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## Misreading the Williams Act

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# MISREADING THE WILLIAMS ACT†

*Lyman Johnson\* and David Millon\*\**

The Commission does not believe that any bill should be adopted which would either encourage or discourage takeover bids, nor does the Commission want to be involved in any way in passing upon the merits or conditioning the terms of takeover bids.

— Manuel F. Cohen, Chairman of the SEC,  
during Senate committee hearings on  
the proposed Williams Act, 1967.<sup>1</sup>

[T]he [C]ommission has instructed us to support challenges to the constitutionality of the Delaware [antitakeover] statute . . . I identified that as a top priority because our success or failure in those challenges will have a far[-]reaching effect on tender offer practice and quite likely on what Congress does with respect to tender offer legislation.

— Daniel Goelzer, General Counsel of the  
SEC, July 22, 1988.<sup>2</sup>

## INTRODUCTION

Prompted by the sharply rising tide of hostile takeover activity, and fearing its disruptive effects on their economies, most states have enacted legislation to regulate takeover contests.<sup>3</sup> Because Delaware's recent statute<sup>4</sup> alone governs approximately one half of all New York Stock Exchange-listed companies, the vast majority of public corporations are protected by state legislation. While state takeover statutes assume several different forms, all recent legislation shares a common

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1. *Full Disclosure of Corporate Equity Ownership and in Corporate Takeover Bids: Hearings on S. 510 Before the Subcomm. on Securities of the Senate Comm. on Banking and Currency*, 90th Cong., 1st Sess. 178 (1967) [hereinafter *Senate Hearings*].

2. *Special Report*, 20 Sec. Reg. & L. Rep. (BNA) 1176 (July 22, 1988) (interview transcript).

3. According to a recent survey, since 1982 at least 29 states have adopted one or more of the various forms of takeover laws. See Grippio, *In Defense of State Takeover Laws*, 8 N. ILL. L. REV. 273, 273-74 n.4 (1988). States continue to act in this area. See Lipman, *Another Generation of Antitakeover Laws Beginning to Develop*, Natl. L.J., Feb. 20, 1989, at S18.

4. DEL. CODE ANN. tit. 8, § 203 (1974 & Supp. 1988).

purpose. It aims to discourage hostile takeover attempts by placing various obstacles — such as required target management approval and the resulting delay, uncertainty, and increased costs — in the path of takeover bids. Although often shrouded in the rhetoric of shareholder welfare, the primary goal of these laws is to protect various *non-shareholder* interests thought to be adversely affected by hostile takeover activity.<sup>5</sup> State legislators are particularly concerned about the increasingly typical “bust-up” takeover, in which the bidder seeks to profit from large-scale asset liquidations or corporate restructurings that result in plant closings, employee lay offs, and out-of-state relocations.<sup>6</sup> Takeovers motivated by such objectives are believed to threaten jobs, established customer and supplier relationships, tax revenues, charitable contributions, and other economic and social benefits provided by resident companies to local communities.<sup>7</sup> Together with the threat to incumbent corporate managements,<sup>8</sup> these concerns have

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5. See Johnson, *Corporate Takeovers and Corporations: Who Are They For?*, 43 WASH. & LEE L. REV. 781, 783 n.11 (1986):

There are, of course, a great variety of concerns about the effects of takeover activity — actual and threatened — on persons and groups other than shareholders. One way to classify many of these misgivings is to separate a concern for the effects on persons whose lives are immediately affected by a particular corporation from concerns that are more national in scope. “Stakeholders” in specific corporations such as employees, suppliers, creditors, customers, and local enterprise-dependent communities fall within the former category. Diversion of credit to unproductive uses, narrow management focus on short-run economic performance, inordinate use of debt, and waste of society’s resources are oft-cited concerns about takeovers that fall within the latter category. Obviously, the distinction is somewhat artificial since many corporate activities affect both categories. Nonetheless, it serves as a reminder that while there are many persons and groups interested in the fate of individual corporations, there is also a larger societal concern about the cumulative effects of takeover activity.

In this Article, the term “nonshareholder” is used to refer to both kinds of nonshareholder interests.

6. The “bust-up” motivation, rather than a desire to increase efficiency by replacing management, is now the dominant motivation for hostile takeovers. Coffee, *Shareholders Versus Managers: The Strain in the Corporate Web*, 85 MICH. L. REV. 1, 2-7 (1986). This development has been linked to certain characteristics of the present business environment — termed “the age of finance corporatism” — that stress short-term maximization of investment returns. See Lipton, *Corporate Governance in the Age of Finance Corporatism*, 136 U. PA. L. REV. 1, 5-6 (1987).

7. See A. SCHLIEFER & L. SUMMERS, *HOSTILE TAKEOVERS AS BREACHES OF TRUST* (National Bureau of Economic Research Working Paper No. 2342, 1987) (arguing that shareholder gains in “bust-up” takeovers result from breaches of implicit contracts between shareholders and stakeholders); COFFEE, *The Uncertain Case for Takeover Reform: An Essay on Stockholders, Stakeholders and Bust-Ups*, 1988 WIS. L. REV. 435; Lipton, *supra* note 6, at 1, 25-26. For particular examples, see Nussbaum & Dobzynski, *The Battle For Corporate Control*, BUS. WK., May 18, 1987, at 102, 103; Sheets, *People Pay the Highest Price in a Takeover*, U.S. NEWS & WORLD REP., July 22, 1985, at 51.

8. Professor Romano has argued that protection of incumbent management is the real reason behind state antitakeover legislation, citing the leading role played by the Aetna Life and Casualty Insurance Company and the Connecticut Business and Industry Association in the passage of Connecticut’s statute. Romano, *The Political Economy of Takeover Statutes*, 73 VA. L. REV. 111, 122 (1987). Her argument minimizes the possible significance of evidence of organized labor’s support for takeover legislation in other states. See *id.* at 137-38. Furthermore, in Connecticut itself, labor was on record as supporting plant-closing legislation. *Id.* at 134 n.58.

occupied the legislators' attention as they respond to heightened takeover activity. Thus, for obvious economic and political reasons, deterrence of tender offers, not "investor protection," is emerging as the states' principal motivation in passing takeover laws, a fact state legislators are beginning to acknowledge more candidly.<sup>9</sup>

While perceived by state legislators to damage nonshareholders, tender offers have been hailed by several sources as a godsend for shareholders. Over the past two decades, the hostile takeover has replaced the proxy fight as the more potent vehicle for wresting corporate control from incumbent management. Thus the takeover provides a critical market-based mechanism for assuring better management accountability to shareholders.<sup>10</sup> In this respect, hostile takeover attempts not only enhance shareholder wealth in the short run,<sup>11</sup> they also play an important role in redressing the "internal" imbalance of power between managers and shareholders that exists in the contemporary state law-created corporate governance scheme. To accomplish these laudable purposes, the would-be acquirer does nothing more than appeal directly to the target company's shareholders to sell their stock at a price substantially over market price. Thus, while having an obvious connection to "internal," state-established corporate relationships, tender offers circumvent the pro-management tilt of that regime. They do so by operating through the medium of the "external" nationwide securities markets and by being directed to only one party in the governance scheme — the shareholder.

This shareholder-centered perspective on tender offers is accurate as far as it goes, but control over corporate assets, not shareholder stock, is the bidder's ultimate goal. It is the aftermath of a stock acquisition that is of concern to the corporate entity and its entire field of constituent relationships. The purchase of stock from shareholders is

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Although labor took no active role in enactment of the antitakeover law, legislators who assumed a connection between hostile takeovers and plant closings may have taken for granted labor's position on the takeover question. Romano also makes no effort to explain language from other state statutes expressly referring to a broad range of nonshareholder interests. *See infra* notes 69 & 78. Finally, the equation of management support with selfish entrenchment objectives may be questionable; many corporate managers would dispute the suggestion that their desire to keep their jobs is motivated by narrow self-interest rather than by a genuine concern for the welfare of a broad range of constituencies whose lives are affected by corporate activity. *See* Bryan, *The Corporation and the Executive in the Community*, 1987 COLUM. BUS. L. REV. 695 (lecture by Chairman and CEO of Sara Lee Corporation).

9. *See infra* notes 76-79 and accompanying text.

10. *See, e.g.,* 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); Easterbrook & Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161 (1981).

11. Premiums average 30% to 40% over market price. Jensen & Ruback, *The Market for Corporate Control: The Scientific Evidence*, 11 J. FIN. ECON. 5 (1983).

simply the means to achieve other objectives that implicate a diverse array of nonshareholder interests. Consequently, as states seek to protect local enterprise-dependent economic interests by curbing takeover activity, they emphasize the hostile takeover's significance as a "corporate" rather than a purely "shareholder" or capital market matter. Therefore, as with mergers, substantial asset sales, dissolutions, or other fundamental changes in corporate structure, takeovers are seen properly to lie within the traditional sphere of state corporation law, and are regarded as appropriate subjects for regulation through the general corporation statute. In short, recognizing the potential impact of tender offers on local constituent interests, and thus on their economies, states have sought to reclaim primary authority over this capital market phenomenon by "corporatizing" the law of takeovers.<sup>12</sup> This is necessarily done at the price of denying shareholders the wealth and governance benefits of takeovers.<sup>13</sup> Thus, while takeovers are touted as a powerful antidote for the longstanding governance ills of state corporation law, statutory counter-measures jeopardize their potency.

As states pursue their "corporatization" strategy by passing increasingly robust antitakeover laws, their efforts are being challenged by the Securities and Exchange Commission with its simpler, shareholder-oriented capital market perspective on tender offers. The SEC denies that tender offers are accurately characterized as "corporate" matters. Instead, the SEC emphasizes that tender offers involve the sale and purchase of stock and therefore are best described as securities transactions. The SEC and other critics argue that state antitakeover legislation has intruded into an area properly subject to federal regulation, that is, the fair and efficient functioning of the national capital markets.<sup>14</sup> By insisting that the Williams Act,<sup>15</sup> which regulates limited aspects of tender offers, embodies a pervasive federal takeover policy that precludes state interference, the SEC reads the Williams Act as "federalizing" or "securitizing" tender offer regulation. Consequently, it is argued that the Williams Act preempts state

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12. To the extent that state antitakeover laws aim to regulate the effects of corporate activity on a broad range of nonshareholder constituencies, these laws represent a return to an earlier vision of the appropriate uses of corporation law, a vision that rejects corporation law's narrow preoccupation with the internal relation between management and shareholders in favor of a broader regulatory perspective acknowledging the social impact of corporation law. See Millon, *State Takeover Laws: A Rebirth of Corporation Law?*, 45 WASH. & LEE L. REV. 903 (1988).

13. The antitakeover — and therefore antishareholder — thrust of state legislation may conflict with common law developments imposing a duty on target company management to maximize shareholder wealth in certain takeover situations. See Johnson, *The Eventual Clash Between Judicial and Legislative Notions of Target Management Conduct*, 14 J. CORP. L. 35 (1988).

14. See *infra* Part IV.

15. 15 U.S.C. §§ 78m(d)-(e), 78n(d)-(f) (1988).

"corporate" legislation aimed at achieving nonshareholder protection objectives that are threatened by unfettered capital markets. The result is not simply that state corporation law is displaced by federal securities law; the Williams Act's modest provisions are transformed into a broad federal pro-takeover policy.

Underlying the SEC's preemption claim is its conviction about the pernicious effects of antitakeover legislation. The SEC, together with many other critics of antitakeover laws,<sup>16</sup> objects to the harmful impact of those statutes on shareholder well-being, its sole concern. To the extent that these laws reduce the aggregate level of hostile takeover activity, the probability of a shareholder receiving a stock price premium of the magnitude that invariably accompanies a tender offer is greatly diminished.<sup>17</sup> Shareholders as a group also lose the heightened attention to profit maximization that a credible hostile takeover threat imposes on corporate management.<sup>18</sup> Furthermore, society as a whole is denied the supposed benefits of takeovers as a force for reallocating economic resources to higher-valued uses.<sup>19</sup> As a result, according to

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16. See, e.g., Steinberg, *Tender Offer Regulation: The Need for Reform*, 23 WAKE FOREST L. REV. 1 (1988); Pozen, *The New Round of State Tender Offer Statutes*, 53 BROOKLYN L. REV. 89 (1987); Block, Barton & Roth, *State Takeover Statutes: The "Second Generation,"* 13 SEC. REG. L.J. 332 (1986); Levmore, *Interstate Exploitation and Judicial Intervention*, 69 VA. L. REV. 563, 619-26 (1983); Comment, *State Antitakeover Legislation: Unconstitutional Economic Folly*, 20 ARIZ. ST. L.J. 475 (1988).

