THE TENDER OFFER REGULATION BATTLE CONTINUES: SHOULD STATES REGULATE ONLY LOCAL COMPANIES?

Proxy solicitations[1] and cash tender offers[2] are two techniques frequently used to transfer corporate control between investors. In the past two decades, the tender offer has emerged as the primary transfer method largely because of its relative speed, low cost, and efficiency.[3] Until 1968, tender offers were essentially unregulated. The tender offer tactic did not exist when the federal securities laws were enacted as part of the 1930's New Deal legislation. Consequently, neither the Securities Act of 1933[4] nor the Securities Exchange Act of 1934[5] specifically regulated tender offers. In the 1960's, however, tender offers increased dramatically, as did complaints of actual and potential abuses of the tactic.[6] Congress responded by amending the 1934 Act with the passage of the Williams Act[7] which provides both offering and target companies with basic guidelines. At the same time, states began enacting their own tender offer laws, variously termed takeover bid disclosure acts,[8] investor protection acts,[9] or tender offer acts.[10]

State tender offer laws are complex and often contradictory which in turn cause compliance problems for potential bidders. State statutes arguably conflict with the federal tender offer provisions,[11] thus giving rise to questions

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1. Proxy contests typically occur when two or more parties seek shareholder proxies authorizing the solicitor to cast the shareholder's vote at the corporation's annual or quarterly meeting. Proxy solicitation is regulated by § 14 of the Securities and Exchange Act of 1934, codified at 15 U.S.C. §§ 78n(a)-(c) (1982). For a more complete discussion of proxy regulation, see generally, L. LOSS, FUNDAMENTALS OF SECURITIES REGULATION 509-67 (2d ed. 1983); E. ARANOW & H. EINHORN, PROXY CONTESTS FOR CORPORATE CONTROL 89-263 (2d ed. 1968) (discussing proxy contests as a means of acquiring corporate control).

2. A cash tender offer is a public offer inviting all shareholders of a target firm to sell their shares to the acquiring firm for a specified price, usually within certain time limits. The price quoted usually includes a substantial premium over the current stock market price. Under an exchange offer, in contrast, the tendering shareholders receive stock in the acquiring firm, rather than cash payments for the stock tendered. *See* Jarrell & Bradley, *The Economic Effects of Federal and State Regulations of Tender Offers,* 23 J. LAW & ECON. 371, 371 n.1 (1980); Note, *Commerce Clause Limitations Upon State Regulation of Tender Offers,* 47 S. CAL. L. REV. 1133, 1133-34 (1974).

3. Note, *supra* note 2, at 1134.

4. 15 U.S.C. § 77a-77aa (1982).

5. *Id.* § 78a-78kk.

6. *See* E. ARANOW & H. EINHORN, TENDER OFFERS FOR CORPORATE CONTROL 64-66 (1973); Warren, *Developments in State Takeover Regulation: MITE and Its Aftermath,* 40 BUS. LAW. 671, 673 (1985); Note, *supra* note 2, at 1136-39.

7. Pub. L. No. 90-439, 82 Stat. 464 (1968) (codified at 15 U.S.C. § 78m(d), 78m(e), 78n(d)-78n(f) (1982).

8. *See, e.g.,* ALASKA STAT. § 45.57.020 (1980); MO. ANN. STAT. § 409.515 (Vernon 1979).

9. *See, e.g.,* TENN. CODE ANN. § 48-5-101 to -112 (1984 & Supp. 1985).

10. *See, e.g.,* CONN. GEN. STAT. ANN. § 36-460 (West Supp. 1985).

11. *See infra* notes 64-131 and accompanying text.

of the constitutionality of state laws.[12] In *Edgar v. MITE Corp.*,[13] the United States Supreme Court held that the Illinois Business Takeover Act[14] violated the commerce clause of the Constitution.[15] Because *MITE* generated six different opinions, many questions were raised and left unanswered. The most important question, for purposes of this Note, is the extent to which states are still allowed to regulate the tender offer process.[16]

In February of 1983, the Securities and Exchange Commission (SEC) established the Advisory Committee on Tender Offers (Committee) to examine tender offers and other control acquisition techniques. The Committee was directed to recommend any changes it considered necessary for improving the current regulatory system.[17] After reviewing a range of acquisition techniques—including proxy contests, cash tender offers, exchange tender offers,[18] and front-end loaded or two-tier bids[19]—the Committee suggested limiting state regulation to takeovers involving local companies.[20] The Committee did not specify what constituted a loeal company, but did recommend several elements that could identify a local company for regulatory purposes. These factors include: the percentage of voting shares held within the state of incorporation; the absence of a listing on a national stock exchange; a specified trading volume for stock held by nonaffiliated shareholders, and an aggregate market value ceiling for such stock.[21] The factors are helpful as a starting point for defining a local company, but are far from definitive. Equally as important as listing the factors is the provision of reasons for selecting each particular factor. The Committee failed to do so, leaving it to each interested party to speculate on the wisdom and rationale of the Committee's suggestions.

As a basis for analyzing the committee recommendations regarding the objectives and role of takeover legislation, this Note first examines the Williams Act requirements. The Note discusses common state regulatory provisions, comparing them with existing federal provisions and assessing the constitutionality of the state statutes. After evaluating several committee

12. *Id.*

13. 457 U.S. 624 (1982).

14. ILL. REV. STAT. ch. 121-1/2, §§ 137.51 to .70 (Supp. 1982) (repealed 1983).

15. U.S. CONST. art. I, § 8.

16. Although state statutes differ in some respects from each other, many provisions of the Illinois Act found objectionable in *MITE* are similar to those in other states' laws. With the invalidation of the Illinois law, the constitutionality of other states' tender offer laws is also questionable.

17. Advisory Committee on Tender Offers, U.S. Securities and Exchange Commission, Report of Recommendations, 1 (July 8, 1983) [hereinafter cited as *Advisory Committee Report*].

18. *See supra* note 2.

19. Two-tier offers are tender offers followed by mergers or other transactions in which greater consideration is paid in the tender offer stage than in the merger stage, which is designed to eliminate minority shareholders. Survey, *Annual Review of Federal Securities Regulation*, 40 BUS. LAW. 159, 202 (1984).

20. *Advisory Committee Report*, *supra* note 17, Recommendation 9(a) at 17.

21. *Id.* at 17 n.17.

recommendations, this Note concludes by considering whether a definition of a local company is in fact necessary, and if so, what such a definition should encompass.

I. The Williams Act

The market approach[22] to investor protection is the key to the Williams Act. Requiring extensive precommencement disclosure ensures that current shareholders will have sufficient information to decide whether to tender their shares.[23] Disclosure also enables potential investors to make fully informed decisions on whether to engage in open market trading in the target company stock.[24] Under the market approach, the federal government does not examine the merits of a proposed tender offer. The government, through the SEC, merely reviews the adequacy of the disclosure, ordering further disclosure when necessary to clarify or to supplement the revealed information.

There are five main categories of information required to be disclosed. First, the information must specify the offeror's identity, background, address and citizenship, as well as the nature of the offeror's beneficial ownership, if any.[25] Next, the disclosure must reveal the sources and the amount of funds or other consideration used to purchase the tendered shares.[26] Along with the sources and the amount of funds, the financial data must also state whether any of the purchase price represents funds borrowed specifically for the tender offer.[27]

The third classification requires the offeror to disclose his shareholdings and any rights he has to acquire additional shares.[28] The fourth category requires the bidder to set forth any plans it has that involve liquidating the target company, selling its assets, merging it with another company, or making any other major business or structural changes.[29] The final category requires the bidder to list and describe any contract or agreement he has made concerning the acquisition and disposition of the firm's securities.[30]

Another way the Williams Act protects investors is by relieving the time pressures associated with tender offers. This in turn provides the investor with an opportunity to fully evaluate the offer. One way the time pressure is reduced is by granting shareholders a right of withdrawal. Tendering shareholders may withdraw their shares within seven days of the original

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22. Comment, *AMCA International Corp. v. Krouse: The Saga of State Takeover-Act Constitutionality Continues,* 10 CAP. U.L. REV. 129 (1980).
23. *Id.*
24. *Id.*
25. 15 U.S.C. § 78m(d)(1)(A) (1982).
26. *Id.* § 78m(d)(1)(B).
27. *Id.*
28. *Id.* § 78m(d)(1)(D).
29. *Id.* § 78m(d)(1)(C).
30. *Id.* § 78m(d)(1)(E).

publication of the offer,[31] and again after sixty days from the original publication date.[32] Another shareholder right that alleviates time pressures is the pro-rata take-up requirement. Shareholders do not need to rush to tender their shares on a first-come, first-taken basis. In the event of oversubscription, the offeror must purchase the tendered shares on a pro-rata basis.[33] The final safety-valve is the requirement that all tendering shareholders receive the same purchase price. Should the offering price change during the course of the offer, shareholders who tendered early are treated the same as those who tender after the price change occurs.[34]

Taken as a whole, then, the Williams Act protects investors by requiring disclosure of information vital to the decision-making process.[35] Shareholders need a basis for choosing whether to remain associated with the firm after new management and a new controlling shareholder group have taken charge. Shareholders are better equipped to make this decision if they know the identity of the offeror, its financing, and its plans for the company.[36] Relieving the time pressures inherent in a tender offer allows investors to avoid making hurried and ill-considered decisions that are not readily reversible.

