. In addition, if more shareholders deposit their shares in response to a tender offer than the offeror is bound or willing to pay for, then the offeror must purchase the shares on a pro rata basis. This provides an equal opportunity for shareholders to tender their shares, and does not place pressure on shareholders to make hasty decisions. All tendering shareholders must receive the same purchase price. This is a particularly important feature of the Act. If a tender offeror changes the offered price during the pendency of the offer, all tendering shareholders must receive the highest consideration offered.

Congress intended the Williams Act to assist both sides of the takeover process. The Act attempted to give shareholders significant information and protection in arriving at the proper decision while preventing unreasonable delays by setting time limits on both shareholders and target management. The ultimate intent was to protect shareholders by taking the element of surprise out of the takeover process.

2. Supremacy Clause

Opponents of state takeover statutes argue that where such statutes conflict with the terms of the Williams Act, the statutes violate the supremacy clause of the United States Constitution. As a result, opponents argue that the Williams Act preempts state statutes that conflict with a goal of the Act: to strike a balance between the offeror and the target management. Most state statutes strongly favor incumbent management and are often designed to protect a particular corporation facing a hostile takeover. The Supreme

29. Id. § 240.14d-7(b) (written notice must include “the name(s) of the tendering stockholder(s), the number or amount of the securities to be withdrawn and the name(s) in which the certificate(s) is (are) registered, if different from that of the tendering security holder(s)”).
31. Id. § 78n(d)(6) (also applies to securities deposited within 10 days after notice of an increase in the consideration offered to shareholders).
32. Id. § 78n(d)(7).
33. Id.
34. U.S. Const. art. VI, cl. 2; see supra note 7; see also Siamas, Can States Curb Tender Offers?, A.B.A. J., May 1, 1987, at 80 (“The supremacy clause is at issue because the Williams Act, a set of 1968 amendments to the Securities Act of 1934, was passed to bring takeover offers within the disclosure requirements imposed on the purchase and sale of securities.”).
35. Siamas, supra note 34, at 80 (“The disclosure function of the Williams Act is designed to put management and the tender offeror on an equal footing.”); see supra notes 10-11 and accompanying text; see also Great W. United Corp. v. Kidwell, 439 F. Supp. 420, 437 (N.D. Tex. 1977), aff’d, 577 F.2d 1256 (5th Cir. 1978), rev’d on other grounds sub nom. Leroy v. Great W. United Corp., 443 U.S. 173 (1979). The district court held that the Williams Act preempted an Idaho takeover statute. 439 F. Supp. at 437. The court stated that the statute ruined “the careful balance struck in the Williams Act between the offeror and the management of the target company designed to protect the interests of the shareholders.” Id. The Supreme Court reversed the lower courts’ decisions on the basis of improper venue. 443 U.S. at 187. The majority opinion did not address questions regarding the constitutionality of the state statute under the Williams Act. Id. at 190-91 (White, J., dissenting).
Court recently emphasized that the Williams Act does not preempt all state takeover legislation, just the legislation that upsets the balance between the offeror and target management as provided for by the Williams Act.\textsuperscript{37}

**B. The Commerce Clause**

Many courts have struck down state anti-takeover statutes on the grounds that the statutes violate the commerce clause.\textsuperscript{38} The commerce clause of the United States Constitution simply states that Congress has the express authority to regulate commerce.\textsuperscript{39} In \textit{Pike v. Bruce Church, Inc.}\textsuperscript{40} the Supreme Court developed a standard to determine the constitutionality of a state statute under the commerce clause.\textsuperscript{41} If the burdens of the state statute imposed on the exchange of securities between shareholders exceed the local benefits of shareholder protection and the corporation's regulation of internal affairs, then courts implementing the \textit{Pike} standard strike down the statute as a violation of the commerce clause.\textsuperscript{42}

The effects of anti-takeover statutes on interstate commerce cannot be determined until a large number of states implement such legislation. At that point tender offers will likely decrease, and incumbent management will again settle into its position, leaving investors to incur the stifling impact these statutes will have on their ability to trade in a national securities market.\textsuperscript{43}

\textsuperscript{37} CTS Corp. v. Dynamics Corp. of Am., 107 S. Ct. 1637, 1644, 95 L. Ed. 2d 67, 78 (1987). The court declared that a state statute is preempted only "where compliance with both federal and state regulations is a physical impossibility, or where the state law stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." \textit{Id.} (citations omitted) (quoting Ray v. Atlantic Richfield Co., 435 U.S. 151, 158 (1978)).


\textsuperscript{39} U.S. CONST. art. I, § 8, cl. 3; see supra note 8.

\textsuperscript{40} 397 U.S. 137 (1970). The Supreme Court declared unconstitutional an Arizona statute that prohibited grower of produce to transport uncrated produce from Arizona to California for packing and processing. \textit{Id.} at 146. The statute was designed to motivate the growers to build packing facilities in Arizona. The Court ruled that the statute created an undue burden on interstate commerce. \textit{Id.}

\textsuperscript{41} \textit{Id.} at 142. "Where the statute regulates even handedly to effectuate a legitimate local public interest, and its effect on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits." \textit{Id.}

\textsuperscript{42} See supra note 38.

II. HISTORY OF STATE TAKEOVER LEGISLATION

After Congress enacted the Williams Act, states immediately began to pass legislation that far exceeded the provisions of the federal legislation. Thirty-six states enacted takeover legislation during the fifteen-year period following the enactment of the Act. This first generation of takeover legislation contained three main features. First, most of these statutes contained a provision that required a filing with the secretary of state twenty days before a tender offer officially commenced. This provision allowed target management additional time to prepare defensive mechanisms to fend off a hostile takeover, including distribution of information to shareholders regarding the upcoming offer. Tender offerors could not provide any information to shareholders during this period of time. Second, the secretary of state had the ability to call a hearing to determine the fairness of the offer. This caused delay, which again benefited target management by providing additional time to prepare defenses to the offer. Third, a state commissioner held the right to deny the tender offer if the commissioner believed the offer was simply inequitable.