17. There is considerable evidence that shareholders of target companies profit from corporate takeovers. See *supra* note 11; see also Jensen, *Takeovers: Folklore and Science*, 62 HARV. BUS. REV. 109 (Nov.-Dec. 1984); Jarrell, *The Wealth Effects of Litigation by Targets: Do Interests Diverge in a Merge?*, 28 J. L. & ECON. 151 (1985). Not only do takeover statutes threaten shareholder opportunities to realize such profits, the passage of takeover laws may itself diminish the value of stock in corporations subject to such laws. If capital market participants believe that state takeover laws will succeed in reducing the probability of shareholders receiving takeover premiums, then, if capital markets are efficient, share prices should decline. There is some evidence of such effects, as seen for example, in a recent study by the SEC's Office of the Chief Economist. The study found that the passage of Ohio's 1986 takeover law was followed by a drop in share prices of Ohio corporations in an amount roughly equal to two percent in value. The study concluded that the law appears to "redistribute wealth from shareholders of Ohio firms to the incumbent managements and workers of these firms, residents of Ohio." OFFICE OF THE CHIEF ECONOMIST, SEC. & EXCH. COMM., *SHAREHOLDER WEALTH EFFECTS OF OHIO LEGISLATION AFFECTING TAKEOVERS* 3, 23 (May 18, 1987). The net result, if this study is correct and typical, is that shareholders lose immediate wealth as well as the possibility of even greater wealth from future takeover attempts. But see Romano, *supra* note 8, at 111, 180-87 (no statistically meaningful effect or result of Connecticut, Missouri, or Pennsylvania statutes).

18. See Gilson, *A Structural Approach to Corporations: The Case Against Defensive Tactics in Tender Offers*, 33 STAN. L. REV. 819, 841 (1981) ("[T]he market for corporate control may be the only potentially serious force for limiting management discretion."); Weiss, *Economic Analysis, Corporate Law, and the ALI Corporate Governance Project*, 70 CORNELL L. REV. 1, 27 (1984) ("[T]he market for corporate control in general, and tender offers in particular, are the most important disciplinary factors in the corporate governance system, and should be encouraged.").

19. Professor Demsetz has asserted that "takeovers and tender offers serve the interests of both shareholders and the nation." ECONOMIC FORUM ON TENDER OFFERS: PROCEEDINGS OF THE SECURITIES AND EXCHANGE COMMISSION 16 (Feb. 20, 1985) (statement by Professor Demsetz) (transcript on file with the *Michigan Law Review*). The Annual Report of the Council of

these critics, states are promoting parochial interests at the expense of shareholder property rights and the general society-wide interest in freely functioning capital markets and efficient resource allocation. This undesirable policy objective of state legislatures purportedly clashes with the investor protection aim of the Williams Act, and thus state legislation is said to be preempted.<sup>20</sup> To the extent this reading of federal law has the further effect of imposing substantive restrictions on matters previously deemed to be within the province of state corporation law, it essentially federalizes portions of state corporation law and presumably will require the piecemeal development of a federal constitutional law of corporate takeovers.<sup>21</sup>

This Article examines the emerging controversy over preemption of the most potent of recent antitakeover laws, the so-called business combination statutes recently passed by Delaware, New York, and other states, and Pennsylvania's director-approval statute.<sup>22</sup> After examining the strategy employed by the states to shield these statutes from constitutional attack, we consider the issues raised by the preemption claim and the arguments currently being advanced by the SEC and others in favor of preemption. Resolving the preemption controversy requires inquiry into the original meaning and objectives of the Williams Act. We argue that this should involve attention not only to the statute's linguistic context but also to certain critical assumptions about takeovers and corporation law that formed the back-

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Economic Advisors for 1985 reached a similar conclusion, finding that takeovers both increased national wealth and enhanced shareholder well-being:

The available evidence, however, is that mergers and acquisitions increase national wealth. They improve efficiency, transfer scarce resources to higher valued uses, and stimulate effective corporate management. . . . The evidence is overwhelming that successful takeovers substantially increase the wealth of stockholders in target companies.

ECONOMIC REPORT OF THE PRESIDENT 196-97 (Feb. 1985).

20. The preemption arguments presently being advanced with respect to state legislation also apply to state common law governing takeovers. See Johnson & Millon, *Does the Williams Act Preempt State Common Law in Hostile Takeovers?*, 16 SEC. REG. L.J. 339 (1989).

21. A tentative, fact-sensitive analysis of the impact of Delaware's new takeover statute on two takeover bids was displayed in recent decisions considering the constitutionality of that statute, see *infra* text accompanying notes 89-96. The decisions indicate that a whole body of law passing on the constitutional status of that and other statutes will need to be developed under the various economic and business scenarios of particular takeover bids. If, as the SEC argues, "shareholder welfare" is the touchstone against which these statutes are to be evaluated, see *infra* Part IV, then their constitutionality cannot be determined simply in the abstract, but only according to how they operate in particular factual circumstances, which, in the takeover industry, will continue to evolve rapidly.

22. As part of a major overhaul of its corporation statute, Pennsylvania has adopted, effective October 1, 1989, a provision empowering a corporation, acting through its board of directors, "[t]o accept, reject, respond to or take no action in respect of an actual or proposed acquisition, divestiture, tender offer, takeover or other fundamental change . . . ." 15 PA. CONS. STAT. 1502(A)(18). Since the basic thrust of Pennsylvania's law is the same as that of the business combination statutes, it will not be addressed separately.



drop against which Congress acted in 1968. We conclude that a proper understanding of the Williams Act offers no credible support for the preemption claim. Not only does a conventional analysis of statutory language and legislative history reveal that Congress did not seek to enact a general federal policy in favor of a robust market for corporate control, but appreciation of the historical context within which Congress acted demonstrates that such arguments are based on a mistaken equation of congressional *assumptions* with congressional *intentions*. In 1968 Congress made assumptions about certain core premises of state corporation law and about the macro-effects of takeovers. These assumptions, however, did not amount to intentions about how we ought to regulate takeovers in a markedly different economic and legal environment, an environment in which those assumptions no longer hold true. Congress did no more than address the takeover issue as it existed in 1968. It never addressed the important and distinctive policy questions that occupy us today. Accordingly, rather than claiming to find in the tea leaves of the Williams Act evidence of an intent that does not exist, judges and policymakers should take a fresh look at the costs and benefits of hostile takeovers and the appropriate role of the states in their regulation.

## I. THE PREEMPTION CONTROVERSY AND ITS BACKGROUND

### A. *The CTS Decision*

In *CTS Corp. v. Dynamics Corp. of America*,<sup>23</sup> the United States Supreme Court rejected commerce and supremacy clause challenges to the Indiana "control share acquisition" takeover statute.<sup>24</sup> The statute provides that a tender offeror — one who has acquired a specified percentage of the stock of a target corporation chartered in and having other statutorily defined contacts with Indiana<sup>25</sup> — will enjoy voting rights only if the remaining shareholders vote by a majority of shares to grant such voting rights.<sup>26</sup> If the offeror is unwilling to await the

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23. 481 U.S. 69 (1987).

24. IND. CODE ANN. §§ 23-1-42-1 to -11 (West 1989).

25. In addition to Indiana incorporation, the statute is limited to corporations having 100 or more shareholders, principal place of business or principal office, or substantial assets in Indiana, and either 10% of its shareholders resident in Indiana or 10% of its shares owned by Indiana residents, or 10,000 shareholders resident in Indiana. IND. CODE ANN. § 23-1-42-4 (West 1989).

26. Voting rights require approval by a majority of all shares and then by a majority of disinterested shares. "Interested" shares are defined as those shares held or controlled by the acquirer or by officers or inside directors of the target company. IND. CODE ANN. §§ 23-1-42-3, -9(b) (West 1989). Because only shares owned or controlled by the bidder or by target company insiders are deemed to be "interested" and the bidder generally will not have purchased tendered shares by the plebiscite's record date, the stock of tendering shareholders evidently can be voted favorably on the voting rights question. This feature significantly dilutes the power of nontender-

next annual meeting for such a plebiscite, it may request that a special shareholders' meeting take place to decide the voting rights question within fifty days, at the offeror's expense. If the target company shareholders vote to confer voting rights, all nonbidder shareholders then have the option to "dissent" and receive "fair value" for their shares from the target corporation.<sup>27</sup>

Indiana's legislative strategy responded to the Supreme Court's decision in *Edgar v. MITE Corp.*,<sup>28</sup> which had struck down an Illinois antitakeover law on commerce clause grounds. The Illinois law applied to foreign as well as domestic corporations, imposed various procedural burdens on hostile takeovers, and required a state administrative proceeding that, among other matters, subjected an offer to a vaguely defined "fairness" review.<sup>29</sup> Emphasizing its extraterritorial impact and the insufficiency of the local interests it was designed to protect, the Court in *MITE* held that the statute unconstitutionally burdened interstate commerce.<sup>30</sup> In addition, three justices found the statute to be preempted by the Williams Act.<sup>31</sup> This plurality interpreted the Williams Act as mandating that shareholders possess the power to decide whether a tender offer will succeed. Shareholders exercise this power through their individual decisions to tender or hold their stock in response to a hostile bid. The Illinois statute, however, effectively usurped that power from the shareholders by interjecting a state administrator into the takeover process. Even if that regulatory mechanism were truly designed to enhance target shareholder welfare in some substantive fashion, the plurality argued, it would be preempted by the Williams Act because, procedurally, it interfered with shareholder resolution of takeover contests.<sup>32</sup>

*MITE* seemed to sound the death knell for state efforts to regulate hostile takeovers.<sup>33</sup> However, by locating takeover provisions within

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ing shareholders to block a tender offer whenever a majority of "disinterested" shares has responded favorably.

27. IND. CODE ANN. § 23-1-42-11 (West 1989).

28. 457 U.S. 624 (1982).

29. See Illinois Business Take-Over Act, Pub. Act No. 80-1421, §§ 1-20, 1978 Ill. Laws 1581, 1581-95, repealed by Act Effective Sept. 14, 1983, Pub. Act No. 83-365, [1983] 2 Ill. Laws 3094.

30. 457 U.S. at 640-46.

31. 457 U.S. at 630-40.

32. 457 U.S. at 633-34.

33. After *MITE*, virtually all challenged takeover statutes were held unconstitutional. See Johnson, *Minnesota's Control Share Acquisition Statute and the Need for New Judicial Analysis of State Takeover Legislation*, 12 WM. MITCHELL L. REV. 183, 191-92 n.29 (1986) (collecting pre-1985 decisions); see also *Dynamics Corp. v. CTS Corp.*, 794 F.2d 250 (7th Cir. 1986), *revd.*, 481 U.S. 69 (1987); *Fleet Aerospace Corp. v. Holderman*, 796 F.2d 135 (6th Cir. 1986), *remanded sub nom. Ohio v. Fleet Aerospace Corp.*, 481 U.S. 1026 (1987); *Terry v. Yamashita*, 643 F. Supp. 161 (D. Haw. 1986).

the general incorporation statutes and structuring them as laws defining shareholder voting rights rather than directly regulating the takeover process as such, Indiana and other states adopting control share acquisition laws sought to characterize their efforts as legislation entirely within the jurisdictional sphere traditionally reserved to the states.<sup>34</sup> This basic strategy, as far as it went, was vindicated in *CTS*. The Supreme Court's commerce clause analysis was strongly influenced by its view of the Indiana law as one entitled to the deference traditionally accorded state legislation addressing internal corporate governance matters.<sup>35</sup>

Speaking to the preemption issue,<sup>36</sup> the Court in *CTS* emphasized the lack of a direct conflict between federal and state law.<sup>37</sup> The Court interpreted the Williams Act as having two purposes: to protect shareholders in relation to offerors and to adopt a neutral posture vis-à-vis bidders and target company management.<sup>38</sup> The Court read the Indiana statute as a proshareholder enactment, and therefore consistent with federal law, for two reasons. First, the Court simplistically equated shareholder decisionmaking power with proshareholder policy.<sup>39</sup> The Indiana statute gave shareholders, as a body, the apparent ability to determine whether a hostile offer will succeed through exercise of their power to decide the voting rights question. The Court thus implicitly denied the importance of the distinction between *indi-*

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34. See Cox, *The Constitutional "Dynamics" of the Internal Affairs Rule — A Comment on CTS Corporation*, 13 J. CORP. L. 317 (1988).

35. The Court acknowledged the statute's interstate impact, conceding that it applied to shareholders of Indiana corporations who resided outside Indiana's borders. Noting that many features of state corporation law have a similar impact, the Court concluded that, absent discrimination or inconsistent regulation, such effects could not be a basis for commerce clause invalidation. Furthermore, the Court viewed the statute as designed primarily to protect shareholders of Indiana corporations against coercive two-tier offers, deemed by the Court to be a legitimate state interest. See 481 U.S. at 91-93.