II. State Regulation

A. *A Comparison of State and Federal Provisions*

Reaction to the Williams Act was generally favorable after its passage in 1968. State legislators, however, still believed that tender offers posed problems for their constituents, problems, such as the corporate raider,[37] that are inadequately addressed by the Williams Act. As a result, thirty-six states have enacted tender offer laws since the Williams Act was passed.[38]

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31. *Id.* § 78n(d)(5). This has been extended from seven to 15 days under the SEC's rule-making ability. *See* 17 C.F.R. § 240.14d-7(a)(1) (1984).

32. 15 U.S.C. § 78n(d)(5) (1982).

33. *Id.* § 78n(d)(6).

34. *Id.* § 78n(d)(7).

35. Target companies also have disclosure duties so that shareholders will be fully informed. For the target's disclosure requirements, see 17 C.F.R. § 240.14d-1 to -4 (1985).

36. 113 Cong. Rec. 24,664, 24,665 (1967).

37. The corporate raider strips the company of its assets and pockets the proceeds from their sale, leaving the company nothing more than a shell which quickly collapses.

38. Thirty-seven states have enacted tender offer laws but Virginia passed its law immediately before the enactment of the Williams Act. Many of these state laws have been repealed in the wake of the *MITE* decision, *supra* notes 13, 16. *See also infra* notes 86-103 and accompanying text. The thirty-six statutes are: Alaska Stat. §§ 45.57.010 to .120 (1980); Ark. Stat. Ann. §§ 67-1264 to -1264.14 (1980); Colo. Rev. Stat. §§ 11-51.5-101 to -108 (Supp. 1982) (repealed 1984); Conn. Gen. Stat. Ann. §§ 36-456 to -468 (West Supp. 1985); Del. Code Ann. tit. 8, § 203 (1983 & Supp. 1984); Fla. Stat. Ann. §§ 517.35 to .363(West Supp. 1978) (repealed 1979); Ga. Code Ann. §§ 14-6-1 to 14-6-15 (1982 & Supp. 1983); Hawaii Rev. Stat. §§ 417 E-1 to -15 (1976 & Supp. 1984) (repealed effective 1986); Idaho Code §§ 30-1501 to -1513 (1980 & Supp. 1985); Ill. Rev. Stat. ch. 121-1/2, §§ 137.51 to .70 (Supp. 1982) (repealed 1983); Ind. Code §§ 23-2-3.1-0.5 to -11 (1982); Iowa Code Ann. §§ 502.211 to .215 (West Supp. 1985); Kan. Stat. Ann. §§ 17-1276 to -1284 (1981 & Supp. 1984); Ky. Rev. Stat. Ann.

The claimed rationale of state tender offer regulation is the same as that of the Williams Act: investor protection.[39] State regulation differs from federal regulation in several important aspects. First, disclosure under state laws is generally more extensive than that under the Williams Act. The Ohio Takeover Act,[40] for example, requires much of the same disclosure that the federal act demands. Ohio, however, extends beyond the federal provisions by ordering the disclosure of what is termed "complete information" regarding the organization and operations of the offeror.[41] This broad definition of complete information may trigger the charge by the tender offer opponent of inadequate disclosure. Such an exclusion of information may also be found by a court to be a false and misleading act, which could subject the offeror to heavy penalties.[42]

A second difference between federal and state regulations lies in the timing of the disclosure. Federal disclosure occurs at the commencement of the tender offer, when the offeror files a Schedule 13D[43] form with the SEC. Many states, on the other hand, mandate disclosure prior to the effective date of the offer. The respective states demand notification and disclosure anywhere from ten[44] to sixty[45] days before the offer is effective. Under state statutes, furthermore, only the bidder is required to reveal information; under the Williams Act, both the target company and the bidder have disclosure obligations.[46]

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§§ 292.560 to .630 (Bobbs-Merrill 1981 & Supp. 1983) (repealed 1984); LA. REV. STAT. ANN. §§ 51:1500 to :1512 (West Supp. 1985); ME. REV. STAT. ANN. tit. 13 §§ 801-817 (1981 & Supp. 1984-85); MD. CORPS. & ASS'NS. CODE ANN. §§ 11-901 to -908 (1985); MASS. ANN. LAWS ch. 110C §§ 1-13 (Michie/Law. Co-op. Supp. 1985); MICH. COMP. LAWS ANN. §§ 451.901 to .908 (West Supp. 1985); MINN. STAT. ANN. §§ 80B.01 to .13 (West Supp. 1984); MISS. CODE ANN. §§ 75-72-101 to -121 (Supp. 1984); MO. ANN. STAT. §§ 409.500 to .565 (Vernon 1979 & Supp. 1985); NEB. REV. STAT. §§ 21-2401 to -2417 (1977) (repealed); NEV. REV. STAT. §§ 78.376 to .3778 (1979) (amended 1983); N.H. REV. STAT. ANN. §§ 421-A:1 to :15 (Supp. 1979) (repealed 1981); N.J. STAT. ANN. §§ 49:5-1 to -19 (West Supp. 1985); N.Y. BUS. CORP. LAW §§ 1600-1614 (McKinney Supp. 1984-85); N.C. GEN. STAT. §§ 78B-1 to -11 (1981); OHIO REV. CODE ANN. § 1707.041 (1985); PA. STAT. ANN. tit. 70, §§ 71-85 (Purdon Supp. 1985); S.C. CODE ANN. §§ 35-2-10 to -130 (Law. Co-op. Supp. 1984); S.D. CODIFIED LAWS ANN. §§ 47-32-1 to -48 (1984); TENN. CODE ANN. §§ 48-2-101 to -114 (1984); Texas Administrative Guidelines for Minimum Standards in Tender Offers §§ 065.15.00.100 to .800, *reprinted in* 3 BLUE SKY L. REP. (CCH) ¶¶ 55,671-55,682; UTAH CODE ANN. §§ 61-4-1 to -13 (1978) (repealed 1983); WIS. STAT. ANN. §§ 552.01-.25 (West Supp. 1985).

Virginia's statute can be found at VA. CODE §§ 13.1-528 to -541 (1978 & Supp. 1982).

39. Although this is the claimed rationale, it is questionable whether this is in fact the real rationale. For a further discussion of this issue, see *infra* notes 108-17 and accompanying text.

40. OHIO REV. CODE ANN. § 1707.041 (1985).

41. *Id.* § 1707.041(B)(3)(b)-(g). For a comparison of the Ohio and Williams Acts, see Comment, *supra* note 22, at 137-41.

42. The definition of a false and misleading act is purposefully broad so as to not exclude any potentially fraudulent acts.

43. Schedule 13D of the Securities Exchange Act of 1934, 17 C.F.R. § 240.13d-101 (1983).

44. *E.g.*, ARK. STAT. ANN. § 67-1264.2(5) (1980).

45. *See, e.g.*, DEL. CODE ANN. tit. 8, § 203(a) (1983) (from 20 to 60 days pre-effective notice). Apparently some state legislators have concluded that their pre-effective notification period is too long, and have stricken these clauses. *See, e.g.*, HAWAII REV. STAT. § 417E-3(f) (1976) (repealed effective July, 1986).

46. *See supra* notes 23, 25-30, 35 and accompanying text.

The SEC has recognized the incompatibility of state and federal disclosure timing. In a 1979 release accompanying proposed changes to the Williams Act, the SEC stated:

> [T]he conflict between Rule 14d-2(b) and such state statutes is so direct and substantial as to make it impossible to comply with both sets of requirements as they presently exist . . . the Commission . . . believes that the state takeover statutes presently in effect frustrate the operations and purposes of the Williams Act. . . .[47]

Frustration of the Williams Act's operations and purposes is an important element in assessing the constitutionality of state statutes. This area will be examined in greater detail in a subsequent section of this Note.[48]

State jurisdictional claims are premised on a substantially different basis than that of federal regulation. The Williams Act applies to transactions, that is, securities purchases and the making of bids. The Act is triggered by the attainment of a certain percentage of stock ownership.[49] Most states claim jurisdiction not upon any specific securities transactions involving state residents or occurring within state borders, but upon the status of the target company. Target companies are broadly defined as including those corporations incorporating within the state;[50] locating the principal place of business within state borders;[51] or having a substantial amount of assets within the state.[52]

Companies either employing a given level of their total work force within the state[53] or having a certain percentage of shareholders who are state residents are similarly subject to state jurisdictional claims.[54] State tender offer statutes apply as well to companies that fit into several of the previously mentioned categories.[55]

Registration of the firm's equity securities under federal securities laws or state blue sky laws serves as a final jurisdictional basis.[56] This basis assumes

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47. SEC Release No. 34-16384, *reprinted in* [1979-80 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 82,373 at 82,584 (Nov. 19, 1979).

48. *See infra* notes 78-103 and accompanying text.

49. 15 U.S.C. § 78n(d) (1982).

50. *See, e.g.,* DEL. CODE ANN. tit. 8, § 203 (1983); PA. STAT. ANN. tit. 70, § 73 (Purdon Supp. 1984); ARK. STAT. ANN. § 67-1264(6) (1980).