In 1982 the Supreme Court finally ruled on the constitutionality of these state statutes. In *Edgar v. MITE Corp.* the Supreme Court held that the Illinois Business Take-Over Act violated the commerce clause by placing too heavy a burden on interstate commerce. The Court used the balancing test articulated in *Pike* to determine whether the Illinois act violated the commerce clause. Using the *Pike* test, the Court determined that the added protection to shareholders did not outweigh the burdens imposed on interstate commerce. As a result, the Court struck down the statute on commerce clause grounds. This decision marked the end of the first generation takeover statutes. After the *Edgar* decision many lower courts struck
down similar first generation statutes as being unconstitutional.56

After Edgar states passed statutes to maintain regulation of takeovers within state boundaries, which eliminated many of the features deemed unconstitutional in Edgar.57 These new statutes became known as second generation statutes.58 Most of these statutes were simply old laws the legislatures revised to eliminate the problems of the statute labeled unconstitutional in Edgar.59

The second generation statutes generally fall into five main divisions. The first category contains the fair price statutes.60 These statutes address the two-tier takeover bid.61 An investor will often pay a high price in an initial tender offer.62 If the offer is successful, the investor may then use the resulting newly acquired control to force the remaining shareholders to sell their shares at a much lower price than the original tender offer price.63 The fair price statutes require a successful tender offeror either to obtain supermajority approval (usually eighty percent),64 or pay a fair price to the

that the burdens of the Act exceeded the local benefits and declared the Illinois Act unconstitutional under the commerce clause. Id. at 645-46.


57. Statutes such as those in Hawaii, Indiana, and Ohio eliminate precommencement filings, hearings to determine the fairness of the offer, and state rights to deny the offer. HAW. REV. STAT. §§ 415-171 to -172 (1985); IND. CODE ANN. §§ 23-1-42-1 to -11 (Burns Supp. 1988); OHIO REV. CODE ANN. § 1701.83.1 (Anderson 1985).


59. Pinto, supra note 44, at 478.


61. See generally Note, Second Step Transactions in Two-Tiered Takeovers: The Case for State Regulation, 19 GA. L. REV. 343 (1985). The first step of a two-tier bid involves an investor who makes a tender offer to purchase enough shares to possess a majority interest (greater than 50% of the outstanding shares) in the target corporation. If the investor succeeds in acquiring a majority interest, he then merges the target corporation into his corporation. Now the investor implements the second step by forcing the minority stockholders to accept cash or debt in exchange for their shares at a price substantially lower than the price initially offered by the acquiring investor in the tender offer. Id. at 344-45.

62. Id. at 344 (often called the front-end bid).

63. Id. at 344-45 (this transaction is commonly referred to as a "freezeout"). For a general discussion of freezeouts, see Brudney & Chirelstein, A Restatement of Corporate Freezeouts, 87 YALE L.J. 1354 (1978).

64. See MD. CORPS. & ASS'NS CODE ANN. §§ 3-601 to -603 (1985). To obtain supermajority approval under the Maryland statute, the board of directors must approve the combination and the proposal must receive at least:
remaining shareholders based on a statutory formula.65

The second category of second generation statutes is comprised of registration and disclosure statutes.66 These statutes require the tender offeror to file a registration statement with a state commissioner at the time of the offer.67 Most of the requirements parallel those required by the Williams Act.68 In addition, the statutes generally require additional disclosure, including sources of financing, future plans after the takeover, and an evaluation of potential legal claims.69 To this date, registration and disclosure statutes have survived the constitutionality tests under both the supremacy clause and the commerce clause.70

The third category of second generation takeover statutes encompasses the director approval statutes.71 Director approval statutes prevent mergers

(1) 80 percent of the votes entitled to be cast by outstanding shares of voting stock of the corporation, voting together as a single voting group; and
(2) Two-thirds of the votes entitled to be cast by holders of voting stock other than voting stock held by the interested stockholder who is (or whose affiliate is) a party to the business combination or an affiliate or associate of the interested shareholder, voting together as a single voting group.

Id. § 3-602.

65. Id. § 3-603(b). The general statutory formula is as follows:
(1) The aggregate amount . . . to be received per share by holders of common stock in such business combination is at least equal to the highest of the following:
(i) The highest per share price . . . paid by the interested stockholder for any shares of common stock . . . or
(ii) The market value per share of common stock . . . on the announcement date or on the determination date, whichever is higher; or
(iii) The price per share equal to the market value per share of common stock . . . multiplied by the fraction of:
1. The highest per share . . . price paid by the interested stockholder for any shares of common stock . . . , over
2. The market value per share of common stock . . . on the first day in such 2 year period on which the interested stockholder acquired any shares of common stock.

Id.


67. Pozen, The New Round of State Tender Offer Statutes, 53 BROOKLYN L. REV. 89, 90 (1987). These statutes avoid one serious pitfall of first generation statutes by not requiring filing before the time of the offer. Id.

68. Note, supra note 13, at 424. For further discussion of parallel requirements under the Williams Act, see supra notes 17-33 and accompanying text.

69. Pozen, supra note 67, at 90. These additional requirements exceed any SEC requirements for tender offers. Id.

70. See Cardiff Acquisitions, Inc. v. Hatch, 751 F.2d 906, 914 (8th Cir. 1984). Although the court found two provisions of the statute unconstitutional for vagueness, it upheld the constitutionality of the Minnesota Corporate Takeovers Act on both supremacy clause and commerce clause grounds. Id. But see L.P. Acquisition Co. v. Tyson, 772 F.2d 201, 205, 209 (6th Cir. 1985). The court upheld the constitutionality of the Michigan Take-Over Offers Act on commerce clause grounds, but held that the Williams Act preempted the statute under the supremacy clause. Id.

between investors and target corporations for a set number of years, usually five, unless the target's board of directors approves the combination. After the set period, the investor must pay a fair price to all shareholders unless the shareholders decide otherwise. These statutes parallel control share acquisition statutes to a large extent, except that the investor needs approval from the target corporation's board of directors rather than from the shareholders. The Delaware Legislature recently passed a director approval statute requiring approval of any transaction by an investor owning between fifteen and eighty-five percent of the company's stock. Director approval statutes possess many of the same conflicts with the supremacy clause and commerce clause as do the control share acquisition statutes, but the courts have yet to rule on the constitutionality of these statutes.

The fourth category of second generation takeover statutes are the control share cash-out statutes. These statutes provide a unique set of rights for the shareholders of a target corporation. Once an investor crosses a specified ownership threshold, a shareholder may require the investor to purchase the shareholder's stock at fair market value unless they agree to another price. Shareholders who oppose the shift in control possess an option under the statute to reduce or eliminate their interest in the corporation and receive a fair price. Although these statutes appear to meet the constitutional guidelines more closely than the other second generation statutes, the courts have not ruled on their status.

The fifth category of second generation takeover statutes consists of the control share acquisition statutes. After the Supreme Court recently upheld the constitutionality of the Indiana control share statute, many states either have passed or are considering control share legislation. Due to the recent popularity of these statutes, an analysis of the various control share statutes and a discussion of the controversy surrounding these statutes follows.