36. The supremacy clause, U.S. CONST. art. I, § 8, cl. 3, is the source of the preemption doctrine. The Supreme Court has enunciated four different grounds for preemption. First, Congress may expressly preempt state law in a particular area. See, e.g., *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 236 (1947). Second, a court may find that Congress intended "to occupy a field" by means of a pervasive regulatory scheme. See, e.g., *City of Burbank v. Lockheed Air Terminal, Inc.*, 411 U.S. 624, 633-34 (1973). Third, where "compliance with both federal and state regulations is a physical impossibility," preemption may be found. See, e.g., *Florida Lime & Avocado Growers, Inc. v. Paul*, 373 U.S. 132, 142-43 (1963). Finally, a law that "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress" is preempted. *CTS Corp. v. Dynamics Corp.*, 481 U.S. 69, 79 (1987) (quoting *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941)). Only the fourth of these tests applies to the question of the constitutionality of state antitakeover laws under the Williams Act. See *CTS*, 481 U.S. at 79. For a critique of the preemption doctrine as developed by the Supreme Court, see Wolfson, *Preemption and Federalism: The Missing Link*, 16 HAST. CONST. L.Q. 69 (1988).

37. See 481 U.S. at 78-87.

38. 481 U.S. at 81-84.

39. 481 U.S. at 84.

*vidual* shareholder decisionmaking, expressed through decisions to tender or hold stock, and *collective* choice exercised by means of deciding to grant or withhold voting rights. Second, quite apart from the ostensible shareholder democracy design of Indiana's law, the Court stressed that the effect of the statute is to protect shareholders from the coercion of two-tier tender offers.<sup>40</sup> This *ex post* view of Indiana's law, which focuses on how target company shareholders are protected by the statute once a takeover bid is launched, ignores the *ex ante* concern that such legislation might dampen the aggregate level of takeover activity, to the detriment of shareholders as a class.<sup>41</sup> Thus, while the Court in *CTS* declined to decide whether the *MITE* plurality's reading of the Williams Act is correct,<sup>42</sup> it concluded that the Indiana statute meets that standard of investor protection in any event, because it is a proshareholder enactment.<sup>43</sup> The Court shed little light, however, on the meaning of "investor protection" under the Williams Act because it failed to define whether the word "investor" in that phrase means shareholders as a nationwide class, actual target company shareholders, or merely some subset of target shareholders, namely those facing coercive bids. Moreover, the Court failed to clarify whether the word "protection" always, never, or sometimes means substantive, paternalistic protection of shareholders rather than preservation of shareholder decisionmaking autonomy. This guarded resolution of the preemption issue leaves undecided the pivotal question of whether the Williams Act requires that individual target company shareholders possess the power to determine a hostile bid's success or failure where the decisionmaker is not a state agency as in *MITE*, or other shareholders as in *CTS*, but target management itself.

*CTS* also leaves undecided the more fundamental question of whether the Williams Act mandates an unflinching shareholder welfare policy that overrides state legislative efforts to protect nonshareholders at shareholders' expense. The failure to address this issue is odd because Justice Powell, author of the Court's opinion in *CTS*, concurred in *MITE* on the ground that states possess a legitimate in-

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40. 481 U.S. at 84. Such bids can result in coercion of shareholders to tender because the offeror announces that it will pay a high premium only to a certain percentage of shareholders who tender promptly, the remainder to be cashed out later at a lower price by means of a merger. For discussion of how control share acquisition statutes ameliorate the coercion problem, see Booth, *The Promise of State Takeover Statutes*, 86 MICH. L. REV. 1635 (1988). For a response to Professor Booth, see Johnson & Millon, *Missing the Point About State Takeover Statutes*, 87 MICH. L. REV. 846 (1989). In fact, two-tier offers are extremely rare nowadays. *Id.* at 847 & nn.6-7; see *infra* note 73.

41. See *supra* notes 17-18; see also Cox, *supra* note 34, at 333-36.

42. 481 U.S. at 80-81.

43. 481 U.S. at 84.

terest in considering nonshareholder constituencies.<sup>44</sup> Additionally, Indiana corporation law expressly authorizes directors to consider an array of such factors in determining how to respond to a takeover bid.<sup>45</sup> This bedrock question was not addressed because the Court fastidiously avoided any serious analysis of the purpose or effect of the Indiana statute.<sup>46</sup> It would have been impossible to see the Indiana statute as a proshareholder enactment if the Court had been persuaded that its design and operation reflected a purpose to protect local non-shareholders by reducing *ex ante* the volume of hostile takeovers. Indiana conceded in its brief that at least one of the statute's purposes was to address concerns about corporate liquidations and removals from the state.<sup>47</sup> It responded to those concerns by giving target company shareholders, who it unrealistically stated might themselves be community residents, employees, or suppliers of the corporation,<sup>48</sup> the power to block takeovers that might have those effects.<sup>49</sup> By simplistically equating ostensible shareholder decisionmaking power with proshareholder purpose, however, the Court did not expressly consider whether the statute's real beneficiaries were intended to be non-shareholders. Thus, it did not resolve the constitutional propriety of deploying state corporation law in a manner harmful to investors, the intended beneficiaries of the Williams Act. As for the statute's likely effect, Judge Posner's opinion for the Court of Appeals for the Seventh Circuit, which struck down the Indiana statute on preemption and commerce clause grounds, had concluded that the burdens imposed by the statute on offerors would have a severe chilling effect on tender offers.<sup>50</sup> In short, Judge Posner looked through the statute's cosmetic proshareholder design to its actual effects on aggregate takeover activity and hence on the welfare of shareholders generally. To this the Supreme Court, in its commerce clause analysis, tersely responded that it saw "little evidence" that the statute would decrease the number of successful tender offers,<sup>51</sup> and that its analysis would not change even if the statute demonstrably had that effect.<sup>52</sup>

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44. See *Edgar v. MITE Corp.*, 457 U.S. 624, 646 (1982).

45. IND. CODE ANN. § 23-35-1 (West 1989).

46. See 481 U.S. at 82 n.7 and 94.

47. See 481 U.S. at 99-106 (White, J., dissenting).

48. See 481 U.S. at 99-106 (White, J., dissenting).

49. See 481 U.S. at 99-106 (White, J., dissenting).

50. See *Dynamics Corp. v. CTS Corp.*, 794 F.2d 250, 262-63, 264 (7th Cir. 1986), *revd.*, 481 U.S. 69 (1987).

51. 481 U.S. at 93. Apparently, the record before the Court contained no such evidence. See Langevoort, *The Supreme Court and the Politics of Corporate Takeovers*, 101 HARV. L. REV. 96, 103 n.45 (1987).

52. 481 U.S. at 93.

The Court in *CTS* disregarded the significant likelihood that shareholders in companies subject to the Indiana statute might, as the ironic price for receiving an apparently central role in takeover decisionmaking, lose opportunities to receive tender offers. Therefore, it saw no need to decide whether a takeover statute causing such a substantial chilling effect would offend the policy of the Williams Act. Nevertheless, by emphasizing that Indiana's law would not "alter the balance between management and offeror in any significant way,"<sup>53</sup> the Court seemed to interpret the much-heralded "investor protection" policy of the Williams Act as requiring a kind of substantive evaluation of how shareholders fare under Indiana's law.<sup>54</sup> However, the Court ignored this requirement in the commerce clause portion of the opinion when it indicated that the statute's deterrence of bids would not alter that analysis.<sup>55</sup> By refraining from a corresponding disclaimer in the preemption analysis, the Court seems to imply that the *effect* of a statute on shareholder welfare does make a difference and that, constitutionally, a statute significantly precluding the occurrence of takeover bids would run afoul of the Williams Act. Measuring the macroeconomic effects of antitakeover statutes in this fashion is extraordinarily difficult. It also reads the Williams Act as an overarching federal policy on takeovers designed to ensure that states cannot, in the name of "corporatizing"<sup>56</sup> the law governing takeover contests, substantially curtail the frequency of hostile bids to the detriment of shareholders. Thus, while the Court in *CTS* may have concluded that, viewed *ex post*, Indiana's statute provides some measure of formal shareholder protection, it also seems to assume that the Williams Act would prevent the states from limiting too severely the aggregate level of takeover activity in order to protect nonshareholders. The tension in these two positions is obvious, but was deftly dodged in *CTS*.

B. "*Business Combination*" Antitakeover Statutes and the  
"*Corporatization*" of Tender Offer Regulation

The design of the control share acquisition statute at issue in *CTS*,

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53. 481 U.S. at 82 n.7.

54. Justice Powell's opinion also includes a strong flavor of shareholder autonomy, a point seen in his analysis that an assessment of a takeover statute's impact on shareholder status vis-à-vis management was necessary for preemption analysis. He stated that the Indiana statute "protects the independent shareholder against [both] of the contending parties. . . . Unlike the MITE statute, the Indiana Act does not give either management or the offeror an advantage in communicating with the shareholders about an impending offer. . . . The Act allows *shareholders* to evaluate the fairness of the offer collectively." 481 U.S. at 82-84 (emphasis added).

55. 481 U.S. at 93-94.

56. See *infra* text accompanying notes 80-82.

along with the Court's almost shut-eyed analysis of its true purposes and likely effects, allowed the Court to avoid confronting hard questions of policy and constitutionality. A more potent form of antitakeover statute, recently adopted by several states, presents those questions in a manner that demands resolution. So-called "business combination" statutes take an altogether different approach to the problem of takeover regulation. At least sixteen states, including Delaware and New York, have adopted versions of this type of statute.<sup>57</sup> These statutes, subject to certain exceptions, prevent hostile tender offerors from completing defined "business combinations" — such as mergers, consolidations, substantial sales of assets, and liquidations — for periods of three to five years after acquisition of control through a successful tender offer. The effect is to prevent a hostile bidder from using its power of control to engage in the post-takeover "bust-up" transactions that typically motivate takeovers. The chief uniform exception to the moratorium is advance approval of the stock acquisition itself or the proposed business combination by the pre-offer target company board of directors.<sup>58</sup> The effect of this exception is to require bidders to approach target company boards to discuss proposed acquisitions. Other statutes also allow the board to approve otherwise proscribed transactions after completion of the tender offer.<sup>59</sup> At least one state, Delaware, includes another exception for acquisitions of more than eighty-five percent of outstanding stock in a single transaction; in such cases, the business combination moratorium does not apply.<sup>60</sup>

In contrast to the control share acquisition statutes, the business combination laws do not condition either the purchase or voting of stock on shareholder approval. Rather, they limit the manner in which a successful bidder may exercise control over the acquired com-

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57. See ARIZ. REV. STAT. ANN. §§ 10-1221 to -1223 (1987); 1988 Conn. Pub. Acts No. 88-350 (signed into law June 7, 1988); DEL. CODE ANN. tit. 8, § 203 (Supp. 1988); GA. CODE ANN. § 14-2-237(a) (1988) (to be recodified at § 14-2-1132 on July 1, 1989); IND. CODE ANN. § 23-1-43 (West 1989); KY. REV. STAT. ANN. §§ 271A.396 to .399 (Michie/Bobbs-Merrill Supp. 1988); MINN. STAT. ANN. § 302A.673 (West Supp. 1989); MO. ANN. STAT. §§ 351.450 to .459 (Vernon 1986 & Supp. 1989); N.J. STAT. ANN. § 14A:10A (West Supp. 1988); N.Y. BUS. CORP. LAW § 912 (McKinney 1986 & Supp. 1989); 15 PA. CONS. STAT. 2551-2556 (1988); TENN. CODE ANN. §§ 48-35-201 to 209 (1988); VA. CORP. CODE §§ 13.1-725 to 730 (Supp. 1988); WASH. REV. CODE ANN. § 23A.08.425 (Supp. 1988); WIS. STAT. ANN. § 180.726 (West Supp. 1988).

58. See, e.g., DEL. CODE ANN. tit. 8, § 203(a)(1) (Supp. 1988); N.Y. BUS. CORP. LAW § 912(b) (McKinney 1986 & Supp. 1989).

59. See, e.g., ARIZ. REV. STAT. ANN. § 10-1221(D) (1987); KY. REV. STAT. ANN. § 271A.398(3)(a) (Michie/Bobbs-Merrill Supp. 1988).

60. DEL. CODE ANN. tit. 8, § 203(a)(2) (Supp. 1988). Other states adopting business combination statutes have established higher or lower percentages than Delaware's statute. See, e.g., GA. CODE ANN. 14-2-237(a) (Supp. 1988) (to be recodified at § 14-2-1132 on July 1, 1989) (90%); 15 PA. CONS. STAT. 2551-56 (1988) (80%).

pany. In prohibiting certain transactions by the corporate enterprise, business combination laws less directly interfere with capital market activities and more clearly reflect the strategy of corporatizing a portion of the tender offer process. Since many contemporary hostile bids are followed by partial dismantling of the corporate enterprise to generate funds for repayment of acquisition indebtedness or to realize a profit for the acquirer,<sup>61</sup> one possible effect of the statutes is to discourage those "bust-up" bids that are not approved by the target company board. Almost by definition, board approval of a hostile bid is extremely unlikely because the bid itself is often perceived as an indictment of the target company board's past performance and is likely to result in the loss of jobs by directors and senior management. These statutes therefore present a formidable obstacle to the typical hostile overture, particularly when coupled with laws permitting target company directors to consider nonshareholder constituencies in formulating a takeover response.<sup>62</sup>

The key feature of these statutes is that they expressly inject target company management into the decisionmaking process, giving it an effective veto power over hostile bids to be followed by "business combinations" — a veto that the bidder and target company shareholders are virtually powerless to override. Delaware's exception for tender offers in which the bidder acquires eighty-five percent of target company stock may seem to preserve for shareholders a limited power unilaterally to decide a bid's fate. However, that exception may be of little practical utility because it is unclear whether any significant number of tender offers will attract so favorable a response.<sup>63</sup> Indeed, in early challenges to the statute the SEC has offered evidence that this will not be the case,<sup>64</sup> a position bolstered by the growing practice of placing large blocks of stock in friendly hands such as ESOPs,<sup>65</sup> a tactic recently upheld by the Delaware Court of Chancery.<sup>66</sup> If so, the

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61. See Coffee, *supra* note 6, at 2-4.