51. *See, e.g.,* MASS. ANN. LAWS ch. 110C § 1 (Michie/Law. Co-op. 1985); MICH. COMP. LAWS ANN. § 451.904(1) (West Supp. 1985).

52. *See, e.g.,* ALASKA STAT. § 45.57.110(4) (1980); DEL. CODE ANN. tit. 8, § 203(c)(2) (1983); IDAHO CODE § 30-1501(6) (1980 & Supp. 1985); IND. CODE § 23-2-3.1-1(j) (1982); KAN. STAT. ANN. § 17-1276(A) (1981); KY. REV. STAT. ANN. § 272.560(1) (Bobbs-Merrill 1981 & Supp. 1983) (declared unconstitutional in Esmark Inc. v. Strode, 639 S.W.2d 768 (Ky. 1982)); N.J. STAT. ANN. § 49:5-2m (West Supp. 1985).

53. *See, e.g.,* LA. REV. STAT. ANN. § 51:1500.1(13) (West Supp. 1985).

54. *See, e.g.,* NEB. REV. STAT. § 21-2420(4) (1983); S.C. CODE ANN. § 35-2-20(5) (Law Co-op. Supp. 1984).

55. Most states have a catch-all phrase covering several of these factors, either singly or together. *See, e.g.,* N.J. STAT. ANN. § 49:5-2m (West Supp. 1985).

56. *See, e.g.,* IDAHO CODE § 30-1501(6) (1980); MINN. STAT. ANN. § 80B.01(9) (West Supp. 1985); S.D. CODIFIED LAWS ANN. § 47-32-3 (1983).

that in voluntarily submitting to the detailed informational requirements of the registration process, the company has implicitly agreed to accept the jurisdiction of the state.[57] Relying on a status basis for jurisdiction rather than on a transactions basis brings the state dangerously close to regulating matters in which it has no legitimate regulatory interest because these matters occur outside of the state's boundaries.[58]

Another major difference between state and federal tender offer laws is that the states usually provide for some determination of the offer's merits. A state official, such as the secretary of state or the securities commissioner, often can initiate the hearing at his own option, as well as upon the request of the target company.[59] The hearing, often termed a "fairness hearing," may concentrate on the extent and content of the disclosure as well as upon the equality of the offering to all offerees.[60] If the state official finds either the disclosure or the offer's terms to be inadequate, the offer can be halted or delayed pending modification.[61]

If the target company's management accepts the offer, usually no such hearing occurs. If, on the other hand, the offer is rejected, the offeror will be forced to defend its bid in the fairness hearing. The differing state and federal procedures reflect the concept of fiduciary duty evaluation. In its position as the representative of the company's owners, that is, the shareholders, management has the duty of analyzing the substance of the offer and actively opposing it if the terms are considered unacceptable.[62] The fiduciary duty concept of state law contrasts sharply with the federal emphasis on the market approach, under which the shareholders are presumed to be capable of evaluating the worth of the tender offer.[63]

Differences between state and federal tender offer provisions prompt debates over the constitutionality of the state statutes. Two main theories of state law unconstitutionality have been advanced: preemption by the federal statutes and interference with interstate commerce to such a degree as to be untenable. In addressing each of the arguments, this Note will examine the importance of the different state and federal provisions.

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57. This is similar to arguments supporting long-arm jurisdiction and service of process in cases involving parties who reside in different states. *See infra* note 115. It has not been asserted that this basis of state tender offer jurisdiction violates the minimum contacts test of International Shoe Co. v. Washington, 326 U.S. 310 (1945). Such a discussion is outside the scope of this Note.

58. *See infra* notes 106-31 and accompanying text.

59. *See, e.g.,* OHIO REV. CODE ANN. § 1707.041(B)(1) (Page 1985).

60. *See, e.g.,* IND. CODE § 23-2-3.1-7(a) (1982).

61. *Id.* For further discussion of a similar provision, see *infra* notes 95-98 and accompanying text.

62. *See* Comment, *supra* note 22, at 146.

63. *See supra* notes 22-24 and accompanying text.

B. *Constitutionality of State Takeover Laws*

1. Preemption and the Supremacy Clause

The supremacy clause gives federal laws precedence over state laws if both state and federal laws cover a subject.[64] Where the state law directly contradicts the federal law, the former will automatically be invalidated. Where the two systems do not directly conflict, a more indirect form of analysis is required to assess state law constitutionality. *Pennsylvania v. Nelson*[65] provides a trio of broad guidelines for resolving questions of constitutionality. One standard is that a reasonable inference of congressional preemption arises out of the pervasiveness of the federal regulations.[66] A second principle is that if the federal interest is so dominant that "the federal system [must] be assumed to preclude enforcement of state laws on the same subject,"[67]the state law must be found invalid. The final guideline declares that if the enforcement of state laws would present a serious danger of conflict with the administration of a federal program, the state laws will be stricken as unconstitutional.[68]

The Williams Act does not expressly invalidate existing state tender offer legislation, nor does it specifically prohibit any future state efforts to regulate tender offers. Section 28 of the 1934 Act states in part that "[n]othing in this chapter shall affect the jurisdiction of the securities commission . . . of any state . . . *insofar as it does not conflict with the provisions of this chapter or the rules and regulations thereunder.*"[69] Some commentators claim this savings clause[70] demonstrates a congressional intent to allow states to regulate takeovers in any manner state officials deem appropriate.[71] Other

64. U.S. CONST. art. VI. Article VI provides, in pertinent part:

> 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.

65. 350 U.S. 497 (1955).

66. *Id.* at 502 (citing Rice v. Santa Fe Elevator Corp., 331 U.S. 218, 230 (1946)).

67. 350 U.S. at 504 (citing Rice v. Santa Fe Elevator Corp., 331 U.S. 218, 230 (1946)).

68. *Id.* at 505.

69. 15 U.S.C. § 78bb (1982) (emphasis added).

70. The terms "savings clause," "saving," and "savings effect" refer to the idea that § 28 "saves" the state statutes from being preempted by federal tender offer regulations. *See generally* Note, *Preemption and the Constitutionality of State Tender Offer Legislation,* 54 NOTRE DAME LAW. 725, 731-32 (1979) [hereinafter cited as Note, *Preemption and Constitutionality*]; Note, *supra* note 2, at 1168.

71. One observer suggests that § 28, "although not dispositive . . . raises an inference that Congress intend[s] to supplement rather than to preempt state regulation." Note, *Preemption and Constitutionality, supra* note 70, at 731. This view is shared by another commentator, who states that in passing the Williams Act, Congress acted to ensure investors would have some minimal level of protection in chaotic tender offer contexts. "Congress had no intention of preventing the states from expanding some of these protections by providing for advance notice, or additional disclosures or even fair, just, and equitable tests with respect to takeover offers. . . ." TENTH ANNUAL INSTITUTE ON SECURITIES REGULATION 311 (Fleischer, Lipton & Stevenson eds. 1979). The commentators imply that if Congress had intended the Williams Act to preempt state takeover statutes, the Act would have included a passage directly stating that position.

legal scholars declare that the better view of section 28 is that it saves only the state blue sky legislation existing at the time the 1934 Act was passed. Because tender offers are such a new phenomenon, there was no tender offer regulation in 1934; hence, state controls over tender offers should not be protected by section 28.[72] The final view of section 28 is that it has no real savings effect; instead, the clause merely restates the supremacy clause and reemphasizes its applicability to tender offer legislation.[73] Section 28 under this interpretation is neutral, neither saving nor preempting state tender offer regulation. This neutrality reflects the Williams Act's guiding philosophy of protecting the investor while remaining neutral towards the bidder and the target company.

Under the first *Nelson* guideline, the Williams Act arguably could be considered so pervasive that it leaves no room for concurrent state regulation. The scope of the congressional deliberations, combined with the restatement of federal supremacy in scction 28, points toward the existence of a comprehensive federal scheme for regulating tender offers. By definition, this comprehensive scheme covers all issues deemed important in the tender offer context. The reason why certain state provisions have no Williams Act equivalent is that Congress considered such provisions neither necessary nor desirable. As a result, Congress left no room for state statutes to supplement the federal regulations.

The pervasiveness argument ignores the fact that the Williams Act follows the general pattern of other federal securities law provisions permitting concurrent systems of state regulation.[74] Since states traditionally have been allowed to regulate the securities industry despite existing federal regulation, there cannot be said to be an exclusive, dominant role of federal securities legislation.[75] It is therefore "inappropriate to infer that the Williams Act precludes state regulation of tendcr offers."[76] Simultaneous regulation of

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72. Note, *Preemption and Constitutionality, supra* note 70, at 731. That author discounts this argument as not justifying a finding of congressional intention to preempt state tender offer regulation. He claims that no basis exists for predicting the scope of a savings clause upon a time element. "No decision or analysis of the legislative history of the 1934 Act has ever suggested that the savings clause was meant to be only retrospective. Concurrent regulation of all aspects of securities seems to have been clearly contemplated by Congress." *Id.* at 732. Accordingly, the policy arguments against a declaration of preemption "have nothing to do with a time restriction on the scope of a savings clause. . . . The relevant policy factors are time-independent, and, hence, little or nothing in the way of advancing those policy factors is gained by a restrictive interpretation of the scope of the savings clause." *Id.*

73. This position is particularly evident in E. ARANOW, H. EINHORN & G. BERLSTEIN, DEVELOPMENTS IN TENDER OFFERS FOR CORPORATE CONTROL 225-29 (1977).