73. Id. at 869.
74. Pozen, supra note 67, at 94. For discussion of control share acquisition statutes, see infra notes 80-150 and accompanying text.
76. For discussion of the validity of the New York director approval statute under both the commerce clause and the supremacy clause, see Pinto, N.Y. Law, 8 Nat'l L. J., Feb. 24, 1986, at 1, col. 4
78. Pozen, supra note 67, at 96. The investor crossing the established ownership threshold must provide notice to all shareholders that he has crossed the ownership threshold. Id. Shareholders may then exercise their right to require the investor to purchase their shares at fair market value or a price on which they agree. Id.
79. Id
III. CONTROL SHARE ACQUISITION STATUTES

A. Second Generation Statutes

After the *Edgar* decision, six states created anti-takeover statutes designed to discourage investors who purchased shares with the intent of acquiring control of the corporation within that state. The states accomplished this objective by withholding control of voting rights from any person who, after acquisition of the shares, would significantly control the voting power of the issuing public corporation. Generally, a purchase of stock qualifies as a control share acquisition if after the purchase the investor holds more than twenty percent of the corporation's stock that contains voting rights. All second generation control share acquisition statutes apply only to domestic corporations within that particular state. In addition, the issuing domestic corporation must meet a threshold test. The usual requirements specify a minimum number of total shareholders in the corporation, and mandate that the principal place of business, principal office, or a substantial percentage of the corporation's assets be within that state. Some of the states also re-

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81. The number of shareholders necessary to qualify as a “issuing public corporation” varies with individual state statutes. See, e.g., IDAHO CODE § 30-1601(12) (Supp. 1988) (“Issuing public corporation’ means a publicly held corporation which has at least fifty (50) shareholders . . .’); IND. CODE ANN. § 23-1-42-4 (Burns Supp. 1988) (“issuing public corporation means a corporation that has . . . One hundred (100) or more shareholders . . .”); OHIO REV. CODE ANN. § 170.01(y) (Anderson Supp. 1987) (“‘Issuing public corporation’ means a domestic corporation with fifty or more shareholders. . .”).

82. The Indiana statute defines a “control share acquisition” as “the acquisition (directly or indirectly) by any person of ownership of, or the power to direct the exercise of voting power with respect to, issued and outstanding control shares.” IND. CODE ANN. § 23-1-42-2(a) (Burns Supp. 1988). The Indiana statute defines “control shares” as: [Shares that, except for this chapter, would have voting power with respect to shares of an issuing public corporation that, when added to all other shares of the issuing public corporation owned by a person or in respect to which that person may exercise or direct the exercise of voting power, would entitle that person, immediately after acquisition of the shares . . . to exercise or direct the exercise of the voting power of the issuing public corporation in the election of directors within any of the following ranges of voting power: (1) One-fifth (1/5) or more but less than one-third (1/3) of all voting power. (2) One-third (1/3) or more but less than a majority of all voting power. (3) A majority or more of all voting power. Id. § 23-1-42-1.

83. See Note, supra note 13, at 418; see also Boyer, Federalism and Corporation Law: Drawing the Line in State Takeover Regulation, 47 OHIO ST. L.J. 1037, 1066 (1986). Although 20% is the standard threshold for which a purchase of shares from an investor constitutes a control share acquisition, other thresholds within these statutes do exist. Typically, if an investor's ownership interest surpasses either 20%, 33-1/3%, or 50%, his purchase creates a control share acquisition. For example, an investor currently owning a 17% interest must obtain shareholder approval to obtain another 4% of the corporation's stock. Likewise, an investor currently owning a 42% interest must obtain shareholder approval to obtain another 10% of the corporation's stock. Id.

84. Note, supra note 13, at 418.

85. HAW. REV. STAT. § 415-171 (1985) (corporation must be incorporated in Hawaii with at least 100 shareholders and have its principal place of business or substantial assets
quire that a certain percentage of shareholders reside in that state, a certain percentage of the outstanding shares are owned by that state's residents, or a certain minimum number of shareholders reside in that state.

Other relevant features of control share acquisition statutes include automatic application unless the articles of incorporation or the bylaws provide otherwise. Voting rights must be approved, usually by a majority of all outstanding shares, excluding either interested shares or those shares beneficially owned by the acquiring person. Most second generation anti-takeover statutes define interested shares as those over which either the bidder, an officer of the issuer, or an employee of the issuer who also serves as a director of the issuer may directly or indirectly exercise the corporation's voting power in the election of directors.

A major issue regarding the second generation statutes involves the amount of notice the acquiring investor must give the target corporation. Generally, an investor must file an acquiring person statement with the target corporation specifying the identity of the acquiring party or parties, the number of shares owned by the acquiring group, and the financial backing located in Hawaii; see also Ohio Rev. Code Ann. § 1701.01(Y) (Anderson Supp. 1987) (must be "a domestic corporation with fifty or more shareholders that has its principal place of business, principal executive offices, or substantial assets within this state, and as to which no valid close corporation agreement exists").


[I]ncludes, but is not limited to, any person who directly or indirectly through any contract, arrangement, understanding, relationship, or otherwise has or shares the power to vote or direct the voting of a security and the power to dispose of, or direct the disposition of, the security . . . .

Id.


97. See, e.g., Haw. Rev. Stat. § 415-172(c)(3) (1985) (includes all shares that the bidder beneficially owns); Ohio Rev. Code Ann. § 1701.83.1(B)(3) (Anderson 1985) (includes all shares that the acquiring person owns directly or indirectly).
of the group. Upon delivery of the statement, the acquiring person or group may request a special meeting of the shareholders to determine approval of voting rights for the acquiring person or group, as long as the acquiring group agrees to pay the expenses of the meeting. Typically, the special meeting to decide on voting rights must occur no later than fifty days after receipt of the request.

Some of these control share statutes provide a redemption feature that allows the target corporation to redeem the acquiring person's stock. Indiana's statute provides that a target corporation may redeem the acquiring person's stock under two conditions. First, if the acquiring person does not file an acquiring person statement within sixty days after the last purchase of target company shares, the statute allows the target corporation to buy back the acquiring person's shares. Second, if the shareholders reject full voting rights to the acquiring person or group, then the statute allows the target corporation to redeem the acquiring group's shares.

The last provision present in several second generation statutes involves the rights of the other remaining shareholders after a successful control share acquisition. If the acquiring person receives authorization of voting rights, dissenting shareholders may receive the highest price the purchaser paid for the controlling interest. The denial of voting rights and the unreasonable delay involved in these second generation control share statutes serve to effectively eliminate most bidders' chances of obtaining control of a corporation.

A brief examination of second generation control share acquisition statutes and their track records in the courts provides an insight into the controversy between the states and the federal government with regard to these statutes. Ohio enacted the initial second generation control share statute in

98. See, e.g., Haw. Rev. Stat. § 415-172(c)(5) (1985); Ohio Rev. Code Ann. § 1701.83.1(B)(6) (Anderson 1985). The statement must set forth: "Representations of the acquiring person . . . that the proposed control share acquisition, if consummated, will not be contrary to law, and that the acquiring person has the financial capacity to make the proposed control share acquisition." Id.