62. See *infra* note 69.

63. According to one commentator, "commonly, a substantial fraction of an acquired target's shareholders — frequently as much as twenty or thirty percent — fail to tender their shares." Bebchuk, *Toward Undistorted Choice and Equal Treatment in Corporate Takeovers*, 98 HARV. L. REV. 1695, 1714 (1985) (citing Study of the Office of the Chief Economist, Sec. & Exch. Comm., *The Economics of Any-or-All, Partial, and Two-Tier Tender Offers*, Table 9 (Apr. 19, 1985)). Bebchuk notes that those who do not tender typically fall into one of three categories: those who were unable to tender because they were unaware of the bid or could not tender in time; those who believed that their stock was worth more than the amount offered; and those who chose not to tender for tax reasons. *Id.* at 1714 n.57.

64. See *infra* note 96 and accompanying text.

65. See Hilder & Smith, *ESOP Defenses Are Likely to Increase*, Wall St. J., Apr. 6, 1989, at A2, col. 1.

66. In *Shamrock Holdings, Inc. v. Polaroid Corp.*, [1988-1989 Transfer Binder] Fed. Sec. L.



only meaningful exception to Delaware's prohibition of business combinations will be the procuring of target company management's approval.<sup>67</sup>

The business combination statutes differ from the control share acquisition statutes in another important respect. Their design belies any claim that they are enacted for the primary benefit of shareholders, whether shareholders generally or those actually confronting an offer to purchase.<sup>68</sup> First, by vesting dispositive decisionmaking power in the board rather than with shareholders (either individually or collectively) and conferring apparently broad discretion on the board in its exercise of this power,<sup>69</sup> the statutes contemplate that takeover efforts may fail even though they might have commanded wide shareholder approval. *CTS's* equation of collective shareholder choice and proshareholder purpose cannot be applied here. Nor can its description of Indiana's statute as not altering "the balance between manage-

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Rep. (CCH) ¶ 94,176 (Del. Ch. 1989), the Delaware Chancery Court upheld Polaroid's action of issuing approximately 14% of its outstanding stock to a newly established Employee Stock Ownership Plan. When coupled with Polaroid's share repurchase plan and placement of preferred stock into friendly hands, the ESOP measure made it virtually impossible for Shamrock to acquire 85% of Polaroid's stock as needed to escape operation of Delaware's antitakeover statute. See *supra* note 60 and accompanying text. As a result, Shamrock dropped its bid.

67. Most of the business combination statutes include provisions that allow shareholders to "opt out" of the statutory moratorium. See, e.g., DEL. CODE ANN. tit. 8, § 203(b)(1) (Supp. 1988); N.Y. BUS. CORP. LAW § 912(d)(3)(iii) (McKinney 1986 & Supp. 1989). These opt-out provisions typically require articles or bylaws amendments or other procedures dependent on a shareholder vote. See *infra* note 71 and accompanying text. Presumably management will oppose efforts to escape the statute's coverage. Because management controls the proxy machinery, it is likely to be able to influence decisively the outcome of the shareholder vote in this as in other areas. See generally M. EISENBERG, *THE STRUCTURE OF THE CORPORATION* chs. 9-10 (1976) (discussing management's power through its control of proxy machinery). Indeed, it is precisely because of the difficulties that stand in the way of challenging management in proxy contests that the tender offer has enjoyed such popularity. Thus, the opt-out brings to management in the takeover setting the inherent benefit of the proxy system.

68. One should not be misled by efforts to package these antitakeover laws in proshareholder terms. The Delaware statute's official legislative synopsis suggests that shareholder welfare is the statute's primary criterion, referring to an intention "to strike a balance between the benefits of an unfettered market for corporate shares and the well documented and judicially recognized need to limit abusive takeover tactics." Other states are more explicit, such as North Carolina's description of its business combination statute as "The North Carolina Shareholder Protection Act." N.C. GEN. STAT. § 55-75 (Supp. 1988); see *infra* note 78.

69. Some states explicitly authorize target company boards to take into account the impact of a takeover on nonshareholders. Minnesota, for example, states that "a director may, in considering the best interests of the corporation, consider the interests of the corporation's employees, customers, suppliers, and creditors, the economy of the state and nation, community and societal considerations, and the long-term as well as short-term interests of the corporation and its shareholders including the possibility that these interests may be best served by the continued independence of the corporation." MINN. STAT. ANN. § 302A.251, subd. 5 (West Supp. 1989). Several other states have adopted similar provisions. See, e.g., IND. CODE ANN. § 23-1-35-1(d) (West 1989); ILL. ANN. STAT. ch. 32, § 8.85 (Smith-Hurd Supp. 1988); OHIO REV. CODE ANN. § 1701.59(E)(4) (Anderson Supp. 1988); 42 PA. CONS. STAT. ANN. § 8363(b) (Purdon Supp. 1988). Arizona's provision is unique in being mandatory rather than merely permissive. See ARIZ. REV. STAT. ANN. § 10-1202 (1987).

ment and offeror in any significant way.”<sup>70</sup> Directors, not the body of shareholders or the bidder, are given the central role in the takeover drama.<sup>71</sup>

Second, the rationale for empowering the board for the purpose of paternalistically protecting shareholders, rather than allowing them to decide for themselves whether to tender, does not justify either the broad powers conferred on the board or the kinds of corporate transactions proscribed. One might argue that unimpaired shareholder decisionmaking cannot function properly in cases of two-tier tender offers.<sup>72</sup> In fact, two-tier offers are exceedingly rare today.<sup>73</sup> More important, the coverage of business combination statutes is not confined to those situations in which coercion seems likely. Thus, board approval of cash bids for all of a company's stock is also required. Better tailored to the largely extinct problem of shareholder coercion are the so-called “fair price” and “dissenters' rights” statutes,<sup>74</sup> which attempt to ensure that nontendering shareholders will nevertheless receive fair value for their shares, and control share acquisition statutes allowing shareholders themselves to defuse the coercion. In any event, the “bust-up” acquisitions at which the statute is truly aimed are generally all-cash, all-shares bids that of necessity are financed by huge borrowings sufficient to pay all shareholders immediately and in full. Here, the standard “coercion” argument is inappropriate. So too is the related concern that the resulting entity will be saddled with excessive debt — existing shareholders are gone and have no lingering con-

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70. *CTS Corp. v. Dynamics Corp.*, 481 U.S. 69, 82 n.7 (1987).

71. This has led many institutional investors to sponsor shareholder proposals opting out of Delaware's takeover statute. As stated by Steven Cohen, deputy counsel for the New York City comptroller's office, which oversees the New York City Employees Retirement System: “Institutional investors feel shareholders should have the right to decide whether to accept a tender offer in a hostile takeover. Delaware's law infringes on my right to do that.” Geylein & Koenig, *Pension Funds Plot Against Takeover Law*, Wall St. J., Apr. 5, 1989, at C1, col. 5 (quoting Cohen).

72. See *supra* note 40 and accompanying text.

73. From 1982 to 1986, the number of two-tier offers declined from 18% to only 3%; only six such offers occurred in 1987. See Mendelsohn & Berg, *Anti-Takeover Bill Would Shift Balance of Power*, Natl. L.J., Feb. 8, 1988, at 40, 41 n.21 (citing SEC empirical study and statement of SEC Commissioner Cox before the Senate Committee on Banking, Housing, and Urban Affairs). In the words of Commissioner Cox, “the market appears to have corrected any problem that may have existed.” *Id.* at 40.

74. “Fair price” statutes require the successful bidder to pay a “fair price” to nontendering target company shareholders or obtain supermajority shareholder approval of any merger or consolidation of the target and the acquirer. Examples include CONN. GEN. STAT. ANN. §§ 33-374a to -374c (West 1987); MD. CORPS. & ASSNS. CODE ANN. §§ 3-601 to -603 (1986); VA. CODE ANN. §§ 13.1-725 to -728 (1985). “Dissenters' rights” statutes confer on nontendering target company shareholders the right to be cashed out at either fair value or an agreed-upon price. See, e.g., ME. REV. STAT. ANN. tit. 13-A, § 910 (Supp. 1985); PA. STAT. ANN. tit. 15, § 1910 (Purdon Supp. 1986); UTAH CODE ANN. § 16-10-76.5 (1986).

cern for the condition of the forsaken enterprise. Thus, the business combination statutes are drawn much too broadly to justify management's assigned role of "protecting" shareholder interests.

Third, even if the statutes enable directors to protect shareholders facing a particular bid by serving as bargaining agents whose function is to resist in order to extract higher bids, to the extent the statutes also have the effect of generally reducing the frequency of hostile tender offers *ex ante*, shareholders as a class lose both the opportunity to realize immediate stock price premiums and the accountability mechanisms that the threat of hostile takeovers are said to provide over the longer term. Moreover, until the Delaware courts do what they continually have stopped short of doing — insisting that in *all* instances in which a hostile bid is launched the target company board's sole function is to auction the company to the highest bidder — there is no legal obligation to negotiate at all, much less to do so in a manner that procures the greatest possible premium. Thus, while business combination laws position target directors to bargain vigorously, they do not compel them to do so. Meanwhile, the empowerment of the board may nevertheless have an *ex ante* deterrent effect on hostile bids for company's subject to such statutes.

Finally, the explicit focus of the business combination statutes on "bust-up" rather than coercive takeovers is aimed less at serving shareholders than at protecting nonshareholder interests that will be damaged by asset relocations.<sup>75</sup> Since the statutes do not deprive a successful tender offeror of control as such, a bidder willing to postpone any of the disruptive transactions covered by the statute might not be deterred by its restrictions. The design of the statutes indicates a desire to restrict "bust-up" takeovers but not those motivated by other objectives. Nonshareholder interests might be damaged by corporate "break-ups," but not by bids preserving the business intact; shareholders, however, presumably will benefit from both forms of takeovers. Consequently, the prohibition on post-takeover corporate activity, rather than on the form or conduct of the takeover activity itself, reveals a policy aimed at sacrificing shareholder interests to those of certain enterprise-dependent nonshareholders.

The legislative history of New York's business combination statute, which has provided the model for subsequent enactments in other states, clearly indicates that its purpose is to protect nonshareholders from the impact of hostile takeovers. The official Memorandum on the original bill discusses New York's desire to avoid the adverse ef-

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75. See *infra* note 103.

fects of takeovers on target company employees and local communities, and anticipates that the new law will result in tender offerors having increased commitment to the long-term welfare of New York corporations and their employees.<sup>76</sup> The implication is that the moratorium on post-tender offer transactions will prevent successful acquirers from taking, and prospective bidders from seriously considering, actions that threaten the continuity of target company operations. More broadly, the law seeks to preserve existing relationships between New York corporations and those dependent on them, and thus refers to promotion of "long-term growth of New York resident domestic corporations."<sup>77</sup> Other states that have since adopted business combination statutes have also forthrightly expressed their concern for the effects of takeover activity on nonshareholders.<sup>78</sup> This

76. See Governor's Program Bill, 1985 Extraordinary Session, Memorandum (ch. 915) at 6, 9. In support of the bill, the AFL-CIO stated that "[n]o matter which side wins control in a takeover battle, workers, customers, and the community in which the company is located are the likely ultimate losers." AFL-CIO Support Memorandum 1 (Dec. 10, 1985) (quoting statement of May 8, 1985). The Business Council of New York State endorsed the legislation for similar reasons: "This bill meets our objective — an objective we share with organized labor — of encouraging long-term investment in New York and protecting the long-term interests of New York companies, shareholders, employees and communities . . ." Press Release, The Business Council of New York State (Dec. 10, 1985) (quoting Raymond T. Schuler, president). The authors are grateful to Ted Madara for sharing his research on the New York law's legislative history.