74. These provisions are: 15 U.S.C. § 79u (1982) (Public Utility Holding Company Act of 1935); 15 U.S.C. § 77zzz (1982) (Trust Indenture Act of 1939); 15 U.S.C. § 80a-49 (1982) (Investment Company Act of 1940); 15 U.S.C. § 80b-18a (1982) (Investment Advisors Act of 1940). The provision in the Investment Advisors Act was added in the 1960 amendments, Pub. L. No. 86-750, § 16, 74 Stat. 888 (1960). *See* Bartell, *Federal-State Relations under the Federal Securities Code,* 32 VAND. L. REV. 457, 463 n.28 (1979).

75. SEC Release No. 34-16384, *reprinted in* [1979-1980 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 82,373 at 82,584 (Nov. 19, 1979).

76. Note, *Securities Law and the Constitution: State Tender Offer Statutes Reconsidered,* 88 YALE L.J. 510, 520 (1979).

securities transactions under federal and state laws demonstrates that the second *Nelson* guideline concerning the existence of a dominant federal interest is not met, just as the pervasiveness criterion was not. While there are strong federal interests in policing the securities industry and in maintaining a national securities market, there is no general rule that these interests are reserved for exclusive federal control.[77] The lack of federal legislation taking a definitive stand on excluding state regulation reinforces the absence of a dominant federal interest precluding the enforcement of state laws.

The third preemption argument, that state laws present a serious conflict with the administration of federal regulations, is the most plausible basis for invalidating state takeover laws. A primary example of the serious conflict is the difference in disclosure regulations. The additional disclosure required by state statutes represents a substantial burden on the offeror, a burden that may be of little benefit to the shareholder solicited to tender his holdings.[78] To the extent that state and federal disclosure provisions overlap, no needs are fulfilled by sending the shareholders and target management two sets of the same information.

Disclosure surpassing the Williams Act requirements may be counterproductive. The informational overload has two possible adverse consequences: the shareholders either reduce the amount of material that they read, or they stop reading it altogether. Neither alternative accomplishes the goal of improving the shareholder's decision-making abilities. In *Great Western United Corp. v. Kidwell,*[79] the Fifth Circuit Court of Appeals declared that Idaho's additional disclosure requirement "reduce[d] the utility of federally required disclosure and produce[d] an obstacle to the accomplishment of the federal objective to enable investors to make an informed choice about a tender offer."[80] The appellate court affirmed the district court holding that Idaho's takeover act was unconstitutional.

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77. The interest involved here differs greatly from the federal interest present in earlier cases declaring state laws preempted by federal legislation. Foreign affairs and national security are clearly areas where the federal interest is paramount, as evidenced by Supreme Court decisions in Hines v. Davidowitz, 312 U.S. 52 (1941) and Pennsylvania v. Nelson, 350 U.S. 497 (1956), respectively. *See generally* Note, *supra* note 76.

78. While the state-ordered disclosures are more comprehensive than those demanded by the Williams Act, the disclosures "probably are of little benefit to the shareholders, for the information required to be disclosed may not be significant to them, and may obscure the relevant disclosures." E. Aranow, H. Einhorn & G. Berlstein, *supra* note 73, at 219-20. This assertion is similar to those often made regarding the effectiveness and extent of disclosure for the issuance of new securities under the Securities Act of 1933, 15 U.S.C. §§ 77a-77aa (1982). Critics of the 1933 Act disclosure rules claim that the information revealed is overwhelming in its detail, unrealistic in severely limiting the amount of "soft information," such as forecasts and plans allowed to be revealed, and minimally useful because the information is stale and the market adjusted to that information when it was first revealed. *See generally* Kripke, *The SEC, The Accountants, Some Myths and Some Realities,* 45 N.Y.U. L. Rev. 1151 (1970).

79. 577 F.2d 1256 (5th Cir. 1978), *rev'd on venue grounds sub nom.* Leroy v. Great Western United Corp., 443 U.S. 173 (1979).

80. 577 F.2d at 1281.

State requirements of additional disclosure are typically favored by objects of hostile takeover bids. A target management hostile to the offer often uses the additional information as a powerful weapon to fight the bidder. The more detailed that state regulations are, and the more material that is disclosed, the more opportunities the target has to criticize the disclosures and to obtain injunctions delaying the offer. The extra time needed to gather and disseminate the disclosure material, and the preeffectiveness notification, combine to delay the commencement of the offer, thus giving the target additional time to structure a defense.

Preeffective notification allows the target an advantage in planning and executing its defensive strategies.[81] Tender offer success rates are low,[82] in part because of the difficulties inherent in persuading large numbers of geographically dispersed shareholders to make significant investment decisions in the relatively short time that an offer is outstanding.[83] A successful tender offer, furthermore, is highly dependent upon the advantage of surprise in announcing the offer. Once word is out that an offer is contemplated, the immediate reactions of the stock market and of the target company's management increase the offeror's difficulty in successfully concluding the offer.[84] By giving target companies a defensive advantage, state regulations conflict with the avowed intentions of the Williams Act sponsors, who stated that "extreme care" was taken to "avoid tipping the scales either in favor of management or in favor of the person making the takeover bids."[85]

State-sanctioned merit hearings also seriously conflict with the administration of the federal laws, giving target managements another advantage. The Seventh Circuit Court of Appeals found this advantage objectionable in

81. *See generally* Edgar v. MITE Corp., 457 U.S. 624 (1982); MITE Corp. v. Dixon, 633 F.2d 486 (1980); Great Western United Corp. v. Kidwell, 577 F.2d 2356 (1978). *See also* E. ARANOW, H. EINHORN & G. BERLSTEIN, *supra* note 73; Note, *supra* note 2; Note, *supra* note 76.

82. One study tabulated that in the decade 1956-1966, only 29 of 83 contested bids were successful. Hayes & Taussig, *Tactics of Cash Takeover Bids*, 45 HARV. BUS. REV. 135, 137, 139 (Mar.-Apr. 1967).

83. *See generally* E. ARANOW, H. EINHORN & G. BERLSTEIN, *supra* note 73; Easterbrook & Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161 (1981); Hayes & Taussig, *supra* note 82.

84. The increased difficulty facing the bidder is that the target company will have had time to set up its defensive strategy. One common defense tactic is a solicitation by incumbent management of a "white knight," who comes into the tender offer scene with a competing tender bid. A second defense strategy is to merge the potential target with a corporation selected by the target company management. Another device used by the target management is a repurchase of its own shares to lower the number of outstanding shares. With fewer shares outstanding, the market price of the remaining outstanding shares will rise; the shareholders consequently have little incentive to tender their shares. Other transactions which enhance the desirability of the stock in the eyes of the shareholders, such as declaring stock splits or extending dividend increases, are also possible with the early warning provided target managements by the preeffective filing. *See generally* E. ARANOW, H. EINHORN & G. BERLSTEIN, *supra* note 73, at 234-74; Note, *supra* note 2, at 1136.

85. 113 CONG. REC. 24,663, 24,664 (1967) (statement of Sen. Williams).

MITE Corp. v. Dixon,[86] where it affirmed the district court's decision holding the Illinois Business Takeover Act[87] unconstitutional on both supremacy and commerce clause grounds. In addition to requiring a pre-offering filing and a twenty day waiting period, the Illinois statute provided for a hearing if requested by one of three different groups: the secretary of state, a majority of the outside directors of the target firm, or investors holding ten percent of the target's outstanding shares.[88]

Reviewing the lower court's decision, the court of appeals declared that by relying "upon its Secretary of State's judgment rather than upon investors' own judgment after full disclosure of the relevant facts, [Illinois'] regulatory scheme stands in fundamental conflict with federal law and is therefore unconstitutional."[89] Noting that the interests of the target management may differ from those of the company's shareholders, the court of appeals stated:

> [A]nything which suggests delegation to management of the right to call hearings (of potentially indefinite duration) does not further the congressional goal of insuring freedom of action of informed stockholders . . . [i]n general, any delegation of the right to call hearings to private parties potentially (but realistically) subject to management influence or direction must be regarded as suspect.[90]

Although the court of appeals and the district court considered this conflict sufficient to constitute a basis for federal preemption of state tender offer regulation under the third *Nelson* criterion, the United States Supreme Court did not agree. In *Edgar v. MITE Corp.*,[91] Justice White's plurality opinion briefly mentioned the lower courts' positions and simply agreed with the prior reasoning.[92] Chief Justice Burger and Justice Blackmun joined in the plurality opinion; Justices Stevens, Powell and O'Connor declared the case controlled by the commerce clause violations.[93] The dissenters, Justices Marshall, Brennan and Rehnquist, never reached the question of preemption, as they would have dismissed the case as being moot.[94]

The plurality opinion in *MITE* also considered the built-in delay features of the Illinois Act to be a source of conflict with federal regulations.[95] Although the Illinois law permitted the secretary of state to call a merit

86. 633 F.2d 486 (7th Cir. 1980), *aff'd sub nom.* Edgar v. MITE Corp., 457 U.S. 624 (1982).