100. Id. § 23-1-42-7(d). The acquiring person can request in writing when he delivers the statement that he does not want the shareholders to hold the special meeting for at least 30 days. Id. § 23-1-42-7(d). The corporation then may not hold the meeting earlier than 30 days after receipt of the statement. Id.

101. See Haw. Rev. Stat. § 415-172(b) (1985) (corporation has option to call shares for redemption either at acquisition price or book value per share); see also Ind. Code Ann. § 23-1-42-10(a) (Burns Supp. 1988) (corporation may redeem shares only at fair value).


103. Id. § 23-1-42-10(b).

104. See Ohio Rev. Code Ann. §§ 1701.84, .85 (Anderson 1985) (shareholders opposing shift in control may receive from corporation cash value of shares if they deliver written demand for payment within 10 days of vote approving control share acquisition); see also Ind. Code Ann. § 23-1-42-11(b) (Burns Supp. 1988) (after granting corporation approval to control share acquisition, corporation must provide notice to all shareholders advising them of control share acquisition and their right to receive fair value of their shares if they so desire).

1982, approximately five months after the Edgar decision.\textsuperscript{106} The Ohio statute required that the corporation have fifty shareholders and either that the principal place of business be in Ohio or that the target corporation maintain substantial assets within Ohio.\textsuperscript{107} The statute also required approval of voting rights by a majority of disinterested shareholders.\textsuperscript{108} In Fleet Aerospace Corp. v. Holderman\textsuperscript{109} the Sixth Circuit ruled that the Ohio statute violated both the supremacy clause and the commerce clause.\textsuperscript{110} The court held that the resulting unreasonable delay to the bidder conflicted with the objectives of the Williams Act.\textsuperscript{111} The court of appeals agreed with the district court, which stated that the Ohio act strongly favored incumbent management through the requirement of a shareholder vote.\textsuperscript{112}

The scope of Missouri's statute, enacted in 1984, exceeded that of Ohio by requiring a vote of not only a majority, but two-thirds of all outstanding shares, excluding interested shares.\textsuperscript{113} In Icahn v. Blunt\textsuperscript{114} a United States District Court declared the Missouri Control Share Acquisition Statute invalid due to violations of both the commerce and supremacy clauses.\textsuperscript{115} The court's reasons were similar to those the Sixth Circuit used to strike down the Ohio statute.\textsuperscript{116} The Missouri statute, however, went further in its provisions by mandating that the offeror receive approval from the shareholders before the offeror could make the acquisition.\textsuperscript{117} By requiring the approval of the shareholders prior to commencement of the offer, the statute made it virtually impossible to comply with the provisions of the Williams Act, which require a tender offeror to commence his offer within five days after announcement of the offer.\textsuperscript{118} As a result, the court stated that the statute violated the supremacy clause.\textsuperscript{119}

Minnesota followed Missouri in implementing a control share acquisition statute in 1984.\textsuperscript{120} The Minnesota statute resembled the Missouri law in

\textsuperscript{107} Id. § 1701.01.
\textsuperscript{108} Id. § 1701.83.1(E)(1).
\textsuperscript{109} 796 F.2d 135 (6th Cir. 1986), \textit{vacated}, 107 S. Ct. 1949 (1987). The Supreme Court vacated the Sixth Circuit's ruling due to the reversal of \textit{CTS}. \textit{Id.} The Sixth Circuit subsequently remanded the case to the district court to decide whether an intervening merger between the parties renders the case moot and to reconsider the constitutionality of the Ohio statute in light of \textit{CTS}. 20 Sec. Reg. & L. Rep. (BNA) No. 24, at 923 (June 17, 1988).
\textsuperscript{110} 796 F.2d at 139.
\textsuperscript{111} \textit{Id.}
\textsuperscript{112} \textit{Id.; see Fleet Aerospace Corp. v. Holderman, 637 F. Supp. 742, 756 (S.D. Ohio 1986). The district judge stated that the Act "impermissibly tips the scales in favor of incumbent management by requiring a shareholder vote."} \textit{Id.}
\textsuperscript{114} 612 F. Supp. 1400 (W.D. Mo. 1985).
\textsuperscript{115} \textit{Id.} at 1414-20.
\textsuperscript{116} \textit{Id.; Fleet Aerospace Corp., 796 F.2d at 139.}
\textsuperscript{119} Icahn, 612 F. Supp. at 1420.
that it required the offeror to obtain approval of the shareholders before commencement of the offer.\footnote{121} \textit{In APL Limited Partnership v. Van Dusen Air, Inc.}\footnote{122} a United States District Court declared the Minnesota statute invalid because it violated the commerce clause.\footnote{123} The court based its decision on three provisions of the statute. First, since the statute applied to non-Minnesota residents as well as to Minnesota residents, the court held that the statute unreasonably burdened interstate commerce based on the balancing test used in \textit{Pike}.\footnote{124} Second, the court questioned the state's claim that the statute protected the business climate in Minnesota.\footnote{125} This aspect of the statute assumed that acquisitions harm corporations, when in fact that may not be true.\footnote{126} Third, the court ruled the internal affairs doctrine inapplicable because tender offers involve dealings with third parties and shareholders, not just those already within the corporation.\footnote{127}

Hawaii passed the next second generation control share acquisition statute.\footnote{128} This statute prevented a buyer from purchasing control shares if existing shareholders failed to approve the purchase, even if all existing shareholders were nonresidents of Hawaii.\footnote{129} The only requirement necessary for a corporation to qualify under the statute was that it have a minimum of one hundred shareholders and have either its principal place of business or substantial assets in Hawaii.\footnote{130} In \textit{Terry v. Yamashita}\footnote{131} a United States District Court declared the Hawaii statute unconstitutional on commerce clause grounds.\footnote{132} The court used the \textit{Pike} analysis and determined that the statute's burdens exceeded its benefits.\footnote{133} In addition, the court criticized the unlimited delay the statute provided for incumbent management as conflicting with the Williams Act.\footnote{134}

Wisconsin's second generation statute attempts to cushion the blow upon voting rights imposed by the other statutes by giving the acquiring group ten percent of the voting power of any shares they own in excess of twenty percent.\footnote{135} This statute makes a token effort to satisfy acquiring persons and the courts. To date no cases have addressed this statute's constitutionality.