77. Governor's Program Bill, 1985 Extraordinary Session, Memorandum (ch. 915) at 1.

78. For example, a recent statute amending North Carolina's "Shareholder Protection Act" includes this preamble:

Whereas, takeovers and takeover attempts of corporations in North Carolina have been occurring with increasing frequency; and

Whereas, such activity can be highly disruptive to communities within North Carolina by causing, among other things, high unemployment and erosion of the State and local economy and tax base; and

Whereas, many of these corporations are not presently subject to the North Carolina Shareholder Protection Act since while substantially present in North Carolina they are chartered elsewhere; and

Whereas, these corporations offer employment to a large number of North Carolina citizens who pay income taxes, property and other taxes in this State; and

Whereas, these corporations pay significant amounts of income taxes to North Carolina; and

Whereas, these corporations pay substantial State and local property taxes; and

Whereas, these corporations pay substantial sales and use taxes in North Carolina; and

Whereas, these corporations provide their North Carolina employees with health, retirement and other benefits; and

Whereas, these corporations and their employees contribute greatly to community projects in North Carolina; and

Whereas, many unrelated businesses rely on these corporations to purchase goods and services; and

Whereas, North Carolina has a vital interest in providing to these corporations the benefits of the provisions of the North Carolina Shareholder Protection Act; . . .

Act of May 1, 1987, ch. 124, 1987 N.C. Sess. Laws preamble. Wisconsin's statute declares that Wisconsin corporations "encompass, represent and affect, through their ongoing business operations, a variety of constituencies including shareholders, employee[s], customers, suppliers and local communities and their economies," and states further that it is intended "to promote the welfare of these constituencies" and to "allow for stable, long-term growth of resident domestic corporations." Act of Sept. 17, 1987, 1987 Wis. Laws 45, §§ 1(2), (3). Connecticut has recently

refreshing candor has led the SEC to describe the New York and similar laws as an unconstitutional attempt to shield local economic interests from the workings of the national securities markets.<sup>79</sup>

Motivated less by solicitude for nonresident shareholders than by an understandable concern for a host of local nonshareholder interests, states adopting business combination statutes have sought to "corporatize" regulation of the tender offer process. It is possible to regard tender offers as straightforward securities transactions, that is, to characterize their central feature as involving nothing more than the decision by individual shareholders to sell or refuse to sell their stock to a prospective purchaser. Under this view, one could argue that tender offers, as transactions aimed directly at shareholders and effected through the national capital markets, are purely for shareholders to resolve and fall entirely within the domain of federal securities regulation. Tender offers for stock, however, ultimately involve contests for control of corporate assets. Consequently, stock is sought not merely for routine investment purposes, but as the vehicle for achieving more ambitious objectives, objectives that implicate the entire corporate enterprise. Thus, the practical significance of hostile takeovers may more closely resemble the impact on the corporation of a merger, major asset sale, dissolution, or other fundamental change in the corporate entity in which the voice of directors as well as shareholders has long been heard.<sup>80</sup> States, therefore, point to post-acquisi-

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passed a takeover law that empowers something called a Connecticut Partnership Compact — including representatives of labor and citizen groups, as well as of business and the legislature — to impose conditions on certain post-takeover transactions for the benefit of various non-shareholder interests. 1988 Conn. Pub. Acts 88-350, § 6; see *Connecticut Takeover Statute Barring Raiders Signed Into Law*, 20 Sec. Reg. & L. Rep. (BNA) 925 (1988).

79. The SEC has described the New York law as "economic protectionism," "designed to promote the interests of local economies and employees, at the expense of shareholders . . ." *SEC Says New York Takeover Law Violates Commerce, Supremacy Clauses*, 20 Sec. Reg. & L. Rep. (BNA) 379 (1988).

80. See, e.g., MODEL BUSINESS CORP. ACT §§ 11.03, 12.02, 14.02 (1988). The respective roles of directors and shareholders in responding to takeover bids is a bedrock governance issue that not only is addressed in contemporary corporate statutes, but also underlies the judiciary's seemingly unending efforts to delineate the common law fiduciary duties of target management. Recently, the crucial corporate governance dimension of this task has been re-acknowledged. For example, in *City Capital Assocs. v. Interco, Inc.*, 551 A.2d 787 (Del. Ch. 1988), the court stated:

Our corporation law exists, not as an isolated body of rules and principles, but rather in a historical setting and as a part of a larger body of law premised upon shared values. To acknowledge that directors may employ the recent innovation of "poison pills" to deprive shareholders of the ability effectively to choose to accept a noncoercive offer, after the board has had a reasonable opportunity to explore or create alternatives, or attempt to negotiate on the shareholders' behalf, would, it seems to me, be so inconsistent with widely shared notions of appropriate corporate governance as to threaten to diminish the legitimacy and authority of our corporation law.

551 A.2d at 799-800. In *Grand Metropolitan, PLC v. Pillsbury Co.*, [1988-89 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,104 (Del. Ch. 1988), the court stated:

tion aspects of tender offers as justifying their subjection to regulation through state corporation law, with its focus on "internal" governance matters. Viewing takeovers and their aftermath as a "corporate" matter serves to justify the direct involvement of the target company board, whose traditional fiduciary duty is to manage the firm's affairs in the interest of the corporate enterprise as a whole,<sup>81</sup> not purely in the interests of shareholders. Furthermore, like annual directors' elections, takeovers also implicate the "internal" governance question of the relationship between capital providers, on the one hand, and capital managers, on the other. Federal securities law may impose certain disclosure obligations on the process for electing directors through the proxy rules,<sup>82</sup> but the manner in which changes in voting control of corporations may be effected is largely structured by state law.

Thus, motivated by the broad impact of "bust-up" takeovers on the entire web of local corporate relationships, and taking refuge in the supremacy of state law with respect to "corporate" and "internal" matters, states have shrewdly sought to transform tender offers from pure stock disposition matters for individual shareholders — arguably subject to federal rather than state regulation for that reason — into matters properly subject to state corporation law. This corporatization strategy was especially ingenious because it paralleled perfectly the paradoxical philosophy of modern state corporation statutes: broadly empower management for the supposed purpose of benefiting shareholders. Ironically, protakeover corporation law scholars, many of whom are quick to defend enabling, promanagement corporation statutes as entirely consistent with shareholder well-being because of the extra-legal constraints imposed on broad managerial discretion by a well-functioning market for corporate control, found themselves hoisted by their own petards when states devised their corporatization

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To be sure, the Board of Directors are under a duty to exercise their best business judgment with respect to any proposal pertaining to corporate affairs, including tender offers. They may be right; they may know what is best for the corporation, but their judgment is not conclusive upon the shareholders. What is sometimes lost sight of in these tender offer controversies is that the shareholders, not the directors, have the right of franchise with respect to shares owned by them; "stockholders, once informed of the facts, have a right to make their own decisions in matters pertaining to their economic self-interest, whether consonant with or contrary to the advice of others, whether such advice is tendered by management or outsiders or those motivated by self-interest."

[1988-89 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,104 at p. 91,196 n.10 (quoting *Conoco Inc. v. Seagram Co.*, 517 F. Supp. 1299, 1303 (S.D.N.Y. 1981)).

81. Delaware courts have traditionally stated that directors owe fiduciary duties to "the corporation and its shareholders." See *Aronson v. Lewis*, 473 A.2d 805, 811 (Del. 1984); *Guth v. Loft*, 5 A.2d 503, 510 (Del. Ch. 1939), *aff'd*, 19 A.2d 721 (Del. 1941).

82. The SEC Rules relating to proxy solicitation are contained in Regulation 14A, 17 C.F.R. §§ 240.14a-1 to .14a-14 (1988). Even if proxies are not solicited in connection with a shareholder meeting, the proxy rules require furnishing of information substantially equivalent to a proxy statement. See Regulation 14C, 17 C.F.R. §§ 240.14c-1 to .14c-101 (1988).

strategy. After all, the states had succeeded in crippling the workings of the capital market check on the laxity of state corporation law by subjecting capital market transactions themselves to state regulation. This legislative program of co-opting capital market phenomena, initially implemented in the control share acquisition statutes, finds its most mature and powerful expression in the business combination statutes.

### C. *The Present Preemption Controversy*

#### 1. *Shareholder Autonomy Versus Shareholder Protection*

In light of state efforts to "corporatize" regulation of the takeover process, critics of state antitakeover laws in general, and of business combination statutes in particular, have made the most potent attack possible — constitutional infirmity. Invariably, the constitutional challenge is made on both commerce and supremacy clause grounds.<sup>83</sup> The gist of the latter argument is that the Williams Act, adopted in 1968, preempts the state statutes. The SEC has filed *amicus curiae* briefs in cases challenging the New York, Wisconsin, and Delaware statutes.<sup>84</sup> While a preemption argument can take different forms,<sup>85</sup> the SEC argues that these statutes frustrate the Williams Act's purpose. The SEC reads the Williams Act as preserving for target company shareholders the inviolable right to decide whether to accept tender offers, a right that we term "shareholder autonomy"; because business combination statutes impair that right, they are preempted. In a word, the *process* of shareholder resolution of takeover contests is central to the SEC's reading of the Williams Act.

Faced with such constitutional challenges to their "corporatization" strategy, targets and states have responded with their own reading of the Williams Act. While agreeing that the Act was enacted to benefit shareholders, they reject the view that the process of shareholder decisionmaking is a necessary or mandated ingredient in that policy. Instead, the focus is more substantive and evaluative: Is shareholder well-being attained? If so, then the process by which that objective is achieved is irrelevant. Consequently, target management itself might be the mechanism best suited to protecting investors in certain instances. Management might, for example, adopt defensive

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83. Professors Butler and Ribstein have analyzed antitakeover statutes under the contract clause of the Constitution, concluding that both Indiana's and more potent statutes violate that clause. Butler & Ribstein, *State Anti-Takeover Statutes and The Contract Clause*, 47 U. CIN. L. REV. 611 (1988).

84. See 20 Sec. Reg. & L. Rep. (BNA) 379, 419, 735, 774 (1988).

85. See *supra* note 36.

measures that enhance the bidding process for stock, or may go so far as to thwart a takeover bid — denying shareholders any opportunity to tender — where deemed necessary to “protect” shareholder interests.<sup>86</sup> The clearest cases for management intervention would therefore involve conduct aimed at blocking coercive two-tier offers or designed to attract an even higher premium than that being offered in an all-cash, all-shares bid. This reading interprets the Williams Act as allowing state law to accord a role for target company management intervention in the tender offer process where doing so would better protect shareholder interests than leaving them on their own. In short, this “shareholder protection” reading of the Act would justify restricting “shareholder autonomy” where necessary to achieve the higher goal of shareholder welfare.

This basic difference in construing the Williams Act was not before the Supreme Court in *CTS* because the Indiana statute left the decisionmaking power in the hands of target company shareholders, albeit their collective rather than individual hands. *MITE* had presented much the same clash between shareholder autonomy and shareholder protection, but with a crucial difference. A state agency, rather than shareholders or directors, had decisive power. Accordingly, it was the *MITE* decision that prompted states to adopt a “corporatization” rather than an overt regulatory strategy, housing antitakeover laws in the corporation statutes and conferring broad powers on management to look after the interests of the corporation and its shareholders. Furthermore, since only two Justices had joined Justice White’s shareholder autonomy reading of the Williams Act in *MITE*, it seemed unlikely that a majority of the Court would object to a shareholder protection interpretation.

After *CTS*, then, the preemption issue with respect to business combination statutes has been joined over these two readings of the Williams Act. Three recent decisions illustrate the significance of the distinction between the shareholder autonomy and shareholder protection constructions of the Williams Act in the context of these formidable antitakeover statutes. In *RTE Corp. v. Mark IV Industries*,<sup>87</sup> a federal district court accepted the argument that the Williams Act preempts the Wisconsin version of that statute. Supported by an *amicus curiae* brief from the SEC, the court adopted a shareholder auton-

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86. This raises under common law fiduciary duty principles the same shareholder protection/shareholder autonomy issue that arises under antitakeover statutes. See *supra* note 80.

87. No. 88-C-378 (E.D. Wis. May 6, 1988) (unpublished memorandum decision and order), vacated as moot, [1987-1988 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,789 (E.D. Wis. June 22, 1988).



omy construction, holding that Congress sought to accomplish the goal of shareholder welfare by preserving shareholder choice as the means by which takeover contests should be resolved. The court emphasized the Wisconsin statute's ban on post-tender offer business combinations, excused only if target management assents, as an effective veto power over hostile bids. In finding the statute to be preempted on that ground, the court stated that the Williams Act's "purpose . . . is to ensure investor choice with respect to acceptance of tender offers. . . . [I]t should be the shareholders — the actual owners of the corporation — who make the decision whether or not to accept a tender offer."<sup>88</sup>

In contrast, two recent decisions by the federal district court in Delaware reject this preemption analysis, focusing instead on a broader shareholder protection policy and finding the Delaware statute consistent with such a mandate.<sup>89</sup> In both decisions, the court acknowledged that Delaware's statute, like Wisconsin's, accords target company management a critical — and potentially decisive — role in determining whether a hostile takeover will succeed and therefore "restricts shareholder choice in the hostile tender offer context."<sup>90</sup> In *BNS, Inc. v. Koppers Co.*, the court justified management's assigned role as guardian of shareholder interests on the ground that it is consistent with "the norm in current corporate law."<sup>91</sup> The court is referring to state law's enabling philosophy and its reliance on traditional agency and fiduciary principles to circumscribe management discretion and direct it toward achievement of shareholder welfare. In this framework, management, rather than the shareholders themselves, is generally charged with protection of shareholder financial interests. Under this interpretation, Delaware's antitakeover statute was simply another application of this basic idea. There is no preemption because the court saw shareholder protection — not autonomy — as the purpose of the Williams Act. The result is that Delaware corporation law and federal securities law are brought into harmonious accord on the tender offer regulation issue.

