COMMENTS

THE CONSTITUTIONALITY OF THE DELAWARE ANTI-TAKEOVER STATUTE

C. WILLIAM BAXLEY*

INTRODUCTION

Since the passage of the Williams Act,[1] the proper role of the States in regulating corporate takeovers[2] has been the subject of considerable judicial and scholarly debate.[3] Initially, the United States Supreme Court appeared hostile toward state anti-takeover legislation. In 1982, the Court invalidated on Commerce Clause[4] grounds an Illinois statute that directly regulated the tender offer process.[5] More recently, however, the Court has demonstrated a willingness to approve such laws. In *CTS Corp. v. Dynamics Corp. of America*,[6] the Court held that the

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* B.S., University of Alabama, 1986; J.D., Harvard Law School, 1989. Mr. Baxley is an associate at the law firm of King & Spalding in Atlanta, Georgia. He would like to thank Assistant Professor David Charny of the Harvard Law School for his comments on an earlier version of this article.

1. 15 U.S.C. §§ 78m(d)-(e), 78n(d)-(f) (1982). The Williams Act was enacted in two stages in 1968 and 1970 and has been incorporated into the Securities Exchange Act of 1934 at §§ 13(d)-(e), 14(d)-(f).

2. Throughout this Comment, the words "corporate" and "corporation" refer only to public corporations registered under the Securities Act of 1933, and the word "takeover" refers only to takeovers attempted or achieved by means of a tender offer. The constitutionality of state anti-takeover laws (vis-a-vis the Williams Act) is relevant only in this context. States presumably have unbridled discretion to regulate the takeover process as it relates to closely held corporations; at least their discretion in that area remains unaffected by the developments discussed in this Comment.

3. The commentary on both the wisdom and the constitutionality of state statutes regulating the tender offer process has been voluminous. *See, e.g.*, Booth, *The Promise of State Takeover Statutes*, 86 MICH. L. REV. 1635 (1988); Langevoort, *State Tender Offer Legislation: Interests, Effects, and Political Competency*, 62 CORNELL L. REV. 213 (1977); Pinto, *Takeover Statutes: The Dormant Commerce Clause and State Corporate Law*, 41 U. MIAMI L. REV. 473 (1987); Profusek & Gompf, *State Takeover Legislation After MITE: Standing Pat, Blue Sky, or Corporation Law Concepts?*, 7 CORP. L. REV. 3 (1984); Sargent, *Do the Second Generation State Takeover Statutes Violate the Commerce Clause?*, 8 CORP. L. REV. 3 (1985); Shipman, *Some Thoughts About the Role of State Takeover Legislation: The Ohio Takeover Act*, 21 CASE W. RES. L. REV. 722 (1970).

4. U.S. CONST. art. I, § 8, cl. 3 ("The Congress shall have Power . . . To regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes."). Not only does the Commerce Clause operate as an affirmative grant of power to the Congress, but it also limits the States' ability to regulate in ways that impact upon interstate commerce. This latter notion is known as the dormant Commerce Clause doctrine. *See* L. TRIBE, AMERICAN CONSTITUTIONAL LAW § 6-2, at 403 (2d ed. 1988).

5. *See* Edgar v. MITE Corp., 457 U.S. 624 (1982).

6. 481 U.S. 69 (1987).

States may regulate in certain ways the rights of an offeror once that offeror obtains a portion of the target corporation's shares. The *CTS* Court upheld against both Commerce Clause and Supremacy Clause[7] challenges an Indiana statute which denies a potential acquirer the right to vote certain of his shares unless that right is affirmatively granted by a majority of the target's disinterested shareholders.

Given the prominent role that Delaware plays in corporate law,[8] the business and legal communities waited eagerly to see if and how the Delaware General Assembly would respond to the *CTS* decision.[9] Delaware remained conspicuously absent from the group of states that adopted anti-takeover statutes immediately after *CTS*,[10] but on February 2, 1988, the state followed suit when its governor signed into law Section 203 of the Delaware General Corporation Law.[11] Within four months of the law's enactment, Delaware's federal district court was asked to address the statute's constitutionality in two separate cases.[12] In both cases, the court affirmed the statute's validity,

7. U.S. CONST. art. VI, cl. 2 ("This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.").

A state law will be preempted under the Supremacy Clause under four circumstances: (1) Congress has expressly precluded the states from regulating in the area, (2) the Congressional scheme is so pervasive that it occupies the entire field of regulation, (3) the state law conflicts directly with the federal statute, or (4) the state law frustrates the purposes of the federal statute. *See* Pacific Gas & Elec. Co. v. State Energy Resources Conservation & Dev. Comm'n, 461 U.S. 190, 203-04 (1983).

8. Presently, more than 180,000 corporations are chartered in Delaware, including more than half of the Fortune 500 corporations. *See* Veasey, Finkelstein & Shaughnessy, *The Delaware Takeover Law: Some Issues, Strategies, and Comparisons*, 43 BUS. LAW. 865, 866 (1988).

9. *See, e.g.*, *Will Delaware Fall?*, Wall St. J., Dec. 3, 1987, at 30, col. 1; *Ebb in Takeovers Foreseen*, N.Y. Times, Apr. 23, 1987, at D1, col. 3.

10. *See Delaware Fails to Adopt Law on Takeovers*, Wall St. J., June 16, 1987, at 2, col. 2. During the four months immediately following the *CTS* decision, at least eight states adopted anti-takeover statutes. *See, e.g.*, ARIZ. REV. STAT. ANN. § 10-1211 (Supp. 1988) (effective July 22, 1987); FLA. STAT. ANN. § 607.109 (West 1988) (effective July 2, 1987); LA. REV. STAT. ANN. §§ 12:135-:140.2 (West Supp. 1988) (effective June 11, 1987); MASS. GEN. LAWS ANN. chs. 110D, 110E (West Supp. 1988) (effective July 21, 1987); MINN. STAT. ANN. § 302A.671 (West 1988) (effective June 1, 1987); NEV. REV. STAT. ANN. §§ 78.378-78.3793 (Supp. 1988) (effective July 1, 1987); N.C. GEN. STAT. §§ 55-90 to 55-98 (Supp. 1988) (effective August 12, 1987); UTAH CODE ANN. §§ 61-6-1 to 66-6-12 (Supp. 1988) (effective May 29, 1987).

11. DEL. CODE ANN. tit. 8, § 203 (1988). The statute, termed a "business combination statute," consciously parallels the anti-takeover statutes enacted earlier in New York and New Jersey. *See* N.Y. BUS. CORP. LAW § 912 (McKinney 1986); N.J. STAT. ANN. § 14A:10A (West 1987).

12. *See* BNS Inc. v. Koppers Co., Inc., 683 F. Supp. 458 (D. Del. 1988) (decided April

rejecting claims that it violated the Commerce and Supremacy Clauses.

This Comment appraises the constitutionality of the Delaware anti-takeover statute under the framework developed by the Supreme Court in *CTS*. Although not in complete agreement with the reasoning of the Delaware cases, this Comment argues that those judges were correct in finding the Delaware statute constitutional. Part I of this Comment briefly describes the Supreme Court's invalidation of the Illinois anti-takeover statute in *Edgar v. MITE Corp.*.[13] It then examines the Court's apparent about-face in *CTS*. Part II discusses the mechanics of the recently enacted Delaware statute and the Delaware district court decisions that ruled on its constitutionality. Part III applies the Commerce Clause analysis developed in *CTS* to the Delaware statute, and Part IV applies the Court's Supremacy Clause analysis to the statute.

I. The Decline and Rebirth of Anti-Takeover Statutes

A. *Edgar v. MITE Corporation*

One can fully understand the Supreme Court's decision in *CTS* only after examining the Court's earlier invalidation of the Illinois anti-takeover statute in *Edgar v. MITE Corp.* In *MITE*, the Court struck down on Commerce Clause grounds a statute that directly regulated the tender offer process.[14] The statute required that an offeror register with the Illinois Secretary of State[15] and subjected the terms of the offer to the possibility of a fairness review by that office.[16] Relying on *Pike v. Bruce Church, Inc.*,[17] the Court concluded that the statute excessively burdened commerce: It deprived shareholders of the ability to sell their shares at a premium, discouraged the reallocation of re-

1, 1988); RP Acquisition Corp. v. Staley Continental, Inc., 686 F. Supp. 476 (D. Del. 1988) (decided May 9, 1988). More recently, the Delaware district court reached the same conclusion in a third case on the basis of a more fully developed evidentiary record. *See* City Capital Associates Ltd. Partnership v. Interco, Inc., 696 F. Supp. 1551 (D. Del. 1988) (decided September 23, 1988), *aff'd on other grounds*, 860 F.2d 60 (3d Cir. 1988).

13. 457 U.S. 624.

14. *See* Illinois Business Take-over Act, Ill. Rev. Stat. ch. 121 1/2, para. 137.51-.70 (1979), *repealed by* 1983 Ill. Laws 365, § 1.

15. *See id.* para. 137.54.

16. *See id.* para. 137.57.

17. 397 U.S. 137, 142 (1970) (declaring that the burden a state statute imposes upon commerce must not outweigh the "putative local benefits" it serves).

sources to higher uses, and reduced the incentive for target management to perform well.[18] These harms, the Court found, were exacerbated by the fact that the statute affected the interests of both resident *and nonresident* shareholders, and the state had no legitimate interest in legislating the rights of nonresidents.[19]

Specifically, the Court found three attributes of the Illinois statute offensive. First, like the Williams Act, the Illinois statute directly regulated the tender offer process and, thereby, commerce itself.[20] Second, the statute potentially applied to corporations that were not incorporated in Illinois.[21] Finally, the statute provided for the administrative review of a tender offer's fairness.[22] Not only might such review delay the offer beyond the time limits prescribed in the Williams Act, but the Secretary of State was granted unilateral authority to terminate the offer if he found that the offer was misleading or unfair.[23]

Speaking for a plurality of three, Justice White claimed that the Illinois statute also violated the Supremacy Clause.[24] Justice White argued that Congress had intended the Williams Act to establish a careful balance between offerors and target management and to ensure that shareholders were free to choose

18. *See* 457 U.S. at 643. Justice White wrote for the Court and was joined in the essential Commerce Clause portion of his opinion (Part V-B) by Chief Justice Burger and Justices O'Connor, Powell, and Stevens. Justices Powell and Stevens submitted separate concurrences; Justice Marshall dissented in an opinion joined by Justice Brennan; and Justice Rehnquist submitted a separate dissent.

19. *See id.* at 644.

20. *See id.* at 640.

21. *See id.* at 645. The statute applied to target companies of which Illinois shareholders owned ten percent of the securities subject to the offer as well as to target companies for which two of the following three conditions were satisfied: (1) the company's principal executive office was in Illinois, (2) the company was chartered in Illinois, and (3) ten percent of the company's stated capital and paid-in surplus were owned by Illinois shareholders. *See id.* at 627 (summarizing Illinois statute).

22. *See id.* at 643. The statute authorized the Secretary of State to call an administrative hearing if he believed that one was necessary to protect the target company's shareholders, and it *required* him to call such a hearing if one was requested by more than one half of the target's outside directors or by Illinois shareholders owning more than ten percent of the securities subject to the offer. *See id.* at 627 (summarizing Illinois statute).

23. *See id.* at 627. Specifically, the Secretary of State was authorized to deny registration to any offer if he found 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.' " *Id.* (quoting ILL. REV. STAT. ch. 121 1/2, para. 137.57.E).