Indiana adopted the last of the second generation statutes.\footnote{136} This statute

\footnote{121}{Id. § 302A.449(7).}  
\footnote{122}{622 F. Supp. 1216 (D. Minn. 1985).}  
\footnote{123}{Id. at 1225.}  
\footnote{124}{Id. For balancing test, see supra note 41.}  
\footnote{125}{622 F. Supp. at 1223.}  
\footnote{126}{Id.; see infra note 217.}  
\footnote{127}{622 F. Supp. at 1223-24. The internal affairs doctrine expresses the view that only one state should govern a corporation's internal affairs. Edgar v. MITE Corp., 457 U.S. 624, 645 (1982). Internal affairs constitute matters between the corporation and its officers, directors, and shareholders. Id.}  
\footnote{128}{HAW. REV. STAT. § 415-171 to -172 (1985 & Supp. 1987).}  
\footnote{129}{See id. § 415-171.}  
\footnote{130}{Id.}  
\footnote{131}{643 F. Supp. 161 (D. Haw. 1986).}  
\footnote{132}{Id. at 165.}  
\footnote{133}{Id.}  
\footnote{134}{Id. at 168.}  
\footnote{135}{WIS. STAT. ANN. § 180.25(9)(a) (West Supp. 1987).}  
\footnote{136}{IND. CODE ANN. §§ 23-1-42-1 to -11 (Burns Supp. 1988).}
followed the form of the other control share acquisition statutes, but re-
stricted the acquiring party the least and avoided some of the pitfalls of the
other statutes. In an attempt to comply with the commerce clause, the Indi-
ana statute required either that more than ten percent of the corporation's
shareholders reside in Indiana, that Indiana residents own more than ten
percent of its shares, or that ten thousand shareholders reside in Indiana.
In addition, drafters of the statute attempted to avoid problems with the
Williams Act by not requiring advance notice to the target corporation
or shareholder approval before commencement of the tender offer. Otherwise
the statute contained all of the basic provisions of the other control share
acquisition statutes such as requiring an acquiring person state-
ment, allowing a fifty-day lag for approval of voting rights, and includ-
ing both redemption provisions and dissenting shareholder rights.
In *Dynamics Corp. of America v. CTS Corp.* a United States District Court
ruled that Indiana's statute failed to meet the test of constitutionality under
either the commerce clause or the supremacy clause. The court held that
state legislation that upsets the neutral balance struck by the Williams Act
between the investor, incumbent management, and the takeover bidder is
invalid under the supremacy clause. In addition, the court decided that
the burden placed on interstate commerce exceeded the local benefits pro-
vided by the statute. On appeal the Seventh Circuit affirmed the lower
court's decision for the same reasons, emphasizing the positive aspects a
takeover can potentially have on a corporation. On certiorari the
Supreme Court ruled for the first time on the constitutionality of second
generation control share acquisition statutes.

**B. CTS Corp. v. Dynamics Corp. of America**

Before the Supreme Court ruled on the constitutionality of control share
acquisition statutes in *CTS Corp. v. Dynamics Corp. of America*, every
lower court that faced these second generation statutes declared them un-
constitutional. Only the Wisconsin statute stood unchallenged. Each

137. *Id.* § 23-1-42-4(3)(A).
139. *Id.* § 23-1-42-4(3)(C).
140. This avoided the conflicts with the Williams Act found in the Missouri and Minnesota
statutes. *See supra* note 114 and accompanying text.
141. *See supra* note 96 and accompanying text.
142. *See supra* note 100 and accompanying text.
143. *See supra* notes 101-103 and accompanying text.
144. *See supra* notes 104-05 and accompanying text.
146. *Id.* at 399-400, 406.
147. *Id.* at 397.
148. *Id.* at 405-06.
149. *Dynamics Corp. of Am. v. CTS Corp.*, 794 F.2d 250 (7th Cir. 1986). For a discussion
on the potentially positive aspects of takeovers, see *id.* at 253-55.
150. *CTS Corp. v. Dynamics Corp. of Am.*, 107 S. Ct. 258, 93 L. Ed. 2d 17 (1986).
152. *See supra* text accompanying notes 106-50.
court applied the same basic reasoning in reaching its decision. Each court ruled that the excessive burdens on interstate commerce exceeded the local benefits of the statute.\textsuperscript{154} The majority of these decisions also held that the statutes caused unreasonable delay and frustrated the objectives of the Williams Act.\textsuperscript{155} Thereby violating the supremacy clause.\textsuperscript{156} Both lower courts in the CTS case followed this reasoning in analyzing the Indiana statute.\textsuperscript{157}

The Supreme Court shocked many with its analysis in reversing the decision of the lower courts in a six-to-three decision and declaring the Indiana statute valid.\textsuperscript{158} The Court concluded that the statute violated neither the supremacy clause nor the commerce clause.\textsuperscript{159} The Court decided that a company could comply with both the Williams Act and the Indiana statute.\textsuperscript{160} The Court further held that the Indiana statute did not frustrate the purposes of the Williams Act.\textsuperscript{161} The Court explained that the Indiana statute even passed the test of the plurality opinion in Edgar.\textsuperscript{162} The Court stated that the statute successfully placed current shareholders on an equal footing with the tender offeror, thereby furthering the purpose of the Williams Act.\textsuperscript{163} In addition, the Court expressed its opinion that the vesting of voting rights within fifty days did not present an unreasonable delay to the bidder.\textsuperscript{164}

The Court also declared that the statute satisfied the commerce clause by determining that the effect on interstate commerce would be remote, while the state’s interest in protecting shareholders would be great.\textsuperscript{165} The Court explained that since the statute had the same effect on tender offers whether the bidder was a nonresident or a resident, the statute did not violate the commerce clause.\textsuperscript{166} In addition, the Court concluded that the statute would not result in inconsistent regulation of tender offers by different states.\textsuperscript{167} The Court closed by expressing the view that even if the statute discouraged many bidders, the statute would still not violate the commerce clause because each bidder still had the opportunity to purchase shares in

\textsuperscript{154} The courts used the balancing test found in Pike v. Bruce Church, Inc., 397 U.S. 137, 142 (1970). For further discussion, see supra notes 40-41 and accompanying text.

\textsuperscript{155} See supra notes 9-11 and accompanying text.

\textsuperscript{156} See supra notes 34-37 and accompanying text.

\textsuperscript{157} See supra notes 145-49 and accompanying text.

\textsuperscript{158} See, Langevoort, supra note 43, at 110 (Court surprisingly failed to address the true intent of Indiana statute, protection of local managers and economy).

\textsuperscript{159} CTS Corp. v. Dynamics Corp. of Am., 107 S. Ct. 1637, 1652, 95 L. Ed. 2d 67, 88 (1987).

\textsuperscript{160} Id. at 1644, 95 L. Ed. 2d at 78.