While the court in *BNS* was concerned that the Delaware statute

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88. *RTE*, No. 88-C-378, slip op. at 7-8; see also *Alleghany Corp. v. Haase*, 708 F. Supp. 1507 (W.D. Wis. 1989) (citing the *Younger* abstention doctrine in refraining from ruling on constitutionality of Wisconsin antitakeover statute); *Amanda Acquisition Corp. v. Universal Foods Corp.*, 708 F. Supp. 984, 998 (E.D. Wis. 1989) (upholding Wisconsin antitakeover statute), *aff'd.*, 21 Sec. Reg. & L. Rep. (BNA) 856 (1989). For a discussion of the district court's decision in *Amanda*, see *infra* text accompanying notes 219-27.

89. *BNS, Inc. v. Koppers Co.*, 683 F. Supp. 458 (D. Del. 1988); *RP Acquisition Corp. v. Staley Continental, Inc.*, 686 F. Supp. 476 (D. Del. 1988).

90. *BNS*, 683 F. Supp. at 468.

91. 683 F. Supp. at 470.

went beyond Indiana's in empowering target company management, and thus might be vulnerable to the implicit substantive dimension of the *CTS* preemption analysis,<sup>92</sup> it could not determine how much advantage the statute gave to management.<sup>93</sup> The inability to do so reveals the paradox in extending the prevailing management-empowerment philosophy of corporation statutes to antitakeover laws. The market for corporate control normally constrains and channels the broad managerial discretion provided by modern corporation statutes toward shareholder well-being. The potency of this extra-legal capital-market check on management stems from its traditional immunity from dilution by state corporation law. Business combination statutes, however, ironically subject those very market forces to managerial interference.

The court appeared to appreciate this paradox. While speaking the more accommodating language of shareholder protection, the Delaware court appeared unwilling to commit itself to that reading of the Williams Act, perhaps seeing that its proshareholder interpretation of the Delaware statute, if extended far enough, is as disingenuous as was the *CTS* Court's view of the Indiana law. Accordingly, in both decisions the court tempered its blessing of Delaware's management-empowerment statute by suggesting that, in any event, the law preserved a sufficient degree of shareholder *autonomy* to be constitutional.<sup>94</sup> In this regard, the court gave great weight to the statutory exception for tender offers that result in holdings of eighty-five percent or more. Because this exception supposedly allows a body of determined shareholders to facilitate a takeover even in the face of management opposition, the court stated that it preserves a "meaningful opportunity" for a hostile tender offer to succeed.<sup>95</sup> In relying on this standard for assessing the statute's constitutionality, the court struggled against substantial evidence that this contingency is largely chimerical because, as the SEC argued in both cases, few tender offers achieve eighty-five percent acceptance regardless of target company management's attitude.<sup>96</sup> In the end, this alternative basis for the court's

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92. 683 F. Supp. at 470; *see supra* text accompanying notes 53-55.

93. 683 F. Supp. at 470; *see also Staley Continental*, 686 F. Supp. at 481-82.

94. *BNS*, 683 F. Supp. at 470; *Staley Continental*, 686 F. Supp. at 485.

95. *BNS*, 683 F. Supp. at 469; *Staley Continental*, 686 F. Supp. at 485. In *BNS*, the court recognized that the other statutory exceptions, which require board approval, *see supra* text accompanying notes 58-59, "might well be illusory." 683 F. Supp. at 470.

96. *See BNS*, 683 F. Supp. at 470. In the second Delaware case, *Staley Continental*, the SEC offered further evidence on this issue, including an affidavit by Dr. Gregg Jarrell, formerly the SEC's Chief Economist. The evidence was introduced to demonstrate that the statute's 85% threshold is too high to provide a practical means for shareholders to circumvent the statutory prohibition. *See Staley Continental*, 686 F. Supp. at 485; *see also supra* note 66.

holdings, strained and unpersuasive as it is, dramatically underscores the current divergent constructions of the Williams Act. As shown below,<sup>97</sup> it also reveals the futility of referring to legislative intent in answering the preemption question, as that question is now being framed by takeover participants.

## 2. *Shareholders Versus Nonshareholders*

The conflicting interpretations of the Williams Act exemplified in the Wisconsin and Delaware opinions need to be resolved. However, the shareholder autonomy/shareholder protection dichotomy masks a deeper interpretive question. As shown more fully below,<sup>98</sup> the shareholder autonomy idea assumes — and indeed is motivated by — a particular policy stance toward takeovers, a stance that favors a dynamic, essentially unregulated market for corporate control. Proponents of a shareholder protection reading likewise seem to take for granted that shareholder welfare is the fundamental norm, with the argument centering on which approach (procedural autonomy or substantive protection) is better suited to achievement of that objective. Yet instead of a right to unrestricted — or only partially restricted — tender offer opportunities, shareholder welfare may have a more limited compass than either side of the debate seems willing to acknowledge. Under this alternative interpretation, shareholders enjoy access to tender offer opportunities only if and to the extent that state law has made a prior determination that they should have that right. Since state law is the source of law defining stock rights, that law first defines the conditions under which, and the degree to which, shareholders will participate in the takeover decisionmaking. For various policy reasons, states may exercise that power in a manner that serves to reduce both the frequency of certain kinds of takeovers and the voice of shareholders in those that do occur. Far from implying a protakeover policy that overrides conflicting state law, a reading of federal law that allows the states freedom to diminish takeover opportunities and shareholder voice leaves the crucial policy judgment about the appropriateness and frequency of takeovers to the states. Because this aspect of the preemption issue raises the important question of the relationship between state and federal law on corporate-commercial matters, it is more fundamental and important than the narrow debate now taking place between the advocates of shareholder autonomy and shareholder protection. Yet because both camps seem to share a belief

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97. See *infra* section III.B.

98. See *infra* Part IV.

that the Williams Act represents a definitive shareholder-welfare takeover policy — differing only on their interpretations of that policy — their debate obscures rather than sheds light on this important federalism question. Therefore, it is a serious error to focus solely on current formulations of the preemption debate, while failing to address the underlying question of whether the Williams Act is correctly interpreted as embodying a federal takeover policy at all, much less a protakeover policy.

Given the nonshareholder protection motivations for state legislation, it is strange that the preemption issue is phrased in terms of two contrasting approaches to shareholder welfare (shareholder autonomy versus shareholder protection) rather than in terms of whether the Williams Act requires state takeover laws to adopt a shareholder welfare policy at all. In other words, does the Williams Act exclude state leeway to recognize and protect the interests of various nonshareholders adversely affected by rampant takeover activity? *CTS* did not consider this question because the Court uncritically discussed the statute as shareholder-empowering and refused to acknowledge the constitutional significance of the Indiana legislature's desire to protect local economic interests at the expense of nonresident shareholders.<sup>99</sup>

The Wisconsin decision discussed above<sup>100</sup> likewise did not address this question. Even though the Wisconsin court appreciated the disruptive effect of takeovers on nonshareholder constituencies,<sup>101</sup> those interests did not inform its preemption analysis. Instead, the court based its analysis on a reading of the Williams Act as a shareholder autonomy statute and used the rhetoric of shareholder property rights as a basis for its insistence on self-determination. The decision seems to imply rejection of the claim that states may sacrifice shareholder access to tender offer opportunities for the sake of local nonshareholder interests. However, even under the court's premises, such a policy choice might still be acceptable.

Suppose a state law specifies that tender offers might proceed according to whether they are expected to affect nonshareholders adversely. Reading the Williams Act as embodying an overarching proshareholder policy — whether by means of shareholder autonomy or shareholder protection — would mean that in 1968 Congress meant to prohibit states from passing such a law. Alternatively, however, one might argue that the Wisconsin court's shareholder autonomy

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99. See *supra* text accompanying notes 46-52.

100. See *supra* text following note 87.

101. See *RTE Corp. v. Mark IV Indus.*, No. 88-C-378, slip op. at 6-8 (E.D. Wis. May 6, 1988).

reading of the Williams Act applies only in situations in which state law has made a prior determination that tender offerors should have unfiltered access to shareholders. In those situations, management (or others) may not interfere; shareholders must decide the bids' fate in accordance with state-established procedures. But, whether and how often tender offers occur may be influenced by the states according to their own calculations of costs and benefits, taking into account shareholder interests if and to the extent they choose to do so. Again, this issue turns on the deeper question of the reach of the states' traditional jurisdiction over corporate internal affairs and whether, pursuant to that jurisdiction, they can curtail shareholder opportunities to receive tender offers in order to further other interests.<sup>102</sup>

The Delaware federal court also did not address this issue when assessing Delaware's takeover statute.<sup>103</sup> Like the Wisconsin court, its approach to the preemption question does not imply a view one way or the other on the nonshareholder protection issue. Whether the court's shareholder protection reading of the Williams Act implies a constitutional right of access to tender offer opportunities, even where perceived to be harmful to nonshareholders, depends on whether management's power to participate in the takeover decisionmaking process must be exercised solely for the benefit of shareholders. If the oft-cited federal "investor protection" policy is not as pervasive as participants in the preemption debate seemingly assume, it may accommodate the desire of states to temper a general managerial duty to protect shareholders with a grant of authority to consider nonshareholder concerns in certain situations.

Supporters of takeover statutes, because they fall into the trap of reading the Williams Act as reflecting a pervasive federal protakeover and proshareholder policy, have found themselves defending state

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102. The deeper question arises under both state common law principles and statutory law, *supra* note 86, and raises the preemption issue with respect to common law doctrine as well as antitakeover statutes. See *supra* note 20.

103. One might hesitate to consider nonshareholder protection as a motivation for Delaware's statute. The significance of nonshareholder interests in Delaware's statute certainly differs from that in Wisconsin's and others'. Few Delaware corporations conduct significant operations within the state, so protection of local stakeholders like employees, creditors, and the like would not seem to be a useful explanation for the statute's motivation. Nevertheless, out-of-state firms incorporated in Delaware, concerned about such matters, may have expressed their concerns during the legislative process. Such views would not be lightly disregarded because Delaware's citizens stand to lose significant revenues in the form of franchise fees if firms reincorporate elsewhere in order to take advantage of more favorable antitakeover legislation. Franchise revenues represent 17% of Delaware's gross revenues. *BNS Inc. v. Koppers Co.*, 683 F. Supp. 458, 473 n.31 (D. Del. 1988). Defections would also adversely affect Delaware's corporate bar. Thus, while not as dramatic as the concerns underlying the actions of the midwestern industrial states, for example, nonshareholder interests probably were not absent from the minds of Delaware's legislators as they considered and enacted its antitakeover statute.

statutes in terms of shareholder welfare rather than defending the legitimacy of state efforts to realize broader objectives. Not only are such shareholder welfare arguments transparently false, they mislead courts and result in either the superficial analysis of *CTS* or the tortured reasoning of the recent Delaware decisions. Such duplicity, while understandable in a culture and body of law according capital providers special status, impedes grappling with the constitutionality of state protectionist actions in an informed and straightforward manner. Moreover, a legal stratagem of hypocrisy by those who favor state antitakeover action is unnecessary. It is founded, as are the preemption arguments of their adversaries, on a reading of the Williams Act that is historically inaccurate.

## II. THE WILLIAMS ACT AND ITS CONTEXT

### A. *The Limited Objectives of the Williams Act*

Congress passed the Williams Act<sup>104</sup> in 1968 in order to amend certain sections of the Securities Exchange Act of 1934.<sup>105</sup> The Williams Act, as amended, does several things. First, a person or a group whose acquisitions of stock result in beneficial ownership of more than five percent of a class of an issuer's equity security, registered under Section 12 of the Exchange Act, is required to file a Schedule 13D within ten days of the acquisition. Filings must be made with the SEC, with the issuer of the stock, and with each exchange on which the stock is traded. Among other things, Schedule 13D requires disclosure of the purchasers' identity and purpose. If the Schedule is filed by a corporation, the same disclosure must also be made for each executive officer and director of the corporation.<sup>106</sup>

Second, a bidder making a "tender offer" (a term not defined in the Exchange Act)<sup>107</sup> must file a Schedule 14D-1 with the SEC on the date of the commencement of the tender offer. A copy of the Schedule 14D-1 must also be delivered to the target company and to any other bidder who has filed a Schedule 14D-1 and whose offer has not yet terminated.<sup>108</sup> A different schedule, 13E-4, must be filed by a target company responding with a tender offer for its own securities.<sup>109</sup> Both schedules require the bidder to disclose specified information about

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104. 15 U.S.C. §§ 78m(d)-(e) & 78n(d)-(f) (1982).