24. *See id.* at 630-40 (Parts III-IV) (plurality opinion). For the portion of his opinion that discussed the Supremacy Clause, Justice White was joined only by Chief Justice Burger and Justice Blackmun.

whether to tender their shares.[25] The Illinois statute, Justice White contended, was inconsistent with these goals because it tipped the balance in favor of target management[26] and because it interfered with shareholder autonomy.[27]

Although some authorities contended that *MITE* "sounded the death knell" for state anti-takeover statutes,[28] many state legislatures remained steadfast in their desire to regulate the takeover process. Instead of abandoning efforts to regulate the rights and duties of tender offerors, these legislatures drafted statutes designed to conform to the constitutional requirements of *MITE*.[29] Such "second-generation" anti-takeover stat-

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25. *See id.* at 633-34 (plurality opinion).

26. *See id.* at 634-35 (plurality opinion). In support of this point, Justice White noted that the Illinois statute required the offeror to notify both the state and target management of its offer twenty days before the offer became effective. During this twenty-day period, target management was permitted to communicate with shareholders with respect to the offer, but the offeror was prohibited from such communication. Justices Powell and Stevens explicitly rejected the conclusion that the Illinois statute tipped the balance in favor of target management. *See id.* at 646-47 (Powell, J., concurring); *id.* at 655 (Stevens, J., concurring).

27. *See id.* at 630-40 (plurality opinion).

28. Fleet Aerospace Corp. v. Holderman, 637 F. Supp. 742, 744 (E.D. Ohio 1986), *aff'd* 796 F.2d 135 (6th Cir. 1986), *vacated sub nom.* Ohio v. Fleet Aerospace Corp., 481 U.S. 1026 (1987), *remanded sub nom.* Fleet Aerospace Corp. v. Holderman, 848 F.2d 720 (6th Cir. 1988) (quoting Kreider, *Fortress Without Foundation? Ohio Takeover Act II*, 52 U. CIN. L. REV. 108, 108 (1983)).

29. For an expansive list of states that have adopted second-generation statutes, see Veasey, Finkelstein & Shaughnessy, *supra* note 8, at 876-79 & nn.42, 44, 46, & 48. The following summary of information is largely borrowed from them:

> The second generation statutes have taken four forms. Under control share acquisition statutes, an offeror is prohibited from exercising the voting rights of his "control shares" unless approval is received from the target's shareholders. *See, e.g.*, HAW. REV. STAT. §§ 416-171 to -172 (1985); IND. CODE ANN. §§ 23-1-22-4, 23-1-42-1 (Burns Supp. 1986); MINN. STAT. ANN. § 302A.671 (West 1985 & Supp. 1987); MO. ANN. STAT. § 351.407 (Vernon Supp. 1987); OHIO REV. CODE ANN. § 1701.01 (Anderson 1985); WIS. STAT. ANN. § 180.25 (West Supp. 1986). "Fair price" statutes generally require the bidder to pay to the back-end shareholders an amount equal to the price the bidder paid for the initial shares. *See, e.g.*, CONN. GEN. STAT. ANN. §§ 33-374a to -374c (West Supp. 1986); GA. CODE ANN. §§ 14-2-1101 (Supp. 1988); MD. CORPS. & ASS'NS CODE ANN. §§ 3-601 to -603 (1985 & Supp. 1986); VA. CODE ANN. §§ 13.1-726 to -728 (1986). "Business combination" statutes, of which Delaware's is one, prevent an offeror from effecting certain transactions with the target, including a merger, unless approval is received from the board of directors or the shareholders of the target. *See, e.g.*, GA. CODE ANN. §§ 14-2-1131 (Supp. 1988); IND. CODE ANN. § 23-1-43 (Burns 1987); N.Y. BUS. CORP. LAW § 912 (McKinney 1986); N.J. STAT. ANN. § 14A:10A (West 1987). Finally, "cash out" statutes require a successful bidder to purchase at fair market value the shares of any dissenting shareholder if that shareholder requests. *See, e.g.*, ME. REV. STAT. ANN. tit. 13-A, § 910 (1987); PA. STAT. ANN. tit. 15, § 1910 (Purdon Supp. 1986); UTAH CODE ANN. § 16-10-76.5 (1987). For a further discussion of the second generation statutes, see Block, Barton & Roth, *State Takeover Statutes: The "Second Generation"*, 13 SEC. REG. L.J. 332 (1986); Sar-

utes do not regulate the market for corporate control a priori; instead, the statutes are limited to prescribing the rights of shareholders who seek to enlarge their interests. Most often, these statutes apply only to corporations chartered in the regulating state. These statutes also contain no provision for administrative review by state officials.[30] Despite these limitations, lower courts after *MITE* almost uniformly held these statutes unconstitutional on either Commerce Clause or Supremacy Clause grounds, or both.[31]

B. *CTS Corporation v. Dynamics Corporation of America*[32]

The Indiana Control Share Acquisition Statute[33] that was at issue in *CTS* is one such second-generation statute. Instead of directly regulating the tender offer process, the Indiana statute restricts the voting rights of shareholders interested in acquiring Indiana corporations.[34] Whenever a would-be acquirer reaches a specified ownership threshold,[35] he loses the ability to vote the shares above that threshold unless a simple majority of the disinterested shareholders of each class of the target's stock explicitly vote to grant him that right.[36] If the would-be acquirer files an "acquiring person statement," this vote must

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gent, *supra* note 3, at 8-12; Note, *CTS Corp. v. Dynamics Corp. of America: A State's Right to Tend to Its Tender Offers*, 37 AM. U.L. REV. 947, 962 (1988) [hereinafter Note, *Tender Offers*]; Note, *The Constitutionality of Second Generation Takeover Statutes*, 73 VA. L. REV. 203, 207-08 (1987) [hereinafter Note, *Second Generation Takeover Statutes*].

30. *See* Sargent, *supra* note 3, at 8-12 (describing state responses to *MITE*); Note, *Second Generation Takeover Statutes*, *supra* note 29, at 207-08.

31. *See, e.g.*, *Fleet Aerospace Corp.*, 637 F. Supp. 742; Dynamics Corp. of Am. v. CTS Corp., 794 F.2d 250 (7th Cir. 1986), *rev'd*, 481 U.S. 69 (1987); Gelco Corp. v. Coniston Partners, 652 F. Supp. 829 (D. Minn. 1986), *aff'd in part and vacated in part*, 811 F.2d 414 (8th Cir. 1987); Terry v. Yamashita, 643 F. Supp. 161 (D. Haw. 1986); APL Ltd. Partnership v. Van Dusen Air, Inc., 622 F. Supp. 1216 (D. Minn. 1985); Icahn v. Blunt, 612 F. Supp. 1400 (W.D. Mo. 1985).

32. For an excellent analysis of the *CTS* decision, see Langevoort, *The Supreme Court and the Politics of Corporate Takeovers: A Comment on CTS Corp. v. Dynamics Corp. of America*, 101 HARV. L. REV. 96 (1987).

33. IND. CODE ANN. § 23-1-42-1 to 11 (Burns 1988); *see supra* note 29 (describing the four prevailing types of anti-takeover laws, of which "control share acquisition statutes" are one).

34. *See* IND. CODE ANN. § 23-1-42-4(a); *CTS Corp.*, 481 U.S. at 73. The statute applies only to corporations chartered in Indiana that have (1) one hundred or more shareholders, (2) their principal place of business, principal office, or substantial assets within Indiana, and (3) a minimum of either ten percent or ten thousand of their shareholders residing in Indiana.

35. *See* IND. CODE ANN. § 23-1-42-1; *CTS Corp.*, 481 U.S. at 73. These thresholds are 20%, 33.3%, and 50%.

36. *See* IND. CODE ANN. § 23-1-42-9.

take place within fifty days of the acquisition date of the threshold shares.[37] If the target's shareholders fail to approve the voting power of the threshold shares, the target corporation may redeem the would-be acquirer's shares at their fair market value, with or without that shareholder's consent.[38]

At issue in *CTS* was an attempt by the management of an electronic products manufacturing firm, CTS Corporation, to rebuff the hostile advances of a diversified conglomerate, Dynamics Corporation of America. On March 27, 1986, just two weeks after Dynamics announced a tender offer for CTS Corporation's stock, the directors of CTS elected to be governed by the Indiana statute. Dynamics immediately sought to enjoin application of the statute, contending that it violated the Commerce Clause and was preempted by the Williams Act. The district court agreed with Dynamics's contentions,[39] and in an opinion by Judge Posner, the Seventh Circuit affirmed.[40]

The Supreme Court, however, reversed, applying an analysis that sharply contrasts with the Court's analysis in *MITE*.[41] In *MITE*, the Court's focus was on the commercial value of an unimpeded market for corporate control. The Court relied heavily on the law and economics literature of the time,[42] emphasizing the benefits that takeovers provide shareholders and the economy as a whole.[43] The emphasis in *CTS* is quite different. Instead of focusing on the benefits of takeovers, the Court emphasized the legitimate interest[44] that states have in

37. *See id.* §§ 23-1-42-6, -7.

38. *See id.* § 23-1-42-10; *CTS Corp.*, 481 U.S. at 75.

39. *See* Dynamics Corp. of Am. v. CTS Corp., 637 F. Supp. 389 (N.D. Ill. 1986).

40. *See* Dynamics Corp. of Am. v. CTS Corp., 794 F.2d 250 (7th Cir. 1986).

41. *See* Langevoort, *supra* note 32, at 97 (noting the Court's change in perspective).

42. *See, e.g.*, Easterbrook & Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161 (1981), *cited with approval in MITE Corp.*, 457 U.S. at 643-44; Fischel, *Efficient Capital Market Theory, the Market for Corporate Control, and the Regulation of Cash Tender Offers*, 57 TEX. L. REV. 1 (1978) (same).

43. *See MITE Corp.*, 457 U.S. at 643-44.

44. One can conceive of four state interests that are served by the enactment of anti-takeover legislation, all of which are clearly "legitimate" from a political if not from a macroeconomic standpoint: (1) to protect local jobs from dislocation and elimination, which often follow a successful takeover, (2) to curry favor with managements already in place, which presumably possess the power to move operations or to divert expansion plans elsewhere, (3) to attract new and foreign corporations with the prospect of managerial job security, and (4) to preserve the state's tax base. To assume that the underlying purpose behind anti-takeover legislation is to protect such in-state interests is neither to assume too much nor to suggest an improper motive on the part of state legislatures. After all, a state can and should *only* enact legislation that promotes domestic interests.

regulating the rights of their corporations' shareholders.[45]

Justice Powell, writing for a majority of six,[46] first analyzed the Indiana statute under the Supremacy Clause. Recognizing that tender offerors can simultaneously comply with the literal terms of both the Williams Act and the Indiana statute, Justice Powell concluded that only one question arose under the Supremacy Clause: Does the statute frustrate the *purposes* of the Williams Act?[47] Although specifically refusing to adopt the preemption analysis set forth by the plurality in *MITE*, Justice Powell explained that the Indiana statute would nevertheless withstand scrutiny under even that "broad interpretation of the Williams Act."[48] According to Justice Powell, the requirement that disinterested shareholders must, in effect, grant the acquirer his voting rights is consistent with the purposes of the Williams Act because it promotes the Act's goal of enabling shareholders to evaluate, without pressure, the fairness of offers and thus " 'places investors on an equal footing with the takeover bidder.' "[49] In this context, the Court noted that the Williams Act permits a tender offer to be conditioned upon ap-

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45. *See CTS Corp.*, 481 U.S. at 89-93.

46. Justice Powell's opinion was joined in its entirety by Chief Justice Rehnquist and Justices Brennan, Marshall, and O'Connor. Justice Scalia joined in what he regarded as the essence of the opinion but submitted a separate concurrence to criticize the *Pike* balancing test, which he regarded as unneccesary to the holding and jurisprudentially flawed. *See supra* note 17 and accompanying text. Justice White dissented in an opinion joined partially by Justice Blackmun and wholly by Justice Stevens.