\textsuperscript{161} Id.

\textsuperscript{162} Id. at 1645-47, 95 L. Ed. 2d at 80-83.

\textsuperscript{163} Id. at 1645-46, 95 L. Ed. 2d at 80. The Senate Report stated the intent of the Williams Act and expressed the purpose as "plac[ing] investors on an equal footing with the take-over bidder." Piper v. Chris-Craft Indus., 430 U.S. 1, 30 (1977) (quoting H.R. REP. No. 1711, 90th Cong., 2d Sess. 1 (1968), reprinted in 1968 U.S. CODE CONG. & ADMIN. NEWS 2811).

\textsuperscript{164} 107 S. Ct. at 1647, 95 L. Ed. 2d at 82.

\textsuperscript{165} Id. at 1652, 95 L. Ed. 2d at 88.

\textsuperscript{166} Id. at 1648-49, 95 L. Ed. 2d at 84.

\textsuperscript{167} Id. at 1649, 95 L. Ed. 2d at 84-85. The statute applies only to Indiana corporations, unless the corporation amends its articles of incorporation or bylaws to opt out of the statute. Id. at 1641, 95 L. Ed. 2d at 74.
Indiana corporations. 168

The dissenting opinion, written by Justice White, in which Justices Blackmun and Stevens joined, presented three arguments. 169 First, the statute prevented minority shareholders from selling their stock when in many cases selling would have been in their better interests. 170 Second, other states will follow Indiana's lead, which will substantially burden the interstate market. 171 Third, the statute violated the intent of the commerce clause by inhibiting interstate commerce. 172 As a result, the dissent argued that the Court should have declared the Indiana statute unconstitutional under both the supremacy clause and the commerce clause. 173

C. Third Generation Statutes

After the Supreme Court reversed the long trend of lower courts that invalidated second generation statutes, 174 several states amended their statutes to reflect the provisions of the Indiana statute. 175 Numerous other states took the Supreme Court's decision as a carte blanche invitation to create control share acquisition statutes. 176 A number of states enacted statutes that strongly resembled Indiana's statute. Statutes in Louisiana, Massachusetts, Minnesota, Missouri, Nevada, North Carolina, Oklahoma, and Utah all look like the Indiana statute. 177 Some of these statutes, however, reach

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168. Id. at 1652, 95 L. Ed. 2d at 88.
169. Id. at 1653-56, 95 L. Ed. 2d at 90-93.
170. Id. at 1654-55, 95 L. Ed. 2d at 90-92.
171. Id. Justice White states with regard to the impact of the Indiana statute, "The majority sees the trees but not the forest." Id. at 1655, 95 L. Ed. at 92.
172. Id. at 1655-56, 95 L. Ed. 2d at 92-93.
173. Id. at 1653-54, 95 L. Ed. 2d at 90.
174. Id. at 1652, 95 L. Ed. 2d at 88.
177. See supra notes 175-76.
beyond the scope of the Indiana statute.

In Nevada the statute applies to domestic corporations with two hundred or more shareholders when at least one hundred shareholders are residents of Nevada. The corporations must do business in Nevada directly or through an affiliated corporation. This minimum threshold test means that a corporation with one hundred thousand shareholders that only does business indirectly through an affiliated corporation and only has one hundred shareholders who are residents of Nevada would fall under the Nevada statute. As a result the Nevada statute would subject ninety-nine thousand, nine hundred nonresident shareholders to its provisions. These provisions do not ensure a significant percentage or number of resident shareholders and clearly exceed the provisions of the Indiana statute.

The North Carolina statute goes beyond the Indiana statute by subjecting foreign corporations to the provisions of the statute. The statute covers a foreign corporation if it has more than forty percent of its fixed assets located in the United States in North Carolina, and more than forty percent of the company's United States' employees are residents of North Carolina. In addition, the corporation must have five hundred or more shareholders, its principal place of business or principal office within North Carolina, and either ten percent of the shareholders residing in North Carolina or more than ten percent of its shares owned by residents of North Carolina. Furthermore, the North Carolina statute contains an inconsistent-regulation provision. If a foreign corporation organizes in any state whose law is expressly inconsistent with the North Carolina provisions, the North Carolina provisions yield to the extent necessary to resolve inconsistencies. The provisions still allow a foreign corporation whose state's law is silent on an area to be subject to North Carolina's statute.

In Minnesota the state legislature reacted to the plea of a local corporation that was the subject of a hostile takeover bid. The legislature responded by amending its existing control share acquisition statute. The amended

179. Id. § 78.3788(2).
180. See supra text accompanying notes 136-39.
182. Id. § 55-90(b)(5)(a)(i)(A).
183. Id. § 55-90(b)(5)(a)(ii)(B).
184. Id. § 55-90(b)(5)(b).
185. Id. § 55-90(b)(5)(c).
186. Id. § 55-90(b)(5)(d)(i).
187. Id. § 55-90(b)(5)(d)(ii).
188. Id. § 55-96.
190. Id. The Massachusetts statute also includes this inconsistent-regulation provision. MASS. ANN. LAWS. ch. 110E, § 6 (Law. Co-op. Supp. 1988).
statute follows Indiana’s model, but has one major provision that exceeds the Indiana statute. The Minnesota statute restricts for five years an acquirer’s right to sell the assets of an acquired company to pay takeover-related costs. This provision steps well beyond the Indiana statute. Other unique aspects of this statute include the prohibition of golden parachutes and greenmail. This statute also imposes a fiduciary duty on the directors to consider employees, customers, suppliers, the community, and the economy of the state.

The Oklahoma statute is almost identical to the Indiana statute. Ironically, however, this statute has received the first constitutional challenge to a third generation statute. In *TLX Acquisition Corp. v. Telex Corp.* a U.S. district court held the Oklahoma control share acquisition statute unconstitutional on commerce clause grounds. The plaintiff, TLX, initiated a tender offer to acquire majority interest in defendant Telex Corp., a Delaware corporation whose principal place of business was in Oklahoma.

The court distinguished *TLX* from the U.S. Supreme Court’s ruling in *CTS* by noting that the Indiana statute upheld in *CTS* applied only to Indiana corporations, whereas the Oklahoma statute potentially applied to foreign corporations as well as Oklahoma corporations. Under the Oklahoma statute, a tender offeror, such as TLX, making a bid for a company such as Telex, a Delaware corporation whose principal place of business was Oklahoma, has no idea which state law governs the voting rights of the target corporation. Accordingly, the *TLX* court ruled that the statute, as applied to foreign corporations such as Telex, violated the commerce clause due to its unacceptable risk of inconsistent regulations by the states. In addition, the district court held the statute in violation of the commerce clause because the benefits of protecting Oklahoma shareholders of Telex, between ten and twenty percent of Telex shareholders, did not exceed the burdens that the statute placed on the nonresident shareholders of a nonresident corporation. This case seems to indicate that in the future courts...
may lean toward a strict interpretation of the *CTS* decision in ruling on the constitutionality of other generation statutes.