105. 15 U.S.C. §§ 78a-kk (1982).

106. See Reg. 13D, 17 C.F.R. §§ 240.13d-1 to .13d-101 (1988).

107. See *Hanson Trust v. SCM Corp.*, 774 F.2d 47, 54 (2d Cir. 1985).

108. See Reg. 14D, 17 C.F.R. §§ 240.14d-1 to .14d-101 (1988).

109. See Rule 13e-1 and Schedule 13E-4, 17 C.F.R. §§ 240.13e-1 & 240.13e-101 (1988).

itself, its source of funds, the purpose of its offer, and any plans or proposals relating to material changes or transactions involving the target company.

Third, any person (including, most importantly, the target company) who makes a solicitation or recommendation for target company security holders to accept or reject a tender offer must file Schedule 14D-9. Schedule 14D-9 requires the target company to state the reasons for its recommendation and to disclose any recent trading in its stock by its executive officers and directors.<sup>110</sup> Without filing Schedule 14D-9, a target company may issue a "stop-look-and-listen" communication to its security holders requesting that they defer their decision on the tender offer until advised of the target company's position.<sup>111</sup>

Fourth, besides implementing provisions aimed at transmitting information to shareholders, the Williams Act and related SEC regulations establish procedural guidelines governing the conduct of tender offers. Offers must remain open for at least twenty business days.<sup>112</sup> Shareholders who tender their stock may withdraw it during the first fifteen business days of the tender offer or, if the offeror has not already purchased their stock, may withdraw it within sixty days of the offer's commencement.<sup>113</sup> If more shares are tendered than the offeror seeks to purchase, it must purchase from all tendering shareholders on a *pro rata* basis.<sup>114</sup> If, having announced a tender offer, the bidder later raises the price it is willing to pay, it must pay that higher price to all tendering shareholders, including those who tendered before the price increase.<sup>115</sup> Finally, material misstatements or omissions and fraudulent, deceptive, or manipulative acts or practices in connection with tender offers are prohibited.<sup>116</sup>

As a method for gaining control of a corporation despite management opposition, tender offers were still a relatively new development when Congress began to consider subjecting them to federal regulation. Previously, would-be hostile insurgents relied principally upon open market purchases of stock or sought to attain voting control through proxy contests.<sup>117</sup> During the early 1960s, however, the

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110. See Reg. 14D, 17 C.F.R. §§ 240.14d-9 to .14d-101 (1988).

111. See Rule 14d-9, 17 C.F.R. § 240.14d-9(e) (1988).

112. Rule 14e-1(a), 17 C.F.R. § 240.14e-1(a) (1988).

113. Rule 14d-7, 17 C.F.R. § 240.14d-7 (1988).

114. Rule 14d-8, 17 C.F.R. § 240.14d-8 (1988).

115. See Rule 14d-10(a)(2), 17 C.F.R. § 240.14d-10(a)(2) (1988).

116. 15 U.S.C. § 78n(e) (1982); Rule 14e-3, 17 C.F.R. § 240.14e-3 (1988); see *Schreiber v. Burlington Northern, Inc.*, 472 U.S. 1 (1985).

117. As stated by the Supreme Court of Delaware: "In the days when *Cheff* [1964], *Bennett*

tender offer emerged as an alternative device for wresting control from incumbent management and, by 1967, had sharply increased in frequency.<sup>118</sup> As a weapon for ousting target management, the tender offer provided a distinct advantage over the proxy contest. Rather than relying on high-sounding promises of "better management" in the future, the hostile bidder proffered something tangible and immediate: cash — including a substantial premium over prevailing market price. Moreover, since prior to enactment of the Williams Act no filing or disclosure requirements applied, the tender offer also provided the tactical advantages of surprise and secrecy, thereby avoiding the delay and disclosure obstacles associated with proxy contests.<sup>119</sup>

As with any newly emerging social phenomenon, takeovers did not fit easily into then-existing modes of intellectual discourse, and, therefore, during the period leading up to the adoption of the Williams Act in 1968, various conflicting attitudes toward tender offers were prominent. Some regarded target corporations as unsuspecting prey needing protection from unwelcome (and undesirable) attacks by so-called "corporate raiders." Thus, in 1965 Senator Williams introduced legislation aimed at deterring tender offers in order to protect incumbent managements.<sup>120</sup> The SEC did not support that bill because of the legislation's decidedly promanagement slant.<sup>121</sup> Eventually, Senator Williams introduced a more balanced bill, but at the time even this was seen by some critics as an antitakeover measure.<sup>122</sup> Indeed, the co-sponsor of the bill, Senator Kuchel, introduced the measure by referring to the threat that "corporate raiders" pose to "our proudest businesses."<sup>123</sup> Thus, quite apart from the statute's design or ultimate effect on the level of takeover activity, in the mid-1960s some politicians hoped, and some observers believed, that the bill would reduce

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[1962], *Martin* [1952], and *Kors* [1960] were decided, the tender offer, while not an unknown device, was virtually unused. . . . Then, the favored attack of a raider was stock acquisition followed by a proxy contest." *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 957 (Del. 1985).

118. In 1966, there were more than 100 tender offers; in 1960, only eight. SENATE COMM. ON BANKING AND CURRENCY, FULL DISCLOSURE OF CORPORATE EQUITY OWNERSHIP AND IN CORPORATE TAKEOVER BIDS, S. REP. NO. 550, 90th Cong., 1st Sess. 2 (1967) [hereinafter SEN. REPORT]. The total dollar value of such offers increased from \$186 million in 1960 to nearly one billion dollars in 1965. *Senate Hearings*, *supra* note 1, at 54.

119. See *supra* note 82 and accompanying text.

120. See 111 CONG. REC. 28,257 (1965) (statement of Sen. Williams).

121. For example, the bill included a provision requiring bidders to notify target company management before launching a bid.

122. See, e.g., *Senate Hearings*, *supra* note 1, at 165-66 ("the benefits will run to ineffective management").

123. See 113 CONG. REC. 857-58, 8236-37 (1967); *Senate Hearings*, *supra* note 1, at 43.



the frequency of hostile bids or at least alter the legal landscape to the advantage of target companies.

Co-existing with concerns about "raiders" were voices trumpeting the many benefits of takeovers. Professor Manne's seminal paper on the utility of tender offers and of an active market for corporate control had just appeared in 1965,<sup>124</sup> and it provided the intellectual foundation for arguments in favor of takeover activity. This view, particularly as embellished by later adherents, emphasized the importance of the threat of hostile takeovers as a management accountability mechanism and as a central feature of a market-oriented model of corporate activity and corporation law. Manne argued that, since capital markets are efficient, suboptimal managerial performance would be reflected in reduced share prices. Discounted share prices would invite tender offers by those seeking to profit from replacing incumbent management and realizing a corporation's full economic potential. The existence of a vigorous, properly functioning market for corporate control would immediately benefit shareholders by offering the prospect of stock premiums. Moreover, shareholders would gain over the longer term because the threat of takeover would encourage managerial diligence. Furthermore, the bidder's direct financial appeal to target shareholders made the tender offer a much more potent takeover device than the proxy contest, in which shareholders might only dimly perceive how granting a proxy to insurgents would actually improve their economic welfare, and in which management enjoyed inherent legal and collective action advantages owing to its control of the proxy machinery. In addition to citing the wealth and governance benefits of takeovers to capital providers, Manne touted the purported benefits of takeovers to society in general. He argued that an effectively functioning market for corporate control rechannels corporate assets into the hands of those most able and willing to maximize their value. The result would be a more efficient use of limited economic resources, by which everyone — not merely shareholders — would benefit.<sup>125</sup>

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124. Manne, *Mergers and the Market for Corporate Control*, 73 J. POL. ECON. 110 (1965) [hereinafter Manne, *Mergers*]; see also Manne, *Tender Offers & the Free Market*, 2 MERGERS & ACQUISITIONS 91 (1966).

125. In several respects, linking shareholder benefits and societal welfare in this manner was, and remains, an intellectual *tour de force*. First, seemingly diverse interests are reconciled. Takeovers are not simply an amusing and lucrative pastime for capital owners, but are good for other groups — and economic classes — as well. Avoiding charges of special interest favoritism is critically important to any effort to address a high-stakes economic issue in a democratic polity eschewing visible class privilege. Second, this accommodation of interests takes place without — indeed is disserved by — governmental intervention or planning. Instead of depending on a misguided public altruism, the greater good is served, as always in neo-classical economic theory, by each economic actor egoistically pursuing his or her own private gain. Thus, at least in the

As Congress deliberated, it was alerted to the larger economic implications of hostile takeover activity, as well as its effects on corporate accountability and shareholder wealth, through testimony at committee hearings.<sup>126</sup> The legislative history reveals that Congress took no definite position either way in this debate, neither embracing nor denouncing the recent phenomenon. This was the unmistakable conclusion expressed in both the House and Senate Reports on the bill.

It was strongly urged during the hearings that takeover bids should not be discouraged because they serve a useful purpose in providing a check on entrenched but inefficient management. It was also recognized that these bids are made for many other reasons, and do not always reflect a desire to improve the management of the company. . . . [The bill] avoids tipping the balance of regulation either in favor of management or in favor of the person making the takeover bid.<sup>127</sup>

Senator Williams repeatedly made the same point on the Senate floor.<sup>128</sup> Thus, SEC Chairman Cohen was merely echoing congressional sentiment when he stated that "[t]he Commission does not believe that any bill should be adopted which would either encourage or discourage takeover bids, nor does the Commission want to be involved in any way in passing upon the merits or conditioning the terms of [particular] takeover bids."<sup>129</sup>

Taking no position with respect to the larger policy issue of

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economic sphere, the age-old dilemma of squaring individual appetite with community good is neatly solved. Third, dissolving possible conflict between private and social good in this manner depends on an acceptable measure of social welfare. That provided in the takeover arena is the one generally provided by economists: efficiency. It was indisputable that more efficient uses of resources are, other things equal, preferable to less efficient uses. Fourth, having chosen efficiency as the measure of good, some workable mechanism for measuring changes in the level of efficiency is needed. Share price behavior provided the perfect answer, since readily ascertainable movements in securities prices are capital-market surrogates for the direct measure of efficiency gains or losses in the deployment of corporate assets. This last ingredient in the linkage of private gain and public good has come under attack, as has the narrowness of the efficiency criterion. As a result, questions about political and social values as well as abstruse economic theory are implicated in this protakeover position.

126. Witnesses expressing generally favorable views about takeovers included Professor Samuel Hayes, *see Senate Hearings, supra* note 1, at 56-57 (typical target firms managed inefficiently); Professor Robert Mundheim, *see id.* at 115 (same); and Stanley F. Reed, editor and publisher of *Mergers and Acquisitions*, *see id.* at 165 (bill "could cause positive harm to shareholder interest by eliminating what Professor Manne calls the 'free market in corporate control'"). The most vocal critic of takeovers was the bill's sponsor, Senator Kuchel. *See supra* text accompanying note 123. Professor Kaplan professed uncertainty about whether tender offers warranted regulation. *See Senate Hearings, supra* note 1, at 134-35.

127. SEN. REPORT, *supra* note 118, at 3; *see also* HOUSE COMM. ON INTERSTATE AND FOREIGN COMMERCE, DISCLOSURE OF CORPORATE EQUITY OWNERSHIP, H.R. REP. NO. 1711, 90th Cong., 2d Sess., *reprinted in* 1968 U.S. CODE CONG. & ADMIN. NEWS 2811, 2813 [hereinafter HOUSE REPORT].

128. *See* 113 CONG. REC. 854-55, 856, 24,664, 24,665 (1967).

129. *Senate Hearings, supra* note 1, at 178; *see also id.* at 16, 25, 188. The Senate hearings transcript includes a speech to the same effect given by Cohen to the New York City Bar Association. *Id.* at 203-06.

whether tender offers should be encouraged or discouraged, Congress instead pursued the narrower aim of attempting to "close a significant gap in investor protection under the Federal securities laws."<sup>130</sup> One "gap" in legal coverage identified by supporters of the legislation concerned the similarity of tender offers to proxy contests as devices for seizing control from incumbent management.<sup>131</sup> With each, shareholders were required to decide whether to shift their loyalties from management to a challenger. To promote informed shareholder choice, federal disclosure requirements applied to proxy solicitations.<sup>132</sup> For the same reason they ought to, but prior to 1968 did not, apply to tender offers as well.