47. *See CTS Corp.*, 481 U.S. at 79.

48. *See id.* at 81.

49. *Id.* at 82 (quoting the Senate Report accompanying the Williams Act, S. REP. NO. 550, 90th Cong., 1st Sess. 4 (1967), *quoted in* Piper v. Chris-Craft Indus., 430 U.S. 1, 30 (1977)).

It is instructive to note that there are two potential constitutional arguments here that the parties did not raise and that the Court did not address. The first is a takings argument, and the second is an equal protection argument. *See* U.S. CONST. amend. V ("No person shall . . . be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation."); *id.* amend. XIV, § 1 ("No State shall . . . deny to any person within its jurisdiction the equal protection of the laws.").

The first argument is that the Indiana statute deprives "interested stockholders" of voting control without due process or just compensation. Presumably, however, the conditioning of voting control on minority shareholder approval does *not* violate the Takings Clause because shareholder rights only exist by virtue of (and as defined by) state corporation codes in the first place. The state is not taking away a property right; it is further defining a right that it, after all, created. State incorporation codes typically reserve the right of the incorporating state to alter and amend the powers of its corporations in explicit terms. *See, e.g.*, DEL. CODE ANN. tit. 8, § 394 (1988) ("This chapter may be amended or repealed, at the pleasure of the General Assembly . . . . This chapter and all amendments thereof shall be a part of the charter or certificate of incorporation of every corporation except so far as the same are inapplicable and inappropriate to the objects of the corporation."); R.I. GEN. LAWS § 7-1-13 (1988) ("The charter or

proval by a majority of the target's disinterested shareholders. The Court also found that the fifty-day waiting period provided by the statute for the shareholder vote does not conflict with the twenty-business-day period established by the Williams Act as the minimum period for which a tender offer may be held open. Even if the Indiana statute imposes some additional delay, the Court concluded, that delay is neither unreasonable nor inconsistent with the requirements of the federal Act.[50]

The Court also expressed concern over the idea of interpreting the Williams Act to preempt any state statute that limits the power of acquiring shareholders. Such an interpretation, Justice Powell contended, "would pre-empt a variety of state corporate laws of hitherto unquestioned validity."[51] In particular, the Court pointed out that undeniably constitutional state laws which stagger the terms of directors may prevent an acquirer from obtaining control of the target's board for a significant period of time and that state laws that provide for cumulative voting often dilute the power of an acquirer.[52] The Court concluded 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 done so explicitly."[53]

Turning to the Commerce Clause, the Court indicated that it would invalidate any state statute that (a) discriminates against interstate commerce or (b) poses a risk of inconsistent[54] state

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articles of association of every corporation hereafter created may be amended or repealed at the will of the general assembly.").

The second argument is that the Indiana statute violates the Equal Protection Clause because the denial of voting rights to interested stockholders results in unequal treatment. Such a one-share, one-vote argument has intuitive appeal, but it has difficulty overcoming two facts. First, the same argument still applies and cuts the other way in the absence of the Indiana statute: Unequal treatment results when shareholders with fifty-one-percent ownership can exercise one-hundred-percent control. Second, one can simply attribute the suspension of voting control to a change in the nature of the investment: Once a party achieves a certain ownership threshold, state law presumes that that party is no longer investing in the current earnings stream but seeking control; the state is telling that party that it has a new investment governed by new rules.

50. *See id.* at 85 (pointing out that the fifty-day waiting period under the Indiana statute is still less than the sixty-day maximum period that Congress provided for the completion of a tender offer under the Williams Act).

51. *Id.*

52. *See id.* at 86.

53. *Id.* Whether Congress even *could* preempt all state statutes that delay the acquisition of voting control is itself an open question that Justice Powell did not address. If stockholder voting rights only exist by virtue of having been granted under state law, then presumably the states that grant those rights can define the nature of their grant. The greater power must subsume the lesser.

54. When speaking of "inconsistent" state regulation, the Supreme Court appar-

regulation. The Court, however, held that the Indiana statute does not discriminate against interstate commerce because it applies equally to in-state and out-of-state offerors.[55] The Court also rejected the argument that the Indiana statute poses a risk of inconsistent regulation:[56] "So long as each State regulates voting rights only in the corporations it has created, each corporation will be subject to the law of only one State."[57] Finally, the Court criticized the Seventh Circuit's conclusion that the statute violated the Commerce Clause because it hinders tender offers. The Court found that this conclusion ignores the traditional authority of the States to define the rights of shareholders:

> The very commodity that is traded in the securities market is one whose characteristics are defined by 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.[58]

Therefore, even if the Indiana statute does result in a decrease in the number of successful tender offers for Indiana corporations, the Court concluded that it does not violate the Commerce Clause.[59]

II. THE DELAWARE BUSINESS COMBINATION STATUTE

A. *The Statute Itself*[60]

Although the Delaware General Assembly passed a "first-generation" anti-takeover statute in the 1970s, that law was later repealed under the understanding that it would be adjudicated unconstitutional if ever challenged,[61] and Delaware re-

ently meant (and I mean) "mutually contradictory" regulation, such that the laws of two or more states apply but simultaneous observance is a legal impossibility: Adherence to the terms of one state's laws necessarily results in the violation of another's. The term is not meant to encompass laws that are merely *philosophically* incompatible. *See CTS Corp.*, 481 U.S. at 88-89.

55. *See id.* at 87-88.

56. *See id.* at 88-89.

57. *Id.* at 89.

58. *Id.* at 94.

59. *See id.*

60. For a more detailed discussion of the mechanics of the Delaware Business Combination Statute, see C. SMITH & C. FURLOW, GUIDE TO THE TAKEOVER LAW OF DELAWARE 17-84 (1988); Finkelstein, *The New Delaware Takeover Statute*, 21 REV. SEC. & COMMODITIES REG. 47 (1988); Veasey, Finkelstein & Shaughnessy, *supra* note 8, at 868-75; *see also* BNS Inc. v. Koppers Co., Inc., 683 F. Supp. 458, 464-66 (D. Del. 1988) (discussing the operation of the Delaware statute).

61. 60 Del. Laws 371, § 1 (1975); 63 Del. Laws 25, §§ 2,3 (1981), *codified at* DEL.

mained noticeably absent from the group of states that revised their anti-takeover statutes to conform to the constitutional mandates of *MITE*. According to one commentator, Delaware was reluctant to pass such legislation because of constitutional concerns and because of the concern that anti-takeover provisions do not fit well into statutes dealing with corporate governance.[62] Nonetheless, in an action that drew wide attention,[63] Delaware's second anti-takeover statute[64] was signed into law on February 2, 1988, with the avowed purpose of protecting shareholders from "well documented and judicially recognized" abusive takeover tactics.[65]

Enacted as Section 203 of the Delaware General Corporation Law, the new statute is a business combination statute. Like the control share acquisition statute at issue in *CTS* and other second-generation statutes, the Delaware statute does not regulate the tender offer process directly. The statute does not proscribe the acquisition of a corporation's shares through a tender offer or otherwise. Instead, it regulates the ability of an offeror to engage in certain transactions with the target once that offeror obtains a certain portion of the target's shares.[66] Also, like the Indiana statute, Section 203 is limited to corporations formed under the laws of the state. The Delaware statute, unlike the Indiana statute, applies to corporations chartered in the state that neither have their principal place of business in Delaware nor have a substantial number of shareholders residing in the state.[67]

The provisions defining the applicability of the statute are quite intricate.[68] Delaware corporations that have a class of voting stock that is either traded on a national securities exchange, quoted on an electronic system such as NASDAQ, or held of

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CODE ANN. tit. 8, § 203, *repealed by* 66 Del. Laws 136, § 6 (1987); *see* Loral Corp. v. Sanders Assocs., 639 F. Supp. 639 (D. Del. 1986) (discussing the apparent unconstitutionality of Delaware's first anti-takeover statute).

62. *See* Black, *Why Delaware Is Wary of Anti-Takeover Law*, Wall St. J., July 10, 1987, at 18, col. 3.

63. *See* Bandow, *Curbing Raiders Is Bad for Business*, N.Y. Times, Feb. 7, 1988, § 3, at 2, col. 3; Veasey, *A Statute Was Needed to Stop the Abuses*, N.Y. Times, Feb. 7, 1988, § 3, at 2, col. 3; Labaton, *A Debate Over the Impact of Delaware Takeover Laws*, N.Y. Times, Feb. 1, 1988, § D, at 1, col. 1.

64. 66 Del. Laws 204, § 203, *codified at* DEL. CODE ANN. tit. 8, § 203 (West Supp. 1988).

65. DEL. CODE ANN. tit. 8, § 203 (Legislative Synopsis).

66. *See id.* § 203(a).

67. *See id.*

68. *See id.* § 203(b).

record by at least two thousand shareholders[69] are subject to the statute unless they take affirmative steps to remove themselves from its coverage.[70] The statute provides two methods for such removal.[71] First, the statute will not apply to a corporation that places in its original charter a provision opting out of the statute. Second, the statute permits a corporation to remove itself from coverage if a majority of the shareholders vote to amend the articles or the by-laws to opt out.[72] If the corporation chooses this second course of action, the opt-out will not become effective for twelve months and will not be applicable to any person who was an "interested stockholder" at or prior to the time of the action.[73]

The heart of the statute places restrictions on these so-called "interested stockholders." By definition, a person who acquires fifteen percent or more of a corporation's voting stock is an interested stockholder and, as such, may not effect certain business combinations with the corporation for three years thereafter.[74] Specifically, an interested stockholder may not effect a merger with the corporation[75] or engage in a purchase of more than ten percent of the corporation's assets[76] during the three-year period. In addition, the statute precludes transactions that result in the issuance of stock to the interested stockholder as well as transactions that increase the interested stockholder's proportionate ownership of the corporation.[77] Finally, the statute bans the receipt by the interested stockholder of loans, guarantees, or other financial benefits from the corporation.[78]

If the corporation fails or declines to opt out of the statute, however, these restrictions still can be avoided if one of three

69. *See id.*

70. Nonpublic corporations have the opposite option: They are not covered by the statute unless they adopt a provision in their articles specifically opting *into* the statute. *See id.* § 203(b)(3), (6).

71. *See id.* § 203(b).

72. The statute also provides that it will not be applicable if a corporation's board of directors opts out of the statute through a provision in the by-laws passed within ninety days of the effective date of the statute. *See id.* § 203(b)(2). This option, of course, is no longer available. At least one major corporation, GAF, took advantage of the opportunity. *See* Lowenstein, *GAF Exempts Itself From Law Barring Raiders*, Wall St. J., Feb. 17, 1988, at 4, col. 3.

73. *See* DEL. CODE ANN. tit. 8, § 203(b)(3).

74. *See id.* § 203(a), (c)(5).

75. *See id.* § 203(c)(3).

76. *See id.* § 203(c)(3)(ii).

77. *See id.* § 203(c)(3)(iii), (iv).

78. *See id.* § 203(c)(3)(v).

exceptions applies. First, the board of directors can exempt a stockholder from the statute's terms or approve a business combination so long as it acts before the stockholder in question acquires a fifteen-percent interest.[79] Second, if a stockholder obtains eighty-five percent of the corporation's shares in the transaction in which he becomes an interested stockholder, he may effect a business combination unilaterally at will.[80] Finally, the restrictions are inapplicable if, after the acquirer becomes an interested stockholder, his proposed business combination is approved by both the board of directors *and* two-thirds of the outstanding voting stock, excluding that owned by the interested stockholder himself.[81]

In short, without the approval of the corporation's board, an otherwise successful offeror will be unable to exercise full control for a period of three years unless the offeror is willing to pay the price that will enable him to purchase eighty-five percent of the target's shares.[82]

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79. *See id.* § 203(a)(1). Clearly, this provision is designed to facilitate the effectuation of friendly combinations.