The question remaining is whether the other third generation statutes, which exceed the bounds of the Indiana statute, pass the test of constitutionality. Challenges to these new control share acquisition statutes undoubtedly will occur. States will continue to press the courts on this issue and the conflict between the federal government and the states for priority of regulation will continue.

IV. **ANALYSIS AND PROPOSAL**

The validity and extent of state control share acquisition statutes remain unresolved. The two United States Supreme Court cases dealing with this area, *Edgar* 204 and *CTS*, 205 have provided guidance in how far states can go before their statutes conflict with federal laws. A gray area still exists, however, between the guidelines for constitutionality provided by these two cases. The Supreme Court has indicated that both the states and the federal government play a role in the regulation of corporate takeovers. 206 The problem centers on the absence of set standards for the states to follow to ensure consistency and constitutionality.

Defining the role that the states should play in regulating takeovers presents a similar dilemma. For many years the federal government regulated stock transactions through the Williams Act while the states regulated corporate bylaws and charters. This division of authority rests upon the practical observation that securities are bought and sold by and for people nationwide, not just by residents of the state where a corporation is organized. 207 The states’ regulation of the exchange of securities would result in fifty different sets of rules governing corporate acquisitions and would create utter chaos. States argue that their goal is shareholder protection, but their true intent appears to consist of upholding the states’ tax base and appeasing their constituents affected by successful bids (management of local corporations, employees, influential citizens benefiting from local companies’ presence). 208 This smokescreen provides the states a defense and avoids the real issue the courts should address: transfer of economic strength from local interests and the states’ right to impose legislation promoting protectionism. 209 States generally should continue to regulate the internal affairs of corporations chartered in their state. The one exception should be issues regarding a change in corporate control. 210 Because of their protectionist

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204. 457 U.S. 624 (1982).
206. *CTS*, 107 S. Ct. at 1644, 95 L. Ed. 2d at 78.
207. The Supreme Court demonstrated this concern regarding the role of the states in *Edgar*: “While protecting local investors is plainly a legitimate state objective, the State has no legitimate interest in protecting nonresident shareholders.” 457 U.S. at 644.
209. Id. at 117.
attitude, states negatively impact our free market system by regulating the market for corporate control.\textsuperscript{211} Federal legislators sit in a better position to provide a less biased approach than the states in the market for corporate control. The exchange of securities should remain the province of federal law to ensure consistency and fairness in the regulation of the national securities market.

In the recent Supreme Court decision in \textit{CTS} the majority failed to address adequately two basic concerns regarding control share acquisition statutes. First, the majority failed to consider fully the situation where an individual investor disagrees with the majority of shareholders who rejected a tender offer by refusing to grant voting rights.\textsuperscript{212} This investor may not sell his stock at a premium to the tender offeror if he now desires. The Supreme Court should address this fundamental problem at its next hearing of the issue. An individual shareholder has the opportunity to purchase ownership rights in a corporation by purchasing stock at an acceptable price. This same individual shareholder should be able to sell his stock when he desires.\textsuperscript{213} The majority apparently failed to consider this type of investor when it stated that the statute did not impose a significant burden on interstate commerce.\textsuperscript{214} As a basic proposition, states should not be allowed to design laws that prevent the free exchange of shares in a company.\textsuperscript{215} Scientific evidence clearly indicates that state takeover regulation negatively impacts the returns for both bidders and target firms' shareholders.\textsuperscript{216} Allowing states to protect incumbent management imposes a great loss on

\textsuperscript{211} See id.

\textsuperscript{212} In the dissenting opinion, Justice White stated, "The problem with the approach the majority adopts today is that it equates protection of individual investors, the focus of the Williams Act, with the protection of shareholders as a group." \textit{CTS}, 107 S. Ct. at 1654, 95 L. Ed. 2d at 90.

\textsuperscript{213} In his dissenting opinion in \textit{CTS}, Justice White articulated his concern for the individual investor's right to sell his stock as follows: "But it is clear to me that Indiana's scheme conflicts with the Williams Act's careful balance which was intended to protect individual investors and permit them to decide whether it is in their best interests to tender their stock." \textit{Id.} at 1654, 95 L. Ed. 2d at 91; see also Simmons, \textit{In defense of the 'corporate raider,'} Dallas Morning News, July 28, 1987, at 1D, col. 3, 13D, col. 2 (article represents view of corporate investor).

\textsuperscript{214} \textit{CTS}, 107 S. Ct. at 1649, 95 L. Ed. 2d at 85.

\textsuperscript{215} In \textit{CTS} the United States and the Securities and Exchange Commission joined as amicus curiae, and argued that the Indiana statute

[\textsl{I}s written as a restraint on the \textit{transferability} of voting rights in specified transactions, and it could not be written in any other way without changing its meaning. Since the restraint on the transfer of voting rights is a restraint on the transfer of shares, the Indiana Chapter, like the Illinois Chapter in \textit{MITE}, restrains "transfers of stock by stockholders to a third party."

107 S. Ct. at 1655, 95 L. Ed. 2d at 92 (White, J., dissenting) (emphasis in original). Justice White concurred with this view in the dissenting opinion. \textit{Id.}

216. Jensen & Ruback, \textit{The Market for Corporate Control: The Scientific Evidence}, 11 J. FIN. ECON. 5, 28 (1983). The evidence demonstrates that although both bidders and target shareholders receive positive abnormal returns as a result of a tender offer, offers subject to state takeover regulations produced less favorable returns than did offers not subject to the state regulations. \textit{Id.} In contrast, implementation of the Williams Act had a positive impact on the returns of target firm shareholders subject to a tender offer. \textit{Id.} For further discussion of the economic impact of takeover regulations, see Jarrell & Bradley, \textit{The Economic Effects of Federal and State Regulations of Cash Tender Offers}, 23 J. L. & ECON. 371 (1980).
the American public of its long standing principles of a free market system, and as a result our nation's economy suffers.²¹⁷

The second area the majority failed to consider involves the redemption provision contained in most of the control share statutes. In the Indiana statute the issuing public corporation may redeem stock that was purchased without subsequently filing an acquiring person statement if the tender offeror had not filed a statement within sixty days after the last acquisition of control shares.²¹⁸ In addition, the corporation may also redeem all control shares not given full voting rights by the shareholders.²¹⁹ In the eyes of investors, this provision constitutes private scrutiny of shareholders.²²⁰ To provide a corporation the right to prevent a shareholder from maintaining an ownership interest in the company when he has done absolutely nothing detrimental to the issuing corporation is clearly inequitable and again a violation of the free market system.