87. ILL. REV. STAT. ch. 121-1/2 §§ 137.51 to .70 (Supp. 1982) (repealed 1983).

88. *Id.* at § 137.54(B), § 131.57(A).

89. *MITE*, 633 F.2d at 494.

90. *Id.* at 495 (footnote omitted).

91. 457 U.S. 624 (1982).

92. *Id.* at 639-40 (opinion of White, J.).

93. Justices Stevens and Powell expressly disagreed with the preemption holding. 457 U.S. at 646-47, 655. Justice O'Connor stated it was unnecessary to reach the preemption argument. *Id.* at 655.

94. 457 U.S. at 655, 664 (Marshall, J., dissenting) (Brennan, J., dissenting); *id.* at 667 (Rehnquist, J., dissenting).

95. 457 U.S. at 636-39 (opinion of White, J.).

hearing, it did not set a deadline for completion of the hearing.[96] The secretary of state was required to render a decision within fifteen days after the conclusion of the hearing, but he could extend that period without limitation.[97] The tender offer could not proceed until the hearing was over and the decision had been rendered.[98]

Delay presents a problem to each side in the takeover because it is costly and frustrating. Some bidders will face competitive offers arising as a result of the disclosure. The competition may generate a higher price for the shares eventually tendered; conversely, competition may cause the original bidder to drop his offer, after which the rival bidder may or may not decide to continue his offer. Delays may also cause potential bidders to lower the initial bid price, thus lowering the final price paid, or may cause corporate officers to refrain from making any offer at all.[99]

Target company shareholders in any event bear the risk of a tender offer. If the offer succeeds, shareholders often will receive a lower price than if there were no state tender offer regulations. If the offer fails, investors receive a minimal net increase in the price of their holdings, if in fact the market value rises at all.[100] Delays caused by the fairness hearing buy time for the target company, but at the cost of increased legal and accounting fees. The shareholders, as owners of the firm, ultimately pay for these additional expenses. In general, therefore, delays may harm shareholders as well as benefit them.

The federal interest in regulating tender offers is the protection of the investing public. Most discussions of the protective purpose focus solely upon the need of the target company investors to be fully informed. While those investors obviously have an interest in the tender offer, two other interested groups are often neglected as deserving of consideration: the shareholders and creditors of the offeror.[101] If the bidder is another business entity, its investors and creditors supply at least a portion of the capital and other consideration needed to acquire the tendered shares. If the potential

96. ILL. REV. STAT. ch. 121-1/2, §§ 137.57.C, D.

97. *Id.*

98. ILL. REV. STAT. ch. 121-1/2, §§ 137.57.A, B.

99. Although the offering of lower bid prices or a reduction in the number of tender offers made have not been firmly established by any authoritative studies to date, these concerns are commonly mentioned and assumed to exist by both commentators and the courts.

100. The market value of the investor's holdings initially will rise. Speculators will purchase the target company stock to obtain the premium, the difference between the market and the tender prices per share, when these shares are tendered to the bidder. The effect of these purchases is to raise the market value of the target company stock; yet any delays may cause the demand for the target stock to level off or even decline. If the investor does not act quickly enough, he will not be able to realize any economic benefits associated with this increased market price. In some instances, however, a tender offer may cause a price decline as investors react to the proposed change in corporate control by selling off their shares rather than tendering the shares to the offeror.

101. Greene & Junewicz, *A Reappraisal of Current Regulation of Mergers and Acquisitions,* 132 U. PA. L. REV. 647, 732-37 (1984).

delays inherent in the state statutes are realized, additional costs are incurred. The shareholders and creditors of both the target and the bidder will be paying for the delays. Any revisions of tender offer regulation must include consideration of the interests of these two affected groups. Although delay presents problems for investors and bidders alike, some commentators argue that delay does in fact benefit target company shareholders by creating an auction market for their shares. The auction market increases the premium ultimately received by tendering shareholders.[102] Neither side of the delay question persuaded a majority of the Supreme Court Justices in *MITE.* Justice White's plurality opinion on this issue was not widely endorsed by his fellow Justices as a basis for state law preemption.

Delays, merit hearings and disclosure differences did not suffice as a basis for holding state laws unconstitutional because of interference with the objectives and purposes of federal regulation, the third of the *Nelson* preemption standards. State tender offer statutes do not conflict with the purpose of the Williams Act even if local management is favored. As one observer states, "[t]he fact that the state statutes may alter this balance [between bidder and target] is therefore an inappropriate basis for statutory preemption. Only if state regulation of tender offers conflicts with the true purpose and objective of the Williams Act—investor protection—should the state laws be held to be preempted."[103] Since state statutes share the Williams Act's investor protection goal, the differences in the way this goal is furthered by state and federal statutes do not generate sufficient conflict to justify federal preemption of state tender offer regulations.

2. The Commerce Clause

The commerce clause[104] gives Congress the power and the responsibility to regulate interstate commerce while severely limiting the ability of state governments to regulate the same subject. A state statute having an effect on commerce will be upheld if it "regulates even-handedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental . . . unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits."[105] Each state regulation alleged to violate the commerce clause must be examined in light of several main factors. The first is the extent of state jurisdictional claims. A second element is the nature of the purpose to be furthered by the regulation. If

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102. *See, e.g.,* Note, *supra* note 76, at 524.

103. *Id.* at 523-24. The Supreme Court stressed that there must be actual conflict to justify preemption—while the conflict need not be express or overt, it cannot be merely a potential conflict. Florida Lime & Avocado Growers, Inc. v. Paul, 373 U.S. 132 (1963).

104. U.S. CONST. art. I, § 8, provides in pertinent part that "Congress shall have power . . . to regulate Commerce among the several states."

105. Pike v. Bruce Church, Inc., 397 U.S. 137, 142 (1970) (citing Huron Cement Co. v. Detroit, 362 U.S. 440, 443 (1960)).

the purpose is one usually deemed legitimate,[106] the statute is one step closer to acceptability. A third factor is whether interstate commerce is affected by the state regulation, and if so, the substantiality of the commerce impact. The analysis finally centers on whether the legitimate state interest outweighs the effect on interstate commerce, and whether a viable alternative exists that still protects the state's interests without affecting interstate commerce to the same extent as does the current regulation.

State jurisdictional claims are the most important element in the commerce clause analysis of tender offer regulation. As noted earlier, states do not base jurisdiction upon securities transactions either specifically involving state residents or occurring solely within state borders. If the state is in fact seeking to protect residents who are shareholders of a target company, the most logical way to do so involves premising state regulation upon the element of state residency or an in-state situs for the transaction.[107] In basing jurisdiction on the formalities of target company incorporation, organization, or location of assets, the state inadequately addresses the problem of shareholder protection. Instead of safeguarding the target company stockholders, the state appears to be concerned only with protecting the target company and thereby also protecting the state's own economy.

The total effect of the additional disclosure, prenotification and filing duties, and the merit hearings is the sheltering of local management against the possibility of a tender offer.[108] By severely limiting and regulating takeovers, the state reduces the chances that a takeover bid will be successful. The state minimizes the risk of a liquidation or relocation of the firm or its assets, thereby avoiding a loss of jobs and tax revenues.[109] Protecting the

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106. Legitimate state purposes are generally considered to include the so-called "police powers" which regulate matters concerning the health, safety and general well-being of society.

107. In a 1976 panel discussion of state takeover statutes and new takeover strategies, Wisconsin's securities commissioner Jeffrey Bartell mentioned his astonishment that

> [n]ot one of the [then existing] 23 state takeover laws defines target company issuers, to which the provision of the laws apply, in terms of the number or percentage of that company's shareholders located in that state. If the statute is honestly designed for the protection of *persons*, it seems to me it must define target company in those terms, and not in terms of characteristics of the *target company* apart from its shareholders.

A.B.A. SEC. CORP. BANK & BUS. LAW, *State Takeover Statutes and New Takeover Strategies—A Panel, reprinted in* 32 BUS. LAW. 1459, 1468 (1976-1977) (emphasis added). Mr. Bartell concluded that state securities commissioners should prompt legislators to correct the portions of the tender offer regulations which "represent overreaching, are extraterritorial in effect or one-sided in application, or are far removed from the objective of providing regulation for the protection and benefit of state shareholders." *Id.*

108. Note, *supra* note 76, at 528. Two distinct rationales support a management-protective approach. One rationale is that the state is responding to the influence and pressure associated with a major local industry. These influences may be monetary, such as contributions to political campaign funds, or personal, such as close friendships between state officials and members of the industry's management. The second theory is that the state is protecting itself economically.