80. In determining whether an interested shareholder achieves the eighty-five-percent ownership level, shares held by persons who are *both* officers *and* directors are excluded from the calculation; however, shares held by directors who are not officers and officers who are not directors are *included* in the calculation. *See id.* § 203(a)(2)(i). Shares held by employee stock ownership plans (ESOPs) are also excluded unless the participants in the ESOP are able "to determine confidentially" whether to tender their shares. *See id.* § 203(a)(2)(ii).

81. *See id.* § 203(a). The statute also contains a grandfather provision that excludes from the definition of "interested stockholder" (1) any person who owned more than fifteen percent of the corporation's voting stock on December 23, 1987, and (2) any person who obtained more than fifteen percent of the corporation's voting stock through a tender offer which was commenced prior to December 23, 1987. *See id.* § 203(c)(5). This exclusion applies only if the person continuously holds fifteen percent or more of the corporation's voting stock. In other words, if a stockholder who owned twenty percent of the target's voting stock on December 22, 1987, sold ten percent of that stock on June 1, 1988, he would be considered an "interested stockholder" (to whom the restrictions would apply) upon acquiring five percent of the stock thereafter. *See id.* The statute also excepts from the definition of "interested stockholder" a person whose ownership of the corporation reaches the fifteen-percent threshold solely as a result of corporate action, such as a stock repurchase. *See id.*

82. While patterned after the New York and New Jersey statutes, the Delaware statute is significantly less burdensome for the acquirer. *Compare* DEL. CODE ANN. tit. 8, § 203 *with* N.Y. BUS. CORP. LAW § 912 (McKinney 1986) *and* N.J. STAT. ANN. § 14A:10A (West 1987). First, while the Delaware statute prohibits business combinations for three years, both the New York and New Jersey statutes prohibit such combinations for five years. Second, the Delaware statute places no restrictions on the acquirer after the three-year period expires. By contrast, even after the five-year period expires under the New York statute, an acquirer is prohibited from merging with the target unless it pays a "fair price." Similarly, the New Jersey statute prohibits mergers after the five-year period unless either the acquirer pays a fair price or two-thirds of the target's disinterested shareholders approve. Finally, neither the New York nor the New Jersey statute permits the acquirer to avoid its terms by acquiring more than eighty-five percent of

B. *The Delaware Cases*

Early last spring, two Delaware federal judges independently determined that the Delaware statute was constitutional, the first in *BNS Inc. v. Koppers Co.*[83] and the second in *RP Acquisition Corp. v. Staley Continental, Inc.*[84] Five months later, in *City Capital Associates Ltd. Partnership v. Interco, Inc.*,[85] another Delaware federal judge reached the same conclusion. Because the analyses of the three Delaware district court decisions are substantially similar, and because the *RP Acquisition* court considered the issues in the most detail, the following discussion focuses on that court's opinion.

On April 8, 1988, RP Acquisition, a wholly-owned subsidiary of the English-based Tate & Lyle, PLC, initiated a tender offer for any and all shares of Staley Continental, an Illinois-based Delaware corporation engaged in the sweetener and food service industries. RP's announced purpose was to acquire Staley so that it could merge Staley into the operations of Tate & Lyle. Additionally, RP planned to sell Staley's food service business. RP conditioned its offer on the inapplicability of the Delaware statute, whether achieved through approval of the deal by Staley's board of directors, successful tender of eighty-five percent or more of Staley's shares, or judicial invalidation of the statute. When Staley's board rejected the offer as not in the best

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the target's shares. *See* Veasey, Finkelstein & Shaughnessy, *supra* note 8, at 879-80 (comparing the Delaware statute with the New York and New Jersey statutes); Hurwitz, *New Jersey Shareholders Protection Act: Validity Questioned in Light of CTS Corp. v. Dynamics Corp. of America*, 44 BUS. LAW. 141, 142-44 (discussing the operation of the New Jersey statute).

As of this writing, the courts have not ruled on the constitutionality of either the New York or the New Jersey statute. *See* Salant Acquisition Corp. v. Manhattan Indus., 682 F. Supp. 199 (S.D.N.Y. 1988) (refusing to address constitutionality of the New York statute because plaintiff unable to show irreparable harm sufficient to merit preliminary injunction). At least one commentator, however, has concluded that the New Jersey statute is unconstitutional under the Supremacy Clause. *See* Hurwitz, *supra*, at 155-56. Recently, though, Wisconsin and Georgia statutes with characteristics more similar to the New York and New Jersey statutes than to Delaware's, were upheld in the federal courts. *See* Amanda Acquisition Corp. v. Universal Foods Corp., 877 F.2d 496 (7th Cir. 1989) (Wisconsin statute); West Point-Pepperell, Inc. v. Farley, Inc., 711 F. Supp. 1096 (N.D. Ga. 1989) (Georgia statute). For a thorough discussion of *Amanda*, see Comment, *Judge versus Professor: Frank Easterbrook and the Wisconsin Anti-Takeover Statute*, 13 HARV. J.L. & PUB. POL'Y 355 (1990) (this issue).

83. 683 F. Supp. 458 (D. Del. 1988).

84. 686 F. Supp. 476 (D. Del. 1988).

85. 696 F. Supp. 1551 (D. Del. 1988), *aff'd on other grounds*, 860 F.2d 60 (3d Cir. 1988); *see also* SWT Acquisition Corp. v. TW Serv., Inc., 700 F. Supp. 1323 (D. Del. 1988) (rejecting a challenge to the Delaware statute on the ground that the suit was not ripe).

interests of Staley's stockholders and when RP failed to acquire the necessary eighty-five percent, RP brought suit to enjoin application of the law.[86]

After accepting RP's allegation of irreparable injury,[87] Judge Roth turned to examine the likelihood of RP's success on the merits and examined the statute under the Supremacy Clause. Following the lead of the Supreme Court in *CTS*, Judge Roth applied, without purporting to adopt, the preemption analysis developed by the *MITE* plurality. Although recognizing that the plurality in *MITE* found that a principal objective of the Williams Act was to establish a balance between the interests of the tender offeror and target management, the judge contended that the *CTS* decision permits the States to alter this balance somewhat in their efforts to protect investors " 'so long as hostile offers [that] are beneficial to target shareholders have a meaningful opportunity for success.' "[88] The court then considered whether the Delaware statute does in fact prevent beneficial hostile offers from having a meaningful opportunity for success. Relying on an affidavit by former SEC Chief Economist Gregg Jarrell, RP argued that the eighty-five percent threshold for unilateral action specified in the Delaware statute provides an illusory privilege because hostile offers historically have failed to achieve so high an ownership level and because typically at least sixteen percent of a corporation's shares are owned either by shareholders who are "blindly pro-management" or by shareholders who do not respond to corporate communications.[89]

The court, however, remained unconvinced. Dr. Jarrell's statistics, the court found, ignored the fact that Section 203 requires the offeror to acquire not eighty-five percent of the target's total stock but eighty-five percent of the outstanding stock not owned by persons who are both officers and directors.[90] The court also pointed out that past statistics were not necessarily a good predictor of the success of offerors after the statute. Before the statute, offerors had no particular incentive to reach the eighty-five-percent threshold; the statute now

86. *See RP Acquisition*, 686 F. Supp. at 477-78.
87. *See id.* at 478.
88. *Id.* at 482 (quoting *BNS Inc.*, 683 F. Supp. at 469).
89. *See RP Acquisition*, 686 F. Supp. at 482.
90. *See id.* at 483.

gives offerors such an incentive.[91]

The court also remained unswayed by RP's evidence that at least sixteen percent of a company's shares are usually in the hands of pro-management or unresponsive shareholders.[92] Judge Roth found unpersuasive proffered studies indicating that, on average, 9.45% of the stock of Fortune 500 companies is in the hands of officers and directors, and that between 11% and 21% of smaller companies' shares are in the hands of such persons. Again, the Judge noted that such statistics are not germane: Under the Delaware statute, shares held by persons who are both officers and directors are excluded from the eighty-five percent calculation. The proffered studies therefore provided "an inadequate factual foundation for a ruling that Section 203 is most likely unconstitutional under the Supremacy Clause."[93] Moreover, although the Judge conceded that "dead" shares do exist, she found that RP's statistics probably overestimated their number.[94] Estimating that the quantity of dead shares generally does not exceed five percent, she concluded "that, despite the existence of dead shares, hostile tender offers retain a meaningful opportunity for success under the [eighty-five] percent exception."[95]

The court similarly found that the Delaware statute satisfies the Commerce Clause, as analyzed by the tests set forth in *CTS*. First, Judge Roth concluded that the law does not discriminate against interstate commerce because it favors neither Delaware offerors nor Delaware shareholders over their out-of-state counterparts. Second, Judge Roth held that the statute does not pose a risk of inconsistent[96] state regulation because it applies only to Delaware corporations.[97]

Finally, the court considered whether the Commerce Clause, as interpreted in *CTS*, required the application of a *Pike*-style balancing test.[98] As the court recognized, some authorities[99]

91. *See id.*
92. *See id.*
93. *Id.*
94. *See id.* at 484.
95. *Id.*
96. *See supra* note 54 (explaining the meaning of the term "inconsistent" as used by the Supreme Court in *CTS* and as used here).
97. *See RP Acquisition*, 686 F. Supp. at 487.
98. *See supra* note 17 and accompanying text (discussing *Pike*).
99. *See* Langevoort, *supra* note 32, at 103-04; Regan, *Siamese Essays: (I) CTS Corp. v. Dynamics Corp. of America and Dormant Commerce Clause Doctrine; (II) Extraterritorial State Legislation*, 85 MICH. L. REV. 1865, 1866-68 (1987).

have contended that *CTS* implicitly abandoned *Pike* and its insistence on the need to examine whether a statute's putative local benefits outweigh its burden on interstate commerce. Judge Roth, however, rejected this suggestion. Immunity to Commerce Clause attack, she concluded, does indeed require *three* findings: (1) an absence of discriminatory effect, (2) no risk of inconsistent regulation, and (3) an overriding local interest.[100] Judge Roth nevertheless found that the statute passed this third test because "Delaware has a substantial, and constitutionally weighty, interest 'in preventing the corporate form [which Delaware itself has created] from becoming a shield for unfair business dealing.' "[101] Thus, under both Supremacy Clause and Commerce Clause standards, the Delaware statute was held to persevere.[102]

III. A Commerce Clause Analysis of the Delaware Statute

A. *The CTS Framework*

The federal judges in *RP Acquisition*, *BNS*, and *City Capital Associates* were correct in finding the Delaware anti-takeover statute valid under the Commerce Clause. Indeed, while some courts and commentators had interpreted the Supreme Court's decision in *MITE* to sound the death knell for state anti-takeover statutes,[103] the truth is that *CTS* may have sounded the death knell for Commerce Clause challenges to such statutes.[104] The *CTS* Court appears to have established only two

100. *See RP Acquisition*, 686 F. Supp. at 488 (citing *CTS Corp.*, 481 U.S. at 94-97 (Scalia, J., concurring)). Although Judge Roth purported to balance local and interstate interests, one may seriously question whether the Judge did in fact engage in balancing. The court's opinion contains no discussion of the interstate burdens of the Delaware statute, and the only "benefit" discussed is that of satisfying the state's interest in promoting stable relationships among parties involved in the corporations it charters. As discussed *infra*, this "benefit" may more appropriately be characterized as a reason for not balancing at all.