The only long-term solution to the applicability of these statutes requires legislation at the federal level that would supersede conflicting state takeover regulation. As Justice White emphasized in the dissenting opinion in CTS, numerous other states will follow Indiana's lead and create similar statutes, which will substantially burden the interstate market.²²¹ Allowing each state to create a unique set of standards for its corporations imposes an unreasonable burden on the investors. Congress must provide a uniform standard for the states to follow that clarifies the ambiguities in determining the balance between target management, the shareholder, and the bidder. Congress should amend the Williams Act to clarify its ambiguities in light of the recent takeover developments that Congress did not foresee when drafting the Act.²²²

The amended statute should provide more precise time and disclosure requirements while keeping in mind the original purpose of the Act, shareholder protection. The legislation should amend section 13(d) of the 1934

²¹⁷. See Jensen & Ruback, supra note 216, at 28. The evidence indicates that both bidders and targets receive positive abnormal returns as a result of a successful tender offer. Id. at 22. The study also suggests that target firms receive positive abnormal returns regardless of whether the tender offeror succeeds in his takeover bid as long as the target of an unsuccessful tender offer receives another tender offer within the following two years. Id. at 15-16. The study in general concludes that takeovers are value-creating transactions. Id. at 22.

²¹⁸. IND. CODE ANN. § 23-1-42-10(a) (Burns Supp. 1988). The issuing public corporation must, however, authorize redemption of control shares in its articles of incorporation or bylaws before occurrence of the control share acquisition. Id.

²¹⁹. Id. § 23-1-42-10(b).

²²⁰. Simmons, supra note 213, col. 2. The Indiana statute provides a redemption feature that "would sanction the private condemnation of stock." Id.

²²¹. 107 S. Ct. at 1654, 95 L. Ed. 2d at 90.

²²². Langevoort, supra note 43, at 113. Congress enacted the Williams Act in 1968. Takeover activity increased dramatically in the early 1970s and continued to increase through the 1980s. The Williams Act does not carry the sophistication necessary to cover the problems inherent in today's takeover activity. This result transfers to the courts the role of interpreting the intent of a general provision into specific situations. See Boyer, Federalism and Corporation Law: Drawing the Line in State Takeover Regulation, 47 OHIO ST. L.J. 1037, 1056-57 (1986); see also Steinberg, State Law Developments: Federal Preemption of State Antitakeover Statutes, 16 SEC. REG. L.J. 80 (1988) (advocates federal reemptions of state statutes).
Act by reducing from ten days to five days the time period within which the investor who has purchased more than five percent of the corporation's stock must report the acquisition through filings with the SEC, the issuer, and the securities exchanges. The amendment should require the purchaser to announce publicly through a national medium the acquisition within twenty-four hours of the acquisition. The public announcement should identify the purchaser, the number of shares acquired, and the nature of ownership (direct or indirect). The measure should direct the purchaser to file and publicly announce any material amendments to the original statement by the end of trading on the exchanges the following business day. These specific disclosure requirements would provide more relevant information to both the corporation's shareholders and management in a timely manner, while minimizing the imposition on the purchaser.

Congress also should amend the Williams Act to prohibit both green-mail\(^{223}\) and golden parachutes.\(^{224}\) In addition, Congress should authorize the SEC to impose appropriate civil penalties for violations of section 13(d) as they have under section 21(d) of the 1934 Act for insider trading violations.\(^{225}\) The measure also should require shareholder approval for implementation of defense mechanisms such as poison pill plans.\(^{226}\)

With regard to the role of the states, Congress should add a provision to the 1934 Act prohibiting certain restrictions on voting rights and the redemption provisions found in control share acquisition statutes. The additions should supersede conflicting state law regarding takeovers. The new section of the 1934 Act, section 36, might resemble the following:

Sec. 36. (a) The Congress declares that the continued regulation by the several States of matters involving the internal affairs of governance of corporations organized under the respective laws of such States is in the public interest, except when such affairs involve a potential change in control of the corporation. The internal affairs or governance of corporations shall be subject to regulation by the laws of the State under which each such corporation is organized, except when such regulations involve a potential change in control of the corporation.

(b) Subject to SEC Rule 19c-4,\(^{227}\) issuers of securities registered pursuant to section 12 of this Act shall not restrict or nullify the voting rights of unaffiliated holders of common shares of the issuer in any way.

(c) Redemption of common shares of securities by the issuing corporation is prohibited, unless agreed to by both the beneficial owner of the common shares and the issuing corporation.

\(^{223}\) See supra note 196.

\(^{224}\) See supra note 195.


\(^{226}\) For a discussion of poison pill defenses, see Herzel & Shapiro, The Changing Fortunes of Takeover Defenses, 15 SEC. REG. L.J. 116, 121-29 (1987); see also Anti-Takeover moves face new challenges, Dallas Times Herald, June 26, 1988, § D (Business), at 1, col. 3 (institutional investors and legislators advocate shareholder approval requirement for rights plan).

\(^{227}\) See Exchange Act Release Nos. 25891 & 25891A, Fed. Sec. L. Rep. (CCH) ¶ 84, 247, at 89,208 (July 7 & 13, 1988) (rule prohibits issuers from taking action which nullifies, restricts, or disparately reduces per share voting rights of common stock shareholders). This rule is commonly referred to as the one-share, one-vote rule.
(d) Any provisions contained in this section, or sections 13 or 14 of this Act or any rules or regulations thereunder shall invalidate and supersede any conflicting law enacted by any State regulating the market for corporate control.228

By implementing the foregoing proposal, courts would not have to continue evaluating the constitutionality of each and every state control share acquisition statute that appears. Specific federal legislation promoting free transferability of shares, while ensuring adequate disclosure, will eliminate confusion and ambiguity for the shareholder, incumbent management, and the bidder.

V. CONCLUSION

Corporate takeovers have become an integral part of our nation’s economy. Investors on both sides typically reap large profits. Entrenched management stands as the only loser. As a result, managements of large corporations persuade state legislatures to establish roadblocks in the form of takeover legislation. The most recent wave of legislation restricts the voting rights of an investor who purchases a significant percentage of the corporation’s voting shares unless the investor receives a majority of the shareholders’ approval. Many of the statutes restrict the free transferability of share ownership and provide for redemption of the issuing corporation’s stock. Congress should create legislation designed to clarify ambiguities in the Williams Act and to promote enforcement of the commerce clause. Implementation of federal legislation would provide a uniform standard under which investors, management, and bidders could operate fairly and effectively.