109. Despite the appealing nature of these justifications for state protection of management, the isolation of a local economy is contrary to the Supreme Court concept of a unified national economy. *See infra* notes 114-15 and accompanying text.

companies and their shareholders from corporate raiders was, in fact, a primary argument supporting state and national regulation of tender offers.[110]

While economic protectionism benefits the state, it does not necessarily benefit the target company shareholders, who theoretically are being protected by the state tender offer provisions. Proponents of tender offers as a corporate control transfer mechanism contend that the potential use of the tactic keeps company management alert to the needs of stockholders.[111] Fearing replacement if an offer is successful, management attempts to forestall bids by dissatisfied investors. In so doing, management constantly searches for the optimal uses of all resources—human as well as capital and material.[112] Without the threat of a tender offer, managerial performance declines as management loses its fear of being fired.[113]

Not only does economic protectionism not benefit the shareholders, it expressly violates the commerce clause as interpreted by the Supreme Court.[114] The pro-management bias of state statutes directly contradicts the Supreme Court directive that a state cannot economically isolate either itself or its local corporations from the rest of the nation by hindering prospective tender offers.[115] A state infringes upon the sovereignty of other states by claiming jurisdiction on an extraterritorial basis. Observers fear that by seeking to protect all corporate shareholders regardless of their residency, state laws will severely inhibit potential offerors.[116] Fewer tender offers will occur, and shareholders will lose opportunities for a premium for their shares.[117]

The Supreme Court used the potential inhibition of offers, the loss of the premium for shares, and the reduced efficiency of management as primary grounds for holding the Illinois takeover act unconstitutional in *Edgar v.*

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110. Jarrell & Bradley, *supra* note 2, at 380.

111. *See, e.g., id.* at 380-81, 384; Easterbrook & Fischel, *supra* note 83, at 1169-74.

112. *See* Easterbrook & Fischel, *supra* note 83, at 1169-75.

113. *Id.* at 1175.

114. *See infra* note 115 and accompanying text.

115. Leading examples of the "economic commonality" doctrine include Pike v. Bruce Church, Inc., 397 U.S. 137 (1970) (striking down an Arizona law that required a company to pack its cantaloupes within the state although it was economically more efficient to package the melons in a neighboring state); Dean Milk Co. v. Madison, 340 U.S. 349 (1951) (invalidating a Madison, Wis., law requiring pasteurization of milk within five miles of city center, on the grounds that it was a discriminatory law designed to benefit a major local industry at the expense of interstate commerce); Toomer v. Whitesell, 334 U.S. 385 (1948) (declaring unconstitutional a South Carolina law requiring state-licensed shrimp fishermen to utilize intrastate packaging facilities).

116. *See generally* Note, *supra* note 2. It is extremely difficult to document whether these fears were justified because it is difficult to ascertain what factors were instrumental in decisions of whether or not to proceed with a tender offer. The Supreme Court, however, accepts the underlying argument of potential inhibition of offers. Edgar v. MITE Corp., 457 U.S. 624, 642 (opinion of White, J.).

117. The premium is the difference between the stock's per share market value and the price offered by the bidder. As a general rule, this premium should be about 20% of the market price. *See* Hayes & Taussig, *supra* note 82.

MITE Corp.[118] By blocking nationwide tender offers, the Court stated, the Act also interfered with the efficiency of the marketplace,[119] since the process of reallocating economic resources to their highest valued use was substantially impeded.[120] The combination of economic elements led the Supreme Court to declare that the burdens placed on interstate commerce by the Illinois law were substantial.[121]

Justice White expressed concern that the Illinois act could be applied to regulate tender offers that involved no Illinois shareholders. If Illinois was allowed to impose such controls, he reasoned, other states could follow suit, resulting in a cumulative suppression of securities transactions based upon tender offers because of the difficulties associated with meeting the requirements of each state's statute.[122] Noting that the commerce clause precludes the application of a state regulation to commercial transactions occurring entirely outside of that state's territory,[123] Justice White concluded that since the Illinois act purported to "regulate directly and to interdict interstate commerce, including commerce wholly outside the State, it must be held invalid. . . ."[124] The Court declared the Illinois law unconstitutional on commerce clause grounds.[125]

Just as the Supreme Court in *MITE* was concerned over the extraterritoriality of regulation, so too was the Fifth Circuit Court of Appeals in *Great Western United Corp. v. Kidwell.*[126] Idaho's securities commissioner invoked the takeover law where only two percent of the company's shareholders were state residents. The court declared that the claimed state interest in protecting shareholders, while legitimate, was weakened by the law's extraterritoriality because "Idaho has little reason to protect the large majority of shareholders affected by the takeover act."[127] The court also noted

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118. 457 U.S. 624, 643 (1982) (citing Easterbrook & Fischel, *supra* note 83, at 1173-74). *See also* Fischel, *Efficient Capital Market Theory, the Market for Corporate Control, and the Regulation of Cash Tender Offers,* 57 TEX. L. REV. 1, 5, 27-28, 45 (1978).

119. The efficient capital market theory states that it is impossible to make abnormal stock market gains by identifying and trading in mispriced stocks because as information about a firm reaches a market the price of that firm's stocks will immediately adjust in response to the news. *See* Easterbrook & Fischel, *supra* note 83, at 1165-66.

120. Resource reallocation in the tender offer context means that the offeror will change his usual capital structure so that there is sufficient cash and other consideration available to complete the offer. This in turn means that by accepting the offer, the shareholder changes how his resources are allocated. Instead of two separate "accounts" labelled "cash" and "company *A* stock," the investor now has a larger balance in the cash "account" and no balance in the "company *A* stock" "account." Through the making and accepting of a tender offer, both parties immediately involved are able to shift their resources according to their own preferences. *See generally* Easterbrook & Fischel, *supra* note 83.

121. *MITE,* 457 U.S. at 643.

122. *Id.* at 642 (White, J., by implication).

123. *Id.* at 643 (citing Southern Pac. Co. v. Arizona, 325 U.S. 761, 775 (1945) and Shaffer v. Heitner, 433 U.S. 186, 197 (1977)).

124. *Id.* at 643.

125. *Id.*

126. 577 F.2d 1256 (5th Cir. 1978).

127. *Id.* at 1285.

that the purported benefits to investors resulting from the state law[128] were not assured. The Idaho statute did not guarantee any benefits, and the court stated it was quite possible that the potential delays could actually harm the investors.[129]

State claims of extraterritorial jurisdiction present another problem: several states may assert control over a proposed tender offer. This nearly happened in *MITE,* where initial lawsuits were filed in Pennsylvania and Illinois. Since there is a strong possibility that takeover regulations differ, the offeror risks violating provisions of one state's law while attempting to satisfy the provisions of another. The complex web of competing state statutes "mak[es] compliance difficult, if not impossible even for the best-intentioned offeror."[130] A solution to this problem does exist: limiting the claimed basis of state jurisdiction. Defining the law in terms of the investors and not in terms of the target company alone would limit the overly broad jurisdictional claims, while also lessening the impact of the state law upon interstate commerce.[131] A lesser commerce clause impact would allow states to continue regulating tender offers without facing problems of constitutionality.

The constitutionality issue raises doubts concerning the proper manner of regulating tender offers; these doubts relate as well to the regulation of other methods used to acquire control over a target company. The next sections of this Note examine the recommendations of an advisory group established by the SEC to investigate the techniques of control acquisition, focusing specifically on the suggestions concerning state and federal regulation of tender offers.

III. Advisory Committee Recommendations

A. Committee Establishment and General Guidelines

Several well-publicized recent takeover attempts[132] together with the *MITE*[133] and *Kidwell*[134] decisions prompted the public and the securities industry to

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128. Benefits often claimed to result from the operation of state tender offer laws include additional time for the investor to consider the proposal because of the delays inherent in the laws; a better-informed decision because of additional disclosure; and a higher tender price resulting from the competing bid of a "white knight" (a competing bidder sought out by the target company management). For a discussion of the adverse effects of delay, see *supra* notes 95-103 and accompanying text.

129. *Kidwell,* 577 F.2d at 1285.

130. E. Aranow, H. Einhorn & G. Berlstein, *supra* note 73, at 228.

131. *See supra* note 107 and accompanying text.

132. The two most prominent tender offers were the 1981 attempted takeover of Marathon Oil Company by Mobil Corporation, and the unsuccessful 1982 effort by the Bendix Corporation to acquire Martin Marietta Corporation. Both attempts led to litigation claiming violations of the Williams Act. *See* Mobil Corp. v. Marathon Oil Co., 669 F.2d 366 (6th Cir. 1981); Martin Marietta Corp. v. Bendix Corp., 549 F. Supp. 623 (D. Md. 1982). The tender offer strategy backfired in the Bendix-Martin Marietta battle; through a skilled use of the "Pac-Man" defense, Martin Marietta made a successful tender offer for Bendix stock, acquiring control of the latter company.

133. Edgar v. MITE Corp., 457 U.S. 624 (1982).

134. Great Western United Corp. v. Kidwell, 577 F.2d 1256 (5th Cir. 1978).

question the purpose and effectiveness of dual registration. The SEC decided that a full-scale review of existing federal tender offer legislation was needed. On February 25, 1983, SEC Chairman John R. Shad established an eighteen-member advisory committee to examine current regulations and to suggest any improvements necessary for the smooth functioning of tender offers within the context of a national securities market.[135]

The Advisory Committee determined that various techniques of acquiring corporate control were interrelated, so that regulation of one method without considering the resultant impact on other methods would be haphazard and problematic.[136] The Committee therefore decided to examine the entire range of acquisition techniques,[137] as well as the relationship of state and federal takeover legislation. The Committee also considered the interaction of federal tender offer statutes with other federal regulatory goals and systems.[138]

B. Recommendations and Analysis

The desirability of tender offers *per se* has been hotly debated since the passage of the first tender offer statutes. Proponents argue that threats of a tender offer stimulate management to continually reevaluate its actions in light of the shareholders' best interests. Opponents view the entire takeover process as detrimental to the shareholders, since management expends a vast amount of its time and the firm's resources to oppose a bid. These critics fear that the successful bidder will strip the firm of its valuable assets, causing the company to collapse and thereby leaving the shareholders with worthless stock.[139]

Not surprisingly, the Committee left the issue unresolved, finding no indication that tender offers were either inherently beneficial or detrimental to the investors. The Committee examined the interplay between the national economy and the national securities markets, implicitly endorsing tender offers as tools for acquiring corporate control. "Such transactions and related activities are a valid method of capital allocation *so long as they are conducted in accordance with the laws deemed necessary to protect the interest and the integrity and efficiency of the capital markets.*"[140] The Committee thus reaffirmed the importance of investor protection, while emphasizing the importance of the capital markets—national economy link.