101. *RP Acquisition*, 686 F. Supp. at 488 (quoting *CTS Corp.*, 481 U.S. at 93).

102. In its efforts to invalidate the Delaware statute, City Capital Associates argued that, in addition to the Supremacy and Commerce Clauses, a third constitutional principle was transgressed: the nondelegation doctrine. City Capital Associates claimed that the statute is invalid because it improperly delegates governmental authority to the directors of private corporations. *See City Capital Associates*, 696 F. Supp. at 1555-56. The district court summarily rejected this argument. *See id.* at 1556.

103. *See supra* note 28 and accompanying text.

104. *See* Comment, *State Takeover Legislation After CTS: Does It Give States a Free Hand to Regulate Tender Offers?*, 13 DEL. J. CORP. L. 1029, 1069 (1988) ("it is difficult to see how the [*CTS*] Court could find a takeover statute unconstitutional under the commerce

simple tests to measure the validity of anti-takeover statutes under the Commerce Clause when those statutes merely regulate the relationship between a corporation's shareholders, directors, and officers. First, does the statute favor in-state offerors over out-of-state offerors? Second, does the statute pose a risk of inconsistent state regulation?[105]

As *RP Acquisition* indicates, some judges and scholars have contended that *CTS* precribes a third test: a balancing of the burdens imposed upon interstate commerce against the statute's putative local benefits.[106] In support of this contention, these courts and commentators point out that Justice Powell's Commerce Clause analysis did not stop after he evaluated the Indiana statute under the first two tests; instead, he engaged in an extended discussion of the interests Indiana had in passing such legislation.[107] This discussion, they contend, suggests the Court's adherence to a *Pike*-style balancing test.[108]

Such an argument, however, rests on a cursory reading of *CTS*. Unlike the majority opinion in *MITE*,[109] Justice Powell's opinion gives little consideration to the burdens that the Indiana statute imposes on interstate commerce. Far from upholding the balancing test as a third requirement, Justice Powell's analysis seems directed toward explaining why the application of a balancing test by the Seventh Circuit was not appropriate. Precisely because Indiana does have a substantial interest in regulating the affairs of its corporations, it was inappropriate for the Seventh Circuit to consider the relative merits and demerits of Indiana's anti-takeover statute. Indeed, Justice Powell pointed out 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

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clause so long as it is based on the state's corporate law and applies only to its own corporations").

105. *See CTS Corp.*, 481 U.S. at 88-89.

106. *See, e.g., RP Acquisition*, 686 F. Supp. at 487; Tyson Foods, Inc. v. McReynolds, 865 F.2d 99 (6th Cir. 1989) (applying a balancing test to find unconstitutional under the Commerce Clause a Tennessee business combination statute which applied to nonresident corporations); TLX Acquisition Corp. v. Telex Corp., 679 F. Supp. 1022 (W.D. Okla. 1987) (applying a balancing test to find unconstitutional under the Commerce Clause an Oklahoma anti-takeover statute which potentially applied to nonresident corporations); *West Point-Pepperell, Inc.*, 711 F. Supp. 1096 (applying a balancing test to uphold the Georgia business combination statute under the Commerce Clause); *see also CTS Corp.*, 481 U.S. at 94-97 (Scalia, J., concurring).

107. *See CTS Corp.*, 481 U.S. at 89-94.

108. *See, e.g., RP Acquisition*, 686 F. Supp. at 487.

109. *See MITE Corp.*, 457 U.S. at 643-44.

whose very existence and attributes are a product of state law."[110] Thus, if anything, the *CTS* Court suggested abandonment of the balancing test in cases that analyze the Commerce Clause effect of state statutes that merely purport to define the rights of corporate officers, directors, and shareholders.[111]

The Delaware business combination statute is therefore valid under the *CTS* Commerce Clause framework. The statute does not discriminate against interstate commerce because it does not favor in-state offerors; it applies to any interested stockholder, regardless of that stockholder's residence (or state of incorporation). Moreover, because it applies only to Delaware corporations, the statute does not pose a risk of inconsistent regulation. So long as each state limits its regulation to its own corporations, there is no danger that a corporation will be subject to conflicting state laws.[112]

CTS also validated the Delaware statute under the Commerce Clause in another way. In analyzing the Illinois statute under

110. *CTS Corp.*, 481 U.S. at 89; *see also* Pinto, *supra* note 3, at 500 (criticizing Seventh Circuit's opinion in *CTS* for ignoring the importance of the internal affairs doctrine).

111. *See Amanda Acquisition Corp.*, 877 F.2d 496, 507 (7th Cir. 1989) (interpreting *CTS* as holding that "[s]tates may regulate corporate transactions as they choose without having to demonstrate under an unfocused balancing test that the benefits are 'enough' to justify the consequences"); Hyde Park Partners, L.P. v. Connolly, 839 F.2d 837, 844 (1st Cir. 1988) ("The balancing test does seem to have been abandoned by the *CTS* Court in cases where the state law merely regulates 'corporate governance.' "); Langevoort, *supra* note 32, at 103 ("in contrast to other modern dormant commerce clause cases (including *MITE*), the *CTS* Court did not closely scrutinize the Indiana statute, much less attempt to balance its benefits and burdens"); Pritchard, *The Case for the Constitutionality of State Business Combination Statutes*, 13 DEL. J. CORP. L. 953, 979 (1988); Regan, *supra* note 99, at 1866-68 (noting "the absence of any reference to balancing in any of the [*CTS*] opinions").

Of course, some degree of balancing is required to determine that there are substantial state interests involved in the first place, but such balancing, the argument runs, has already been performed by the Framers in allocating powers between the dual federal and state sovereigns so as to leave common-law (and corporate) matters to the latter. Such balancing, which is embodied in the Constitution and which the Constitution requires judges merely to recognize and to enforce, must be distinguished from the policy-minded balancing (discussed here) that judges undertake on their own.

112. *See RP Acquisition*, 686 F. Supp. at 487; *BNS*, 683 F. Supp. at 474. In *TLX Acquisition Corp.*, an Oklahoma federal judge held an Oklahoma control share acquisition statute unconstitutional under the Commerce Clause because it posed a risk of inconsistent state regulation. Unlike the Delaware statute, the Oklahoma statute applied to corporations that were not chartered in the state if such corporations had their principal place of business in Oklahoma and had a specified number of shareholders in Oklahoma. Because such a scheme could result in a corporation being subject to the laws of more than one state, the federal judge found that the statute violated the Commerce Clause. *See* 679 F. Supp. 1020, 1030-31; *see also Tyson Foods, Inc.*, 865 F.2d 99 (holding unconstitutional a Tennessee business combination statute that applied to corporations chartered outside of Tennessee because it posed a risk of inconsistent state regulation).

the Commerce Clause in *MITE*, Justice White had announced that "[Illinois] has no legitimate interest in protecting nonresident shareholders."[113] One would expect this language to pose a serious problem for Delaware because most shareholders of Delaware corporations reside outside of the state. Indeed, this language may have contributed to the Delaware General Assembly's reluctance to pass a second-generation statute after *MITE*. The *CTS* Court, however, mitigated the force of this proscription. Although it recognized that "Indiana ha[d] no interest in protecting nonresident shareholders *of nonresident corporations*,"[114] the Court held that Indiana did have an interest in protecting the shareholders of corporations chartered in the state.[115] Thus, if *MITE* left the matter in doubt, *CTS* made clear that Delaware can "protect" the rights of shareholders of its corporations, even if most of those shareholders do not reside in Delaware.[116]

B. *Criticisms of the CTS Framework*

Although the Delaware statute is probably valid under the *CTS* Commerce Clause framework, that probability depends upon the continued vitality of *CTS*. Commentators have challenged the *CTS* framework on two grounds. First, even if *CTS* did not require application of a balancing test, some commentators have insisted that the Commerce Clause does require such a test.[117] Second, some commentators have criticized the Court's analysis of whether the Indiana statute is discriminatory.[118] These commentators argue that confining the analysis to whether the statute discriminates against out-of-state offerors ignores a more subtle form of discrimination. By making the tender offer process more burdensome, state anti-takeover statutes reduce the likelihood that local communities and em-

113. *MITE Corp.*, 457 U.S. at 644; *see* Telvest, Inc. v. Bradshaw, 697 F.2d 576, 581 (4th Cir. 1983) (striking down Virginia's anti-takeover statute on the ground that Virginia had no legitimate interest in protecting nonresident shareholders).

114. *CTS Corp.*, 481 U.S. at 93 (emphasis in original).

115. *See id.*

116. *See BNS*, 483 F. Supp. at 472 ("The fact that a vast majority of Delaware's corporations do not have their main office in Delaware or many resident shareholders does not prevent Delaware from regulating tender offers affecting these corporations.").

117. *See, e.g.*, Note, *Tender Offers*, *supra* note 29, at 980-81.

118. *See* Langevoort, *supra* note 32, at 107; Regan, *supra* note 99, at 1871 (the Supreme Court "is insufficiently imaginative about what sorts of discriminatory purpose might lie behind the [Indiana] statute").

ployees will suffer from procompetitive dislocation.[119]

Although these commentators' criticisms would perhaps be valid in other Commerce Clause contexts, the *CTS* Court properly refused to apply a balancing test and properly refrained from an open-ended inquiry into Indiana's motives. Both analyses inevitably would require the Court to make policy judgments about the appropriateness of state anti-takeover legislation,[120] and thus would interfere with the States' traditional authority to regulate the relationships between shareholders, directors, and officers. There are sound policy reasons for providing States broad authority to regulate the internal affairs of their corporations.[121] While it is arguable that Congress may interfere with that authority, it would be wholly inappropriate for the Court to do so merely through the silence of the dormant Commerce Clause.

An examination of the burdens and benefits of the Delaware anti-takeover statute illustrates how policy judgments necessarily intrude into the application of a balancing test. The most obvious effect of the Delaware statute is to reduce the incentive for takeover activity. A potential hostile bidder for a Delaware corporation will be discouraged from making a tender offer if he is not confident that he will acquire (or if he does not want to acquire) eighty-five percent of the target's shares. This result will burden interstate commerce because it will discourage the reallocation of resources to higher uses and because it will reduce the incentive for target management to perform well.[122] Although commentators in the early 1980s vigorously promoted this argument,[123] later commentators have called into

119. *See* sources cited *supra* note 118.

120. *See CTS Corp.*, 481 U.S. at 1652-53 (Scalia, J., concurring) (arguing that a balancing test requires courts to make policy judgments that courts are not competent to make); Regan, *The Supreme Court and State Protectionism: Making Sense of the Dormant Commerce Clause*, 84 MICH. L. REV. 1091 (1986) (same); Coffee, *Shareholder Versus Managers: The Strain in the Corporate Web*, 85 MICH. L. REV. 1, 96 (1986) (discussing the problems with motive inquiry under the Commerce Clause).

121. *See supra* note 44 (discussing legitimate state interests in passing anti-takeover legislation).

122. *See MITE Corp.*, 457 U.S. at 643.

123. *See, e.g.*, Easterbrook & Fischel, *supra* note 42; Easterbrook & Fischel, *Takeover Bids, Defensive Tactics, and Shareholders' Welfare*, 36 BUS. LAW. 1733 (1981); Fischel, *supra* note 42; Jarrell & Bradley, *The Economic Effects of Federal and State Regulations of Cash Tender Offers*, 23 J.L. & ECON. 371 (1980); Jensen & Ruback, *The Market for Corporate Control: The Scientific Evidence*, 11 J. FIN. ECON. 5 (1983); *see also* Jarrell, Brickley & Netter, *The Market for Corporate Control: The Empirical Evidence Since 1980*, 2 J. ECON. PERSP. 49 (1988) (contending that hostile takeovers enhance efficiency).

question on both theoretical and empirical grounds whether takeovers are always efficiency-enhancing.[124] If the later commentators are correct in arguing that takeovers sometimes result in waste or misallocation of resources,[125] then the burdens that anti-takeover statutes impose on interstate commerce are less clear. A decision to invalidate such statutes when, as in the case of Indiana and Delaware, they are mindful of the more obvious constitutional concerns is therefore not a doctrinal decision but a policy judgment.

The existence and significance of the benefits provided by anti-takeover statutes are also subjects of intense debate. The announced purpose of the Delaware statute is to protect shareholders by limiting abusive takeover tactics such as two-step tender offers.[126] Commentators have long recognized that two-step offers are potentially coercive,[127] but there has been debate over the frequency of coercive tactics and whether these tactics actually harm shareholders or the economy.[128] There-

124. *See, e.g.*, Herman & Lowenstein, *The Efficiency Effects of Hostile Takeovers*, in KNIGHTS, RAIDERS, AND TARGETS 211 (J. Coffee, L. Lowenstein & S. Rose-Ackerman, eds. 1988); Roll, *Empirical Evidence on Takeover Activity and Shareholder Wealth* in KNIGHTS, RAIDERS, AND TARGETS, *supra*. at 241; Law, *Comment* in KNIGHTS, RAIDERS, AND TARGETS, *supra*. at 260 ("there is no credible evidence that social welfare has been increased by any of the acquisition binges of the postwar period"); Coffee, *Regulating the Market for Corporate Control: A Critical Assessment of the Tender Offer's Role in Corporate Governance*, 84 COLUM. L. REV. 1145 (1984); *cf.* SEC ADVISORY COMMITTEE ON TENDER OFFERS, REPORT OF RECOMMENDATIONS 9 (July 8, 1983) ("the Committee does not believe that there is sufficient basis for determining that takeovers are per se either beneficial or detrimental to the economy . . .").

125. *See* Roll, *The Hubris Hypothesis of Corporate Takeovers*, 59 J. BUS. L. 197 (1986) (arguing that excessive pride and ambition induce some offerors to believe in the accuracy of subjective valuations despite the absence of objective support, thus resulting in inefficient acquisitions); *see also* E. PENROSE, THE THEORY OF THE GROWTH OF THE FIRM (2d ed. 1980) (arguing that size is a factor in management compensation that often creates a perverse incentive for acquisitions and inefficiently large-scale operations); O. WILLIAMSON, THE ECONOMICS OF DISCRETIONARY BEHAVIOR: MANAGERIAL OBJECTIVES IN A THEORY OF THE FIRM (1967) (same); Malatesta, *The Wealth Effect of Merger Activity and the Objective Functions of Merging Firms*, 11 J. FIN. ECON. 155, 157 (1983) (same).

126. *See* DEL. CODE ANN. tit. 8, § 203.

127. *See, e.g.*, Brudney & Chirelstein, *Fair Shares in Corporate Mergers and Takeovers*, 88 HARV. L. REV. 297, 330-40 (1974); Brudney & Chirelstein, *A Restatement of Corporate Freezeouts*, 87 YALE L.J. 1354 (1978).

128. *Compare* Two-Tier Tender Offer Pricing and Non-Tender Offer Purchase Programs—Advance Notice of Possible Commission Action, Exchange Act Release No. 21,079, [1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,637 (June 21, 1984) (shareholders receive significant premiums in connection with two-tier offers) *and* Easterbrook & Fischel, *Corporate Control Transactions*, 93 YALE L.J. 698 (1982) *and* Easterbrook & Fischel, *supra* note 42 *with* Bebchuk, *The Pressure to Tender: An Analysis and Proposed Remedy*, 12 DEL. J. CORP. L. 911 (1987) *and* Bebchuk, *Toward Undistorted Choice and Equal Treatment in Corporate Takeovers*, 98 HARV. L. REV. 1693 (1985) *and* Booth, *supra* note 3.

fore, courts that undertake to apply a balancing test inevitably must choose sides in this debate.[129] When they do so, they announce policy judgments that more appropriately are left to the States and to Congress.[130]

The second predominant criticism of *CTS* is that in ruling that the Indiana statute does not discriminate against interstate commerce the Court focused only on whether the statute favored out-of-state offerors, ignoring a more subtle form of discrimination. Anti-takeover statutes protect local communities and employees from the dislocation that takeovers can cause.[131] This protection of local interests, some commentators argue, is the very type of parochialism that the dormant Commerce Clause doctrine is meant to preclude.[132]

Nevertheless, the *CTS* Court's reluctance to inquire into this type of discrimination is justifiable. Although the point is subject to considerable dispute, numerous commentators have argued that anti-takeover statutes do protect the investing public

129. *See* Sargent, *supra* note 3, at 7-8 ("it is impossible to weigh the burdens on interstate commerce or to define the nature and importance of the state interests without considering the economic arguments raised by [commentators] regarding the structural role of hostile takeovers in the corporate system").

130. *See* Pritchard, *supra* note 111, at 983 ("courts should not attempt to second-guess [*sic*] whether business combination statutes will or will not achieve the benefits which the state legislatures intended"); *cf. Amanda Acquisition Corp.*, 877 F.2d at 507-08 (7th Cir. 1989) (insisting that judges should hesitate before trying to "perfect" corporate codes).

131. *See* Coffee, *Shareholder Versus Managers: The Strain in the Corporate Web*, 85 MICH. L. REV. 1, 101 (1986).

132. *See* Langevoort, *supra* note 32, at 107. At first glance, the Delaware statute appears immune from this criticism. Most Delaware corporations have little or no operations in that state; thus, it is unlikely that a hostile takeover of a Delaware corporation would result in employee layoffs or community hardship within Delaware. Moreover, a large number of potential hostile offerors are incorporated in Delaware, and they would likely exert influence against the passage of an anti-takeover statute that unduly favored target management. *See* Romano, *The Political Economy of Takeover Statutes*, 73 VA. L. REV. 111, 141 (1987). Therefore, Delaware appears not to have the same kind of parochial interests that these commentators perceive in Indiana. A closer look reveals that Delaware may have parochial interests to protect. Although every state receives revenues from corporate franchise taxes and fees, Delaware is unique in that it receives almost one-fifth of its revenues from fees paid by corporations chartered in the state. *See BNS, Inc.*, 683 F. Supp. at 473 n.31 (noting that each year Delaware receives $170 million, 17% of the state's gross revenue, from corporate franchise taxes and fees). Thus, the Delaware General Assembly has a strong incentive to cater to the desires of target management to avoid a substantial loss in state revenue that would result if Delaware corporations were to incorporate elsewhere. In addition, certain influential interests such as the Delaware corporate bar benefit greatly because Delaware plays such a prominent role in state corporate law. Indeed, one of the worries expressed during the debate over the adoption of the statute was that Delaware would suffer from an exodus of corporations if an anti-takeover statute were not passed. *See id.*; Veasey, Finkelstein & Shaughnessy, *supra* note 8, at 871 n.30.

and the economy at large,[133] and one cannot deny that a rational state legislature could think that in passing the statute it was protecting investors. If one concedes that the protection of investors is a legitimate state-law objective, then the desire to invalidate an anti-takeover statute poses a dilemma: Either one must decide that the stated objective did not represent the true motive of the legislature in passing the statute, or one must decide that, as legitimate as it is, the promotion of that objective is outweighed by the interstate commercial burdens the statute imposes. The former course would lead the Court into an impractical second-guessing of state legislators' motives, an inquiry many scholars wisely advise against.[134] The latter course would lead the Court into the type of policy-minded balancing that it should (and wanted to) avoid in the first place.[135]

Moreover, it is particularly inappropriate for a court to engage in analyses that require it to make policy judgments when a state's corporation law is involved. The definition of the rights of shareholders has traditionally been left to the States.[136] Although there have been numerous attempts to federalize corporate law, these attempts have been rejected re-

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133. *See supra* notes 125 & 128.

134. *See* Note, *The Constitutionality of State Takeover Statutes: A Response to Great Western*, 53 N.Y.U. L. REV. 872, 895-905 (1978) (criticizing the use of motive review to examine anti-takeover statutes under the Commerce Clause); Coffee, *supra* note 131, at 96 (noting the difficulties involved in ascertaining legislative intent); *see also* Ely, *Legislative and Administrative Motivation in Constitutional Law*, 79 YALE L.J. 1205 (1970) (same).

135. *Cf. CTS Corp.*, 481 U.S. at 1652-53 (Scalia, J., concurring) (rejecting the notion that courts should be involved in making value judgments about the appropriateness of state legislation). *But see* Regan, *supra* note 99, at 1872 (arguing that it is appropriate for courts to inquire into a state legislature's motives in determining whether a state statute is invalid under the dormant Commerce Clause). In supporting motive review, Professor Regan argues that an examination of "legislative purpose [is] more consonant with the judicial role and more suited to judges' capacities" than the examination of a statute under a balancing test. *Id.* Although this statement is accurate, motive review does pose serious difficulties. Often, there will be several possible motives for passing a statute, but because state legislative history is so sparse, the actual motive for the legislation will be unclear. Alternatively, there may be multiple motives, each causally related to the statute in some indeterminable degree. As a result, the court must either abandon the inquiry or make a decision that is implicitly based on value judgments made by judges about the appropriateness of the legislation.

136. *See* Boyer, *Federalism and Corporation Law: Drawing the Line in State Takeover Regulation*, 47 OHIO ST. L.J. 1037, 1037-38 (1986); Pinto, *supra* note 3. One can argue that the takeover context requires a *sui generis* approach and therefore tradition should not control when state law affects the takeover process. To a certain extent, this argument is persuasive. Yet, given that the States traditionally have had the power to define shareholder rights, Congress, and not the courts, should make the political decision whether to take away from the States the power to regulate shareholder rights in ways that affect the takeover process.

peatedly.[137] More than once, the Supreme Court has recognized that "[s]o far as the Constitution of the United States is concerned, a State may, indeed, create a corporation, define its powers, prescribe the amount of its stock and the mode in which it may be transferred."[138]

The repeated refusal to federalize corporate law is based on sound policy reasons. First, having fifty jurisdictions participate in defining the contours of the modern corporate form fosters experimentation.[139] The rapidly changing conditions of the business world continually place new demands on the corporate form. Each of the fifty jurisdictions can respond in its own way to such changes without the tremendous effect that would result if there were only one chartering source. Once successful responses are recognized, other states can adopt them.[140]

A second policy reason, which is closely related to the first, is the desire to create a market for corporate charters.[141] If corporate law were completely federalized, shareholders would have no choice as to corporate form; they would have to accept the corporate form Congress offered. Shareholders, however, may have preferences for a variety of corporate forms. The existence of a pluralistic corporate law system results in competition among the States. If a state corporate statute does not maximize shareholder wealth, corporations can reincorporate

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137. *See* Boyer, *supra* note 136, at 1048-54. Indeed, there was a motion at the Constitutional Convention to give the Congress the power "to grant charters of incorporation where the interest of the U.S. might require & the legislative provisions of individual states might be incompetent." *Id.* at 1041 (quoting 3 M. FARRAND, RECORDS OF THE FEDERAL CONVENTION OF 1787 325 (1911)). This proposal was rejected on the ground that it could result in government-sponsored monopoly. *See id.* Interestingly, one of the arguments in favor of the proposal was that federal incorporation was needed to minimize the commercial friction that would result if the states were granted the exclusive power to incorporate. The delegates making this argument clearly believed that the Commerce Clause did *not* prohibit state corporate law from affecting interstate commerce. *See id.* at 1041-42.