After approving the Williams Act's neutrality towards targets and offerors, the Committee announced several general principles for regulating takeovers.

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135. SEC Release No. 34-19528, 48 Fed. Reg. 9111 (1983).

136. *Advisory Committee Report, supra* note 17, at 1 (Appendix B).

137. *Id.*

138. *Id.* These other regulatory systems include antitrust, taxation, banking and credit regulation, and the traditionally regulated industries such as utilities, insurance companies, and financial institutions.

139. *See* Jarrell & Bradley, *supra* note 2, at 380.

140. *Advisory Committee Report, supra* note 17, at 9 (emphasis added).

Recognizing that tender offers occur in a nationwide market, the Committee called for no undue restriction of innovative techniques so that regulation could respond rapidly to changing market conditions.[141] More important, however, is the Committee's recommendation that states restrict their regulatory efforts to local companies alone.[142] This is not a new suggestion; the same proposal was made by the SEC to Congress in 1980.[143]

The term "local," however, remains undefined. The Committee suggested a possible definition could include:

> Companies with more than 50% of the voting shares held within the state of incorporation, no listing on a national securities exchange, aggregate market value of voting stock held by non-affiliated stockholders of $20 million or less, and annual trading volume of such stock less than one million shares.[144]

There are no reasons given for selecting these particular limitations; state and federal legislators thus are given no real guidelines for revising their respective regulations. For this reason alone, the guidelines deserve further examination.

Some elements of the attempted definition are useful. The absence of a national securities exchange listing in particular would be influential in determining that the firm is a local entity subject to state takeover provisions, since it would indicate how widely held the stock is and where the majority of the firm's stockholders reside. A national listing supports the inference that shareholders are not concentrated in a particular state, thus reducing the basis for any one state to claim jurisdiction over the tender offer.

A twenty million dollar ceiling on aggregate market value and a limit of one million shares in annual trading volume may be too high for a local company not nationally listed. Although the rationale is not specifically stated, the Committee may have set the aggregate market value ceiling purposefully high to counter the effects of inflation; rising market rates in general will not require continual revision of the regulations. There is no specific rationale to support the high annual trading volume ceiling, other than a general hypothesis that states should have some role in regulating tender offers. A trading volume limit of one million shares will enable states to reach the outer limits of their permissible regulatory activity by exercising

141. *Id.* at 15-17, Recommendations 3-6 & 8. The Committee also decided that the scope of tender regulation should be broad enough to protect the shareholders and other market participants from non-disclosure of relevant information, fraudulent practices, and "the creation of situations in which a significant number of reasonably diligent small shareholders may be at a disadvantage to market professionals." *Id.* at 17, Recommendation 7.

142. *Id.* at 17, Recommendation 9(a).

143. Securities and Exchange Commission, *Legislative Proposals on Tender Offers, Beneficial Ownership, Issuer Repurchases,* 542 Sec. Reg. & L. Rep. (BNA) 1 (Special Supp. Feb. 27, 1980). Under this proposal, local companies are defined as those firms with the principal place of business within the state and with over 50% of the shareholders holding more than 50% of the company's outstanding stock residing in that state.

144. *Advisory Committee Report, supra* note 17, at 17 n.17.

jurisdiction over companies with minimal interstate connections. The figures suggested by the Committee, with the exception of the percentage of resident shareholders,[145] are adequate measures of a company's interstate or local nature.

Another important Committee recommendation is that federal takeover legislation should not override or preempt state corporation law except as necessary to eliminate abuses or interference with the intended functioning of the federal provisions.[146] In the aftermath of the *Kidwell* and *MITE* decisions, states may attempt to justify their takeover laws under the "internal affairs" doctrine, which asserts that the states alone have the responsibility and the authority to regulate the manner in which firms conduct business, as well as how the firms relate to their shareholders.[147] Taken literally, the Committee's suggestion would permit any state tender offers enacted as part of the state's corporation laws to stand as valid exercises of state legislative and jurisdictional authority.[148] The only distinction between valid and invalid state tender offer regulations would thus be the positioning of the laws as either a general corporations statute or a blue sky regulation.

Yet this distinction is quite misleading, in view of the Supreme Court's analysis in *MITE*. The essential element is not where the statute appears; rather, it is the impact of that statute upon interstate commerce which determines the statute's constitutionality. It is this fundamental concept that is restated in the Committee's suggestion of limited federal preemption of state corporation law. This suggestion therefore serves only to emphasize the principles currently guiding the courts as they decide the validity of state takeover legislation. No federal legislative action is needed on this point, nor is any expected.

IV. Alternative Approach: Borrowing from the Securities Act of 1933

A. *The Intrastate Offering Exemption of Section 3(a)(11) and Rule 147*

An alternate method of defining a local company for tender offer purposes is the adoption of criteria used in Rule 147 of the Securities Act of 1933.[149] Rule 147 provides objective standards for securities issuers wishing to use the registration exemption allowed for intrastate securites offerings under

145. *See supra* text accompanying note 22; *see also supra* note 107 and accompanying text.

146. *Advisory Committee Report, supra* note 17, at 18, Recommendation 9(b).

147. This doctrine, typically used in resolving choice of law problems, was discussed by the Supreme Court in *MITE*, 457 U.S. at 645.

148. This approach has been advocated by some commentators. *See* Profusek & Gompf, *State Tender Legislation After MITE: Standing Pat, Blue Sky or Corporations Law Concepts?*, 7 Corp. L. Rev. 3, 20 (1984).

149. 17 C.F.R. § 230.147 (1985).

section 3(a)(11) of the 1933 Act.[150] A cost basis and a sufficiency argument together form the rationale for the exemption. In theory, the exemption allows smaller businesses to raise capital quickly by expediting the expensive and time-consuming registration procedures.[151] Since many intrastate companies do not command the resources of companies that deal on a national level, these smaller entities can afford neither the legal and financial expertise necessary to prepare the registration and disclosure forms nor the time required to complete the forms and await a response from the SEC regarding disclosure adequacy.

A second reason for supporting the enactment of the section 3(a)(11) exemption was that the state securities commissioner is in a better position to exercise control over the issuer than is the SEC, since more is known about local investors and important local issues. The state official also is able to respond more quickly should a situation require immediate attention.[152] Legislative history reinforces the claim that existing state securities regulations were sufficient to handle intrastate securities offerings. When the exemption was proposed, there was criticism concerning the nonuniformity of state laws and the uneven application of these laws to interstate offerings. There was, however, no specific criticism directed to state regulation of intrastate securities transactions,[153] and thus no perceived need for federal regulation of intrastate securities transactions.

Rule 147 considers several factors in formulating objective guidelines for a section 3(a)(11) exemption. The place of the issuer's incorporation or organization and the location of the company's principal office or place of business are two important elements.[154] Both reinforce the nature of the issuer as a local entity and serve to partially establish the basis for state exercise of jurisdiction under blue sky laws.

Case law prior to the adoption of Rule 147 resulted in contradictory and often confusing definitions for the "doing business within" requirement of section 3(a)(11). Rule 147 resolves this ambiguity by employing an "eighty percent test" to determine whether the issuer is in fact doing business within

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150. 15 U.S.C. § 77c(a)(11) (1982). Section 3(a)(11) gives only general standards:

> the provisions of this title shall not apply to . . . [a]ny security which is part of an issue offered and sold only to persons resident within a single State or Territory, where the issuer of such security is a person resident and doing business within, or if a corporation, incorporated by and doing business within, such State or Territory.

Id.

151. Alberg & Lybecker, *New SEC Rules 146 and 147: The Nonpublic and Intrastate Offering Exemptions from Registration for the Sale of Securities,* 74 COLUM. L. REV. 621, 622 (1974); Comment, *SEC Rule 147—Distilling Substance from the Spirit of the Intrastate Exemption,* 79 DICK. L. REV. 18, 19 (1974).

152. Comment, *A New Approach to the Intrastate Exemption: Rule 147 vs. Section 3(a)(11),* 62 CALIF. L. REV. 195, 198 (1974).

153. Emens & Thomas, *The Intrastate Exemption of the Securities Act of 1933 in 1971,* 40 U. CIN. L. REV. 779, 781 (1971).