138. Northern Securities Co. v. United States, 193 U.S. 197, 349 (1904).

139. *Cf.* New State Ice Co. v. Liebman, 285 U.S. 262, 311 (1932) (Brandeis, J., dissenting) ("It is one of the happy incidents of the federal system that a single courageous State may, if its citizens choose, serve as a laboratory; and try novel social and economic experiments without risk to the rest of the country."); PRESIDENTIAL ADVISORY COMMISSION ON INTERGOVERNMENTAL RELATIONS, THE QUESTION OF STATE GOVERNMENT CAPABILITY 23-24 (1985) (noting numerous legislative innovations begun at the state level).

140. *See* Shipman, *supra* note 3, at 760 (indicating the value of state experimentation with respect to the corporate form); Note, *Securities Law and the Constitution: State Tender Offer Statutes Reconsidered*, 88 YALE L.J. 510, 522 n.81 (1979) [hereinafter Note, *Securities Law*].

141. *See* Pinto, *supra* note 3, at 492-94.

in other states. As a result of this competition, states will have an incentive to compete to satisfy the preferences of corporations.[142]

A court that engages in analyses that require it to make policy judgments about state legislation defining the rights of shareholders chills both state experimentation and state competition in the market for corporate charters. The *CTS* Court's approach is commendable because it avoids these problems yet prevents the most egregious interferences with interstate commerce by requiring a state anti-takeover statute to pass two threshold tests. If Congress believes that statutes that pass these threshold tests are nevertheless detrimental to the national economy, then Congress may affirmatively preempt these statutes with federal legislation.

IV. A Supremacy Clause Analysis of the Delaware Statute

A. *The Delaware Cases and the MITE Preemption Analysis*

The Delaware federal courts that addressed the issue found that the Delaware statute did not violate the Supremacy Clause, even under the *MITE* plurality's "broad interpretation" of the Williams Act.[143] These courts concluded that a statute is valid under *MITE*'s preemption analysis if it provides "hostile offers [that] are beneficial to target shareholders a meaningful opportunity for success."[144] Because the potential of acquiring eighty-five-percent ownership will permit a hostile acquirer to escape the restrictions of the Delaware statute,[145] the courts

142. *See* R. Winter, Government and the Corporation (1978); Fischel, *The "Race to the Bottom" Revisited: Reflections on Recent Developments in Delaware's Corporation Law*, 76 Nw. U.L. Rev. 913 (1982); Romano, *Law As Product: Some Pieces of the Incorporation Puzzle*, 1 J.L. Econ. & Organization 225 (1985); *cf.* Tiebout, *A Pure Theory of Local Expenditures*, 64 J. Pol. Econ. 416, 418 (1956) (contending that a federalist system promotes individual choice). *But see* Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 Yale L.J. 663 (1974) (arguing that state corporate law does not protect investors).

143. *See City Capital Associates Ltd. Partnership*, 696 F. Supp. at 1555, *aff'd on other grounds*, 860 F.2d 60 (3d Cir. 1988); *RP Acquisition*, 686 F. Supp. at 482; *BNS, Inc.* 683 F. Supp. at 472.

144. *RP Acquisition*, 686 F. Supp. at 482 (quoting *BNS, Inc.*, 683 F. Supp. at 469); *see also West Point-Pepperell, Inc.*, 711 F. Supp. 1096 (applying the "meaningful opportunity for success" standard to find the Georgia business combination statute constitutional).

145. *See RP Acquisition*, at 482-86. In arguing that the Delaware statute is valid under the Supremacy Clause, one commentator has contended that "the continued flurry of takeover activity involving Delaware corporations in the months since the enactment of Section 203 strongly suggests that the statute has had no appreciable impact on stockholders' opportunities to receive tender offers." Silverstein, *An Analysis of the Constitu-*

concluded that the statute is not preempted by the Williams Act.

This analysis is assailable on two grounds. First, it is questionable whether the Delaware anti-takeover statute actually does provide beneficial hostile offers with a "meaningful opportunity for success." In some cases, the eighty-five-percent exception will provide *no* opportunity for success. For example, it is likely that in some small publicly-held corporations, officers who are not directors and directors who are not officers will hold at least sixteen percent of the corporation's shares.[146] Indeed, the Delaware statute creates an incentive for managers of small publicly held corporations to hold at least sixteen percent of the corporation's shares. Even in the case of large publicly-held corporations, the Delaware statute may deprive hostile offers of an appreciable opportunity for success. The *RP Acquisition* court conceded that perhaps as many as five percent of a corporation's shares are held by unresponsive shareholders and that at least some shares are held by persons friendly to management who are not both officers and directors. Assuming that the percentage of dead shares in a given case is 5% and that another 5% are in friendly hands, a hostile offeror must acquire not 85% but 94.4% of the available shares to exert control.[147]

One may respond that although this is a large percentage, the offeror can still succeed by increasing his offering price. The higher the threshold moves, however, the fewer the marginal offers that will achieve success. Suppose, after excluding dead and pro-management shares, that thirty percent of the target's shareholders are willing to tender for forty dollars or more, thirty percent for fifty dollars or more, thirty percent for sixty dollars or more, and ten percent for seventy dollars or more. Under these assumptions, a hostile bid of sixty dollars

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tional Validity of Delaware's "Business Combination" Statute, 13 DEL. J. CORP. L. 861, 870 (1988).

146. *See* DEL. CODE ANN. tit. 8, § 203(a)(2); *supra* note 80 and accompanying text (explaining the operation of the eighty-five-percent exception).

147. This figure is calculated as follows: Assume that a corporation has one hundred shares outstanding that are *not* owned by persons who are both officers and directors. The eighty-five-percent exception requires a hostile offeror to purchase eighty-five of this one hundred to escape operation of the Delaware statute. If, however, five shares are unresponsive and five are friendly to management, then a total of only ninety shares are potentially available. Thus, while the offeror needs 85 of the original 100, he needs 94.4% of the "available" 90 (85/90 = 0.944).

will fail even though ninety percent of the target's active, disinterested shareholders view the offer as beneficial. Moreover, it may not be economical for the bidder to increase his bid to seventy dollars, especially in light of the equal payment requirement of the Williams Act.[148] In such cases, the Delaware statute will deny value-enhancing hostile offers a meaningful opportunity for success.

Large publicly-held corporations can also use the Delaware statute to prevent hostile offers from having a meaningful opportunity for success through the creation of employee stock ownership plans (ESOPs). Under the statute, shares held by an ESOP in which the employee-shareholders have the right to determine confidentially whether to tender their shares are included in determining whether the bidder achieves the eighty-five-percent level.[149] By creating an ESOP that holds more than fifteen percent of the target's shares, the target can effectively thwart prospective bidders from ever achieving the eighty-five-percent level. The employee-shareholders—who are likely to have greater economic interests as employees than as shareholders—will likely refuse to tender their shares to a hostile bidder because of the risks of termination, dislocation, and reduced compensation. Indeed, in 1989, Polaroid used the Delaware statute in combination with an ESOP precisely in this manner to thwart an attempted takeover by Diamond Shamrock.[150]

The second and perhaps more important criticism of the Delaware federal court decisions is that the Delaware anti-takeover statute contravenes the principle of shareholder self-determination that underlies the analysis adopted by Justice Powell in *CTS*.[151] In *MITE*, one of the key objections to the Illinois stat-

148. Section 14(d)(7) of the 1934 Act, as added by the Williams Act, requires that persons who have tendered their shares pursuant to a tender offer before the offeror increases its bid price must receive the same price for their shares as those persons who tender after the increase. *See* 15 U.S.C. § 78n(d)(7) (1982); L. Loss, Fundamentals of Securities Regulation 512 (2d ed. 1988).

149. *See* Del. Code Ann. tit. 8, § 203(a).

150. *See* Shamrock Holdings, Inc. v. Polaroid Corp., 559 A.2d 257 (Del. Ch. 1989).

151. *See* RTE Corp. v. Mark IV Indus., [1987-1988 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,789, at 98,722 (E.D. Wis. 1988) (vacated as moot after finding Wisconsin's business combination statute unconstitutional on Supremacy Clause grounds because it interferes with the goal of investor choice discussed in *CTS*); Great W. United Corp. v. Kidwell, 577 F.2d 1256, 1276 (5th Cir. 1978), *rev'd on other grounds sub nom.* Leroy v. Great W. United Corp., 443 U.S. 173 (1979) ("The function of federal regulation is to get information to the investor by allowing both the offeror and the

ute under the Supremacy Clause had been that the administrative review established by the statute took the decision of whether to accept a tender offer away from the target's shareholders.[152] Justice White argued that "the [Williams] Act was 'designed to make the relevant facts known so that shareholders have a fair opportunity to make their [own] decision.' "[153] In applying the *MITE* preemption analysis to the Indiana statute in *CTS*, Justice Powell echoed these concerns about shareholder self-determination, but he found that the Indiana statute is valid under the *MITE* preemption analysis because it does not interfere with the right of shareholders to decide whether an offer is in their best interests.[154] Instead of allowing the state to impose its view of fairness, Justice Powell argued, the Indiana Act "allows *shareholders* to evaluate the fairness of the offer collectively."[155]

The Delaware statute contravenes this principle of shareholder self-determination because it gives a veto power to a small minority of shareholders. For example, a tender offer which has the support of eighty percent of the target's active, disinterested shareholders will fail if twenty percent do not find it acceptable. If shareholder self-determination means anything, it means that a majority of shareholders who desire to transfer control of a corporation should be permitted to do so. Undeniably, the Delaware statute fails under the *MITE* preemption analysis.[156]

B. *The Validity of the MITE Preemption Analysis*

The Delaware statute would fail under the *MITE* preemption analysis, but that analysis has never received the support of more than three Justices, and three Justices have explicitly re-

incumbent managers of a target company to present fully their arguments and then to let the investor decide for himself.").

152. *See MITE Corp.*, 457 U.S. at 639-40 (plurality opinion).

153. *Id.* at 639 (plurality opinion) (quoting H.R. REP. No. 1711, 90th Cong., 2d Sess. 4 (1968)).

154. *See CTS Corp.*, 481 U.S. at 83-84.

155. *Id.* (emphasis in original); *see also id.* at 82 n.7.

156. *Cf.* Hurwitz, *supra* note 82, at 154-56 (arguing that the New Jersey business combination statute is preempted by the Williams Act because the statute takes from the shareholders the decision of whether the offer should succeed). Although Mr. Hurwitz is correct that the New Jersey statute would be invalid under the *MITE* preemption analysis, the *MITE* analysis is not supported by either the language or the legislative history of the Williams Act.

jected it.[157] In fact, although he applied the *MITE* preemption analysis to the statute in *CTS*, Justice Powell specifically disclaimed any inference that a majority of the Court was adopting it.[158] Thus, before one can condemn the Delaware statute under the *MITE* analysis, one must determine whether that analysis is valid.

The *MITE* plurality's preemption analysis rests heavily on the legislative history of the Williams Act.[159] As originally proposed, Senator Williams's bill was quite hostile toward hostile tender offers and contained a number of provisions designed to deter such offers.[160] It soon became clear that the bill as proposed would not receive the support of a majority of the Congress. The ensuing compromise granted shareholders protection through legislation that requires tender offerors to make extensive disclosures.[161] Senator Williams, in a much-quoted statement, explained this compromise as follows:

> Every effort has been made to avoid tipping the balance of regulatory burden in favor of management or in favor of the offeror. The purpose of the bill is to require full and fair disclosure for the benefit of stockholders while at the same time providing the offeror and management *equal* opportunity to present their case.[162]

The *MITE* plurality interpreted this statement and other statements in the legislative history as evidence that Congress intended through the Williams Act to establish a balance between the offeror and target management.[163] This balance, according to the plurality, would result in informed choice by the inves-

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157. Justice White, joined by Chief Justice Burger and Justice Blackmun, espoused and advanced the *MITE* preemption analysis, while Justices Powell and Stevens explicitly rejected it. *See supra* note 24 and accompanying text. In *CTS*, Justice Scalia rejected the *MITE* plurality's preemption analysis, relying on the express preemption provision of section 28(a) of the Securities Exchange Act. *See CTS Corp.* 481 U.S. at 1653 (Scalia, J., concurring). Of the Justices now on the Court, two, Justices White and Blackmun, have explicitly supported the *MITE* analysis, and two, Justices Stevens and Scalia, have explicitly rejected it.

158. *See CTS Corp.*, 481 U.S. at 81.

159. For a discussion of this legislative history, see Note, *Second Generation Takeover Statutes*, *supra* note 29, at 216-17.

160. *See* S. 2731, 89th Cong., 1st Sess. (1965). The House counterpart of this proposal was H.R. 14,417, 89th Cong., 2d Sess. (1966).

161. *See* 15 U.S.C. §§ 78m(d)-(e), 78n(d)-(f) (1982).

162. 113 CONG. REC. 854-55 (1967); *see also* S. REP. No. 550, 90th Cong., 1st Sess. 3 (1967); H.R. REP. No. 1711, 90th Cong., 2d Sess. 4 (1968).

163. *See MITE Corp.*, 457 U.S. at 633 (plurality opinion) ("it is . . . crystal clear that a major aspect of the [Williams Act] effort to protect the investor was to avoid favoring either management or the takeover bidder").

tor. Consequently, state statutes that frustrate this balance are preempted.[164]

This analysis is subject to criticism on three grounds. First, although it is evident that Congress wanted to prevent *federal* legislation from upsetting the balance between offerors and target management, it is by no means clear that Congress intended to shield this balance from *state* legislation.[165] Second, the *MITE* analysis contravenes prior Supreme Court interpretations of the Williams Act and other federal securities laws. Third, the *MITE* analysis is particularly inappropriate when one considers that the Delaware statute is a state "corporate governance" statute that addresses functions traditionally relegated to the States.

It is unclear from the language and legislative history of the Williams Act whether Congress intended to prevent the States from regulating in ways that might disturb the balance between tender offerors and target management.[166] The fact that a federal statute provides protection to a certain group does not mean that the States are precluded from providing what they believe are additional protections.[167] Congress acts in a number of areas to protect certain groups without either explicitly or implicitly prohibiting the States from giving additional protection.[168] Thus, a claim that a statute is preempted requires more than a statement that Congress intended to protect investors in a particular fashion; there must be a showing that Congress intended for that to be the only manner and

164. *See id.* at 634 (plurality opinion).

165. *See* Note, *Securities Law, supra* note 140, at 522 ("Any balance that emerged from the Williams Act was neither a 'purpose' nor an 'objective' of its draftsmen, but rather a byproduct of the congressional desire to 'require full and fair disclosure.' ").

166. In his *CTS* concurrence, Justice Scalia concluded that the *MITE* preemption analysis was precluded by the language of Section 28(a) of the Securities Exchange Act. 15 U.S.C. § 78bb(a) (1982). Pointing out that this section preserves the jurisdiction of the state unless state law conflicts with the *provisions* of the Securities Exchange Act, Justice Scalia contended that this "language forecloses pre-emption on the basis of conflicting 'purpose' as opposed to conflicting 'provision.' " *See CTS Corp.*, 481 U.S. at 96 (Scalia, J., concurring). This conclusion is questionable. Justice Scalia's interpretation of the term "provisions" may be unduly narrow. Certainly, the term can be construed as referring only to the literal language of the statute, but it is equally possible that the term "provisions" was designed to encompass the general scheme and goals of the Securities Exchange Act.

167. *See Amanda Acquisition Corp.*, 877 F.2d at 503 ("To say that Congress wanted to be neutral between bidder and target . . . is not to say that it also forbade the states to favor one of these sides."); Pritchard, *supra* note 111, at 971.

168. *Cf.* P. AREEDA & L. KAPLOW, ANTITRUST ANALYSIS 142 (4th ed. 1988) (stating that the fact that the Sherman Act permits certain conduct typically does not prevent a state from outlawing such conduct).

mode by which investors are to be protected in the relevant context. The *MITE* plurality's reliance on the legislative history of the Williams Act to prove this intent is misplaced. Although there is evidence that Congress wanted to "avoid tipping the balance" between the offeror and target management, there is no evidence that Congress intended for the balance to be sacrosanct and free from state regulation.[169]

Second, the *MITE* plurality's preemption analysis contravenes recent Supreme Court decisions interpreting the Williams Act and other federal securities laws as disclosure statutes. For example, in *Schreiber v. Burlington Northern, Inc.*,[170] the Court held that a plaintiff must show misrepresentation to recover under section 14(e) of the Williams Act. Relying on its earlier decision in *Santa Fe Industries v. Green*,[171] the Court concluded that the Williams Act is primarily a disclosure statute and that Congress intended to leave to the States the question of substantive protection for investors faced with a tender offer.[172] It would be odd for the Court, after finding that the Williams Act had preserved state authority to protect investors, to find that state protection is invalid if it upsets the Williams Act's balance between offerors and target management.[173]

Moreover, such a holding lacks a limiting principle. Almost any protection that a state provides to investors will affect the tender offer process. Suppose, for example, that a state legislature requires freeze-out mergers to satisfy a "business purpose" test[174] or a "fair price" test. Each of these protections

169. *See MITE Corp.*, 457 U.S. at 655 (Stevens, J., concurring) ("I am not persuaded, however, that Congress' decision to follow a policy of neutrality in its own legislation is tantamount to a federal prohibition against state legislation designed to provide special protection for incumbent management."); *see also Telvest, Inc.*, 618 F.2d at 1034-36; AMCA Int'l Corp. v. Krouse, 482 F. Supp. 929, 937-38 (S.D. Ohio 1979); Shipman, *supra* note 3, at 759-61; Note, *Securities Law*, *supra* note 140, at 522 & n.81.

170. 472 U.S. 1 (1985).

171. 430 U.S. 462 (1977).

172. *See* Coffee, *supra* note 131, at 100 (noting that the *Schreiber* Court, in deference to state regulation, "essentially declared that the Williams Act was simply a disclosure statute"); *cf.* Cort v. Ash, 422 U.S. 66, 84 (1975) ("Corporations are creatures of state law, and investors commit their funds to corporate directors on the understanding that, except where federal law *expressly* requires certain responsibilities of directors with respect to stockholders, state law will govern.").

173. *Cf.* Coffee, *supra* note 131, at 100 (contending that in light of *Schreiber* if the Supreme Court had followed Judge Posner's reasoning in *CTS*, it "would have emptied in the short space of two years both state and federal law of most of their substantive content with respect to takeover regulation").

174. *See, e.g.*, Coggins v. New England Patriots Football Club, Inc., 397 Mass. 525, 492 N.E.2d 1112 (1986) (interpreting Massachusetts merger statute to require a major-

will deter tender offers because they will make the acquisition and control of target corporations more expensive. Under the *MITE* plurality's preemption analysis, these protections are suspect because they disturb the balance between offerors and target management. Yet the Supreme Court in *Santa Fe* announced that these were the very protections that Congress intended the States to provide.[175]

The third criticism, which is related to the second, is that the *MITE* preemption analysis intrudes upon the authority of the States to regulate their own corporations as they so choose. As discussed above,[176] the States traditionally have had the power to regulate the internal affairs of their corporations, and this allocation of power is based upon sound policy reasons. There may be sound policy reasons for departing from this model on certain occasions, but the decision should be made by Congress and not by the courts.[177] Because Congress has not clearly indicated through the Williams Act that the authority of the States to regulate their corporations has been displaced, the courts should not interfere with this authority.[178]

The Supreme Court's opinion in *CTS* suggests an awareness of these criticisms of the *MITE* plurality's analysis. Indeed, Justice Powell seemed particularly concerned that the Court not interpret the Williams Act in a way that would interfere with a state's ability to define the rights of its own corporations' shareholders. Thus, although the Delaware anti-takeover statute would fail under the *MITE* preemption analysis, that analysis probably would (and should) be rejected by a majority of today's Court. Because the Delaware statute does not conflict directly with any provision of the Williams Act, it survives the inference of preemption.

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ity shareholder to have a valid business purpose before "freezing out" minority shareholders).

175. *See Santa Fe*, 430 U.S. at 478-80 (1977).

176. *See supra* note 136 and accompanying text.

177. *See* California v. ARC America Corp., 109 S. Ct. 1661, 1665 (1989) (indicating that courts have been reluctant to infer preemption of state law in those areas that the States have traditionally regulated).

178. *Cf.* Florida Lime & Avocado Growers, Inc. v. Paul, 373 U.S. 132, 146-47 (1963) (the Court should not conclude "that Congress legislated the ouster of this . . . statute [California Agricultural Code § 792] . . . in the absence of an unambiguous Congressional mandate to that effect"); Pritchard, *supra* note 111, at 963.

V. Conclusion

From a policy standpoint, state laws such as the Delaware anti-takeover statute may be unwise, but as Justice Scalia noted in his *CTS* concurrence, "a law can be both economic folly and constitutional."[179] Because the States traditionally have had the authority to define the relationships between shareholders and management, courts should be reluctant to scrutinize "corporate governance" statutes in ways that could result in the courts' substituting their own policy judgments for those of the States. The *CTS* Court recognized this danger. By establishing two threshold tests[180] that a state anti-takeover statute must satisfy under the Commerce Clause, the Court promulgated a standard that invalidates those statutes that are egregiously protectionist; however, the Court's analysis avoids intrusion into the policy judgments of state legislatures.

The Court's position on the Supremacy Clause is not as clear. Although the Court did not explicitly adopt the *MITE* preemption analysis, neither did the Court reject it. Nevertheless, the Court's Commerce Clause analysis provides a clue as to whether the Court ultimately would adopt the *MITE* plurality's analysis. Given the Court's emphatic acknowledgment of the historical legitimacy of state corporate regulation, it is not likely that the Court will use the Supremacy Clause to invalidate state corporate governance statutes that affect takeover prospects. Indeed, as Justice Powell noted in *CTS*, the Supreme Court cannot interpret the Williams Act to preempt state statutes that limit the exercise of power by hostile tender offerors without posing significant threats to a recognized arena of state sovereignty.[181]

Delaware's anti-takeover statute satisfies the two Commerce Clause tests announced by the Court in *CTS*. Although the statute would not survive the *MITE* plurality's Supremacy Clause standard, that standard is itself not likely to survive *CTS*. In sum, Delaware's statute should prevail under current understandings of the Commerce and Supremacy Clauses, the Williams Act, and state authority. The governing principle of these

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179. *CTS Corp.*, 481 U.S. at 96-97 (Scalia, J., concurring).

180. *See supra* text accompanying note 105. To pass constitutional muster under *CTS*, a state statute must (1) not discriminate against interstate commerce and (2) pose no risk of inconsistent (or mutually contradictory) state regulation. *See id.*

181. *See CTS Corp.*, 481 U.S. at 85-86.

understandings is that even if an anti-takeover law *is* "both economic folly and constitutional," then it is economic folly within the prerogative of the several States.