154. 17 C.F.R. § 230.147(c)(1) (1985). The two locations may, but need not, be the same. It is possible that a firm may incorporate in one jurisdiction for special tax or corporate privilege reasons, yet have its principal office or place of operations located in another jurisdiction.

the state. Under this test, if a minimum of eighty percent of gross revenues come from in-state operations, at least eighty percent of total corporate assets are located within the state, and at least eighty percent of the net offering proceeds are intended to be (and actually are) used within the state, then the issuer is deemed to be doing business within the state.[155]

The eighty percent figures have been criticized as being unrealistically high. It has been suggested that this exemption has been transformed from one intended to assist large numbers of local businessmen to one that in actuality aids very few.[156] Most complaints pertain to the requirement that eighty percent of total revenues be locally derived. "It is rare in this age of multistate business operations to find a company with such a high percentage of revenues derived from activities within a single state."[157]

Noting that often a "truly local" company conducts a large amount of interstate business, one writer stated:

> Confining their activities almost entirely to the state of residence or incorporation is contrary to the plain meaning of section 3(a)(11) and conflicts with the policies of its authors. The revenue provision also discriminates against issuers organized under the laws of smaller and less populous states who [need] a certain amount of interstate business to survive.[158]

While the Rule 147 standards have been criticized for the arbitrariness of the figures selected, there are still sound reasons to use them. Partial adoption of the Rule 147 standards is a starting point in improving tender offer regulations. The problems associated with current Rule 147 criteria can be corrected as these standards are tailored to the requirements of the tender offer process. There is less of a chance of surprise in the application of a new tender offer rule based on the Rule 147 criteria. In addition, a partial adoption of these criteria will increase the integration of the 1933 Act with the 1934 Act,[159] thus simplifying and easing the regulatory burdens imposed by federal securities laws.

Borrowing from the Rule 147 standards presents a philosophical difficulty, however, in that the rationale supporting Rule 147 differs from that of the tender offer regulatory scheme. Rule 147 was intended to aid the local issuer, who is already sufficiently regulated by state blue sky laws, and about whom a large amount of information is already known. The rationale for adapting intrastate offering exemption criteria for tender offer regulation purposes, in contrast, is to construct a constitutionally acceptable basis for the exercise

155. *Id.* § 230.147(c)(2)(i)-(iv).

156. *See generally* Alberg & Lybecker, *supra* note 151; Cummings, *The Intrastate Exemption and the Shallow Harbor of Rule 147,* 69 Nw. U.L. Rev. 167 (1974); Comment, *supra* note 152; Comment, *supra* note 151.

157. Cummings, *supra* note 156, at 191.

158. *Id.* at 192.

159. This increased integration results from the use of uniform standards of disclosure to meet the requirements of both Acts.

of state jurisdiction over tender offers. Yet the underlying theme is the same for both regulatory schemes: protection of current and potential investors by ensuring that full information is readily available to the investor without strangling desirable transactions in a noose of needless regulation. Differing aspects of the common problem are addressed by Rule 147 and the Williams Act. The fact that there are other considerations involved should not automatically render the provisions of the former regulation unavailable for use in revising the latter.

B. Refining the Rule 147 Criteria

If the SEC were to adopt the gross revenue—total assets—use of funds test as a means of defining "local" for tender offer purposes, the percentage levels used should be lower than those of the intrastate exemption. It is not clear, however, that the fifty percent figure mentioned by the Advisory Committee for determining shareholder residency would be any more desirable. It is possible that a potential target company, not necessarily local in nature, will, immediately upon hearing the first rumors of a tender offer, attempt to meet the minimum level needed for state protection. A lower figure is obviously easier to attain than a higher one. If successful, this action would circumvent the ideas of neutrality towards both bidder and target as well as exclusive state control over tender offers and takeover battles involving a local company. A figure in the range of fifty-five to sixty-five percent for assets and revenues would allow states to regulate those companies which are truly local and still not intrude into the free flow of interstate commerce by blocking tender offers.

Even if a figure between fifty-five and sixty-five percent is used to define "local," there is still the question of burdening interstate commerce. The new limit arguably burdens interstate commerce; if however, the same number is used to define the company in terms of stockholders who are state residents, the problems of states claiming extraterritorial jurisdiction would be greatly reduced. A careful reading of the Supreme Court holding in *MITE* shows that extraterritoriality was the essential element: Illinois was claiming the authority to protect residents of other states.[160] Limiting a state's jurisdiction to companies with well over fifty percent of their shareholders residing in the state makes claims of state regulation to protect resident investors more credible. This in turn raises the status of the state's legitimate interest in safeguarding its citizens, reducing the disparity between the impact of the law on interstate commerce and the valid purpose behind the state takeover regulation.

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160. Edgar v. MITE Corp., 457 U.S. 624, 643-46 (1982); *see also* notes 118-25 and accompanying text.

V. Should There Be State Regulation of Local Company Tender Offers?

A final consideration is whether there is a need for a definition of a local company and the restriction of state regulation to tender offers for local companies. Judging from the extent of tender offer statutes, state legislators perceive the Williams Act as inadequately protecting their constituents. State interest generally centers on three areas: protection of investors, protection of "noninvestor constituencies" such as employees and suppliers,[161] and regulation of rapid changes of corporate control. The Indiana General Assembly embraced the investor protection rationale in emphasizing the need for more disclosure as a tool for decisionmaking, noting that often the relatively small shareholders lose the benefits of the takeover offer as well as their equity position in the company.[162] Ohio legislators stressed the effects on shareholders of rapid changes in corporate control, and the lack of "normal corporate approval mechanisms" associated with other acquisition techniques as necessitating state regulation of the process.[163]

The SEC Advisory Committee approached the transfer of control problem from a different angle. In Recommendation 33,[164] the Committee endorsed a combination of state corporate laws and the business judgment rule as the general framework for corporate decisions relevant to takeovers.[165] The Committee, however, rejected the state statutes and regulations restricting the ability of a firm to make a tender offer, citing the interstate commerce grounds of the *MITE* holding.[166] Statutes requiring the approval of target company shareholders prior to the completion of a tender bid were specifically mentioned by the Committee as violating the prohibition against undue restrictions of interstate commerce. Shareholder approval, rejected by the Committee, is one of the most frequently used "normal corporate approval mechanisms" cited by the Ohio legislature in its takeover statute.

As a general rule, it seems unlikely that many tender offers intimately involving large numbers of a particular state's residents would actually occur. As the court of appeals pointed out in *Kidwell,*

> the business realities of tender offers make it unlikely that there will be many offers for corporations held predominantly by Idahoans (or citizens of any other narrow geographic area). Investment bankers know that local owners are characteristically loyal to management. Therefore, corporations with widespread stock ownership are more promising tender offer targets.[167]

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161. *See supra* note 101 and accompanying text.
162. Ind. Code § 23-2-3.1-0.5 (1982).
163. Ohio Rev. Code Ann. § 1701.832(A)(2) (Page 1985).
164. *Advisory Committee Report, supra* note 17, at 34.
165. *Id.*
166. *Id.* at 34 n.31; *see also id.* at 35, Recommendation 34.
167. Great Western United Corp. v. Kidwell, 577 F.2d 1256, 1283 (5th Cir. 1978).

Under this reasoning, tender offers as a means of acquiring corporate control will be a phenomenon generally associated with large multistate corporations. These corporations will, by definition, be regulated under the Williams Act; thus, state takeover laws will be of limited use to a company facing a tender offer.

Assuming that adequate controls already exist, from either the business realities mentioned in *Kidwell,*[168] the tendency of investors to act when they perceive action will be both affordable and effective,[169] or the greater impact of state regulations upon smaller companies, there is no real need to carve out a separate tender offer area reserved for state legislative action. The thrust of *MITE* and *Kidwell* is that a state's jurisdiction cannot exceed its boundaries, nor ean the state hinder interstate commerce. As tender offers are usually associated with large companies held by multitudes of investors, very few of whom (either in percentage terms or in absolute numbers) are likely to reside in a certain state, there may be no role for state regulation of tender offers. This being the case, the Advisory Committee's suggestion that state takeover statutes be limited to local companies is largely devoid of significance. Recommendation 9(a) may be simply an exercise in mental gymnastics, requiring no affirmative action to be taken by Congress or the SEC.

Conclusion

Recent court decisions have pronounced state takeover laws unconstitutional because the overreaching claims of state jurisdictions adversely affect the making of tender offers. Conflicting state legislation hinders bidders in their efforts to comply with mandated disclosure and often requires pre-effective notification provisions as preliminary steps to making takeover bids on a nationwide basis. Delays resulting from the operation of state statutes are costly to all involved as a result of lost opportunities, high fees for legal and financial expertise, possible reductions of initial bids, assets expended on pursuing or defending from a tender offer, and a strong likelihood that some offerors will be discouraged from making bids in the first place. The Advisory Committee examined the role of state takeover regulation but failed to do more than repeat the broad themes espoused in *MITE* and *Kidwell.*

If the SEC or Congress decides that the Williams Act should specifically preempt state tender offer laws, or expressly limits such state regulation to local companies, state jurisdictional claims must be more narrowly tailored to reduce the adverse impact of state tender offer regulations upon interstate commerce. The criteria for the intrastate offering exemption of the Securites Act of 1933 are useful in defining the scope of the state's role in regulating tender offers.

Phyllis E. Grimm

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168. *Id.* at 1283.
169. *See* Easterbrook & Fischel, *supra* note 83, at 1170-71.