Supporters identified another "gap" by drawing an analogy between a target company shareholder and a prospective investor in a new firm. Faced with a cash tender offer, the shareholder could either sell or retain his or her stock. If the latter course were chosen and the bidder succeeded in its offer anyway, the shift in control to the bidder would mean that the shareholder was now an investor in what soon could be a very different firm. This choice between sale (exit) and retention (new investment) was likened both to the existing shareholder's decision to accept an exchange tender offer and to a prospective shareholder's decision to invest in a new stock issue.<sup>133</sup> Since exchange offers and new issues were subject to federal securities law disclosure requirements, so the argument went, cash tender offers should be too. This point was particularly apt during the mid-1960s because cash-out mergers were quite new and thus nontendering shareholders might fully expect to remain as investors in the corporation. The analogies on which this "gap-filling" rationale is based might be criticized because a bidder's very success depends on the exit of a large number of target shareholders rather than on their "re-investment." Nonetheless, there was an appealing symmetry to mandated disclosure by cash tender offerors on the one hand, and proxy solicitors, exchange offerors, and new issuers on the other. There was also a vague sense that "secret" raids were unseemly, and that in-

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130. 113 CONG. REC. 854 (1967) (remarks of Sen. Williams). The idea of closing a "gap" is referred to repeatedly in the Williams Act's legislative history. *See, e.g.*, 113 CONG. REC. 24,664, 24,665 (1967); SEN. REPORT, *supra* note 118, at 2-3, 4; HOUSE REPORT, *supra* note 127, at 2812-13, 2814; *Senate Hearings, supra* note 1, at 1, 3, 15, 16, 42, 49, 123, 147, 182; *see also* Cohen, *Takeover Bids*, 2 MERGERS & ACQUISITIONS 87 (1966); Cohen, *A Note on Takeover Bids and Corporate Purchases of Stock*, 22 BUS. LAW. 149 (1966).

131. *See* 113 CONG. REC. 855, 9340, 24,664, 24,665 (1967); SEN. REPORT, *supra* note 118, at 2-3; HOUSE REPORT, *supra* note 127, at 2812-13; *Senate Hearings, supra* note 1, at 19, 20-21.

132. *See supra* note 82.

133. *See* 113 CONG. REC. 855, 24,664 (1967); SEN. REPORT, *supra* note 118, at 2-3; HOUSE REPORT, *supra* note 127, at 2812-13; *Senate Hearings, supra* note 1, at 18-19.

formed investors were better off than uninformed ones so that there was nothing to lose by requiring certain additional disclosures.<sup>134</sup>

Besides filling a gap in the federal securities law disclosure regime, the Williams Act also sought to provide target company shareholders with limited procedural protections in response to unique features of tender offer campaigns. Supporters of the legislation expressed concern that the typical bid might create pressures to tender in situations in which an informed analysis might counsel otherwise.<sup>135</sup> For example, the shareholder faced with a "first-come, first-served" partial offer might doubt the bidder's ability to pay for all stock tendered and therefore might tender early at the initial price rather than waiting for a higher bid. Toward that objective, the statute imposed certain procedural rules designed to protect shareholders from the pressure to make hurried and ill-considered decisions.<sup>136</sup>

In the end, confronted by the surge in cash tender offer activity and, however uncertain about the public policy ramifications of this novel and still-unfolding phenomenon, Congress was persuaded that its general exemption from federal regulation was not good. The Williams Act did not, however, represent a pervasive, all-encompassing articulation of a federal takeover policy. Manne's theoretical arguments in favor of tender offers found no endorsement by Congress.<sup>137</sup> Rather, the Williams Act addressed specific legal deficiencies in the then-current scheme of federal securities regulation. Thus, Congress modestly amended that scheme in a manner consistent with the underlying philosophy of federal securities regulation: to require disclosure in situations where fairness to shareholders seems to warrant it.<sup>138</sup>

The gap-filling aim, limited ambition, and policy agnosticism of the Williams Act are critical to the meaning of the statute's oft-cited twin policies of "investor protection" and "neutrality." Of course, the aim of the statute was "investor protection" in the obvious sense that target company shareholders were the intended beneficiaries of the legislation.<sup>139</sup> After all, they were the ones to receive the newly mandated

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134. See 113 CONG. REC. 857-58, 9338, 24,664, 24,665 (1967); *Senate Hearings*, *supra* note 1, 42-43, 48-49.

135. See, e.g., *Senate Hearings*, *supra* note 1, at 15, 17.

136. See *supra* text accompanying notes 112-15.

137. This is not surprising since Manne himself stated that "[t]he study of the economics of the market for corporate control is still in its infancy." Manne, *Mergers*, *supra* note 124, at 120.

138. "The purpose of the Williams Act is to insure that public shareholders who are confronted by a cash tender offer for their stock will not be required to respond without adequate information . . ." *Rondeau v. Mosinee Paper Corp.*, 422 U.S. 49, 58 (1975); see R. CLARK, *CORPORATE LAW* 366, 719-20 (1986) (disclosure philosophy of Securities Act of 1933 and Section 14 of Securities Exchange Act of 1934).

139. See, e.g., SEN. REPORT, *supra* note 118, at 3-4.

disclosures, and to enjoy the procedural safeguards. It is a dangerous mistake, however, to conclude that the specific, relatively narrow shareholder protections that Congress provided were part of some larger, well-conceived, and theoretically coherent federal policy that defines investor "protection" in terms of an unlimited right of access to tender offer opportunities. Likewise, it is an error to read Congress' so-called "policy of neutrality" — its express desire not to upset the then-existing "balance" between bidders and target company management, or to favor bidders or target company management in takeover contests<sup>140</sup> — as reflecting a policy judgment about the appropriate level of takeover activity or the role of the states in regulating that activity. Instead, Congress' disavowal was a caution regarding the limited nature of its action, imposing limited disclosure and procedural safeguards but refusing to take sides in the controversial debate over whether takeovers should be discouraged or encouraged. Congress was *declining* to act so as to favor the claims of either target company management or would-be tender offerors. It is revealing in this respect to recall Senator Williams' famous statement that forms the basis of the supposed twin policies:

I have taken extreme care with this legislation to balance the scales equally to protect the legitimate interests of the corporation, management, and shareholders without unduly impeding cash takeover bids. 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 this 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 fairly present their case.<sup>141</sup>

Thus, "investor protection," properly understood in its narrow 1968 meaning, is a congressional policy, but only about disclosure to shareholders by the principal antagonists in the takeover battle. It does not reflect an affirmative, integrated federal policy based on an immutable conception of the appropriate roles of bidders, target company management, and shareholders in hostile takeovers.

In short, confronted with sharply conflicting and unresolved views about the desirability of tender offers, Congress took no position on whether to hinder or promote takeover activity, or whether a certain level of takeover activity was desirable. It expressly disclaimed any desire to make it easier or harder for bidders to succeed, or to impede

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140. The legislative history contains several statements by supporters of the bill expressing the view that it was not intended to upset the "balance" or tip the "scales" between the contending parties. See 113 CONG. REC. 854, 24,664 (1967); *Senate Hearings*, *supra* note 1, at 25, 64. The characterization of this approach as a "policy of neutrality" appears in *Piper v. Chris-Craft Indus.*, 430 U.S. 1, 29 (1977). See also *Edgar v. MITE Corp.*, 457 U.S. 624, 633 (1982).

141. 113 CONG. REC. 854-55 (1967).

or enhance shareholder opportunities to receive tender offers. It said nothing about precluding states from acting. Instead, Congress sought simply to make sure that target company shareholders would have sufficient disclosure and procedural protection to respond rationally if and when tender offers occurred. In the words of a distinguished commentator writing in 1970, "federal securities regulation of takeovers is developing, incomplete, and uncertain in its requirements."<sup>142</sup> Because it was true in 1968 and because the premises of the Williams Act have not been materially altered, that description of the statute's modest compass continues to be true today.

### B. *The Williams Act's Context*

Having surveyed the original objectives of the Williams Act, we turn now to three basic assumptions about state corporation law and the character of hostile takeovers that helped form the context within which Congress passed the statute. We focus on these elements because they represent important background assumptions that are no longer valid. Appreciation of the intellectual and legal context and how it has changed reveals why the Williams Act is of such limited relevance to the problems that takeovers present today.

#### 1. *Shareholder Autonomy with Respect to Stock Alienation*

In 1968, Congress relied on certain basic assumptions about how tender offers were typically conducted to address the tender offer phenomenon. A hallmark of state corporation law was its recognition of the shareholder's right to make his or her own determination about when and to whom to sell stock. Corporation statutes at that time allowed articles of incorporation, bylaws, or shareholder agreements to impose reasonable restrictions on alienation,<sup>143</sup> and common law imposed certain limitations on sales by controlling shareholders.<sup>144</sup> Nevertheless, the individual shareholder's right to decide whether and when to sell stock was a fundamental principle of state corporation law, a principle assumed in the 1960s to be fully applicable to the tender offer context.<sup>145</sup>

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142. Shipman, *Some Thoughts About the Role of State Takeover Legislation: The Ohio Takeover Act*, 21 CASE W. RES. L. REV. 722, 760 (1970).

143. See, e.g., DEL. CODE ANN. tit. 8, § 202 (1983); *Allen v. Biltmore Tissue Corp.*, 2 N.Y.2d 534, 161 N.Y.S.2d 418 (1957); *Colbert v. Hennessey*, 351 Mass. 131, 217 N.E.2d 914 (1966).

144. See, e.g., *Perlman v. Feldmann*, 219 F.2d 173 (2d Cir.), cert. denied, 349 U.S. 952 (1955); *Gerdes v. Reynolds*, 28 N.Y.S.2d 622 (Sup. Ct. 1941).

145. Statements occur throughout the Williams Act's legislative history indicating that contemporaries simply took for granted that shareholders (rather than some other group or entity)

Today, we are accustomed to reading about target management's deployment of "poison pills," "shark repellents," "lock-up options," "white knights," and other colorfully labelled defensive "showstoppers."<sup>146</sup> The purpose of such tactics is to prevent a stock purchase offer from getting to the shareholders at all — that is, to deny shareholders an opportunity to exercise their historically unquestioned right to decide whether to sell to a hostile bidder. Subject to certain important qualifications, such practices are generally lawful<sup>147</sup> and can be highly effective.<sup>148</sup> In 1968, however, target management's ability to block hostile tender offers was in its infancy. Because corporate lawyers had not yet devised the sophisticated weapons of the 1980s, the possibilities were very limited and appear quaint by today's standards.<sup>149</sup> The only potentially effective blocking tactic used in 1968, with case law support, was the defensive stock repurchase. Faced with a threat to its control, management might use corporate funds to buy the hostile bidder's block of stock at a premium or simply to purchase other shares on the open market in order to "thin out" the market. However, as a means by which target company management might block unwelcome overtures, the defensive repurchase was not entirely effective. The bidder could simply refuse the buy-out offer and continue its appeal to the shareholders, either in open market purchases or via a tender offer. Further, corporate stock repurchases were subject to criticism precisely because "shareholders are, in effect, deprived of a choice between the conflicting policies and personalities when corporate funds can be used to purchase enough shares to make it impossible for the outsider to gain the control he seeks."<sup>150</sup> In any event, repurchases from hostile bidders — now labeled "greenmail" — were used infrequently during the 1960s.<sup>151</sup>

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would decide the fate of tender offers through their individual decisions to tender or hold their stock. Disclosure requirements would simply augment that key feature of the process. See 113 CONG. REC. 855, 9340, 24,664 (1967); SEN. REPORT, *supra* note 118, at 2, 3; HOUSE REPORT, *supra* note 127, at 2812, 2813; *Senate Hearings*, *supra* note 1, at 15, 16, 17, 64, 97, 156, 184.

146. For definitions of these and other devices, see L. LOSS, *FUNDAMENTALS OF SECURITIES REGULATION* 499-502 (2d ed. Supp. 1988). See also *Unocal Corp. v. Mesa Petroleum Corp.*, 493 A.2d 946, 957 (Del. 1985) (describing development and judicial sanction of growing array of defensive measures).

147. See, e.g., *Moran v. Household Intl., Inc.*, 500 A.2d 1346 (Del. 1985); *Unocal*, 493 A.2d 946.

148. See, e.g., *supra* note 66.

149. See Schmults & Kelly, *Cash Takeover Bids — Defense Tactics*, 23 BUS. LAW. 115 (1967) (describing three general lines of defense with scant recitation of judicial authority validating the tactics described); see also Fleischer & Mundheim, *Corporate Acquisition by Tender Offer*, 115 U. PA. L. REV. 317 (1967).

150. Fleischer & Mundheim, *supra* note 149, at 365.

151. Greenmail was a rare phenomenon until recently. See Macey & McChesney, *A Theoretical Analysis of Corporate Greenmail*, 95 YALE L.J. 13, 13 (1985).

Besides defensive stock repurchases, there was little else target company management could do. It might, for example, try to influence the market for target company shares by enlisting friendly outsiders to purchase target stock; this could bid up the stock price and thereby discourage an insurgent by raising its acquisition costs.<sup>152</sup> Such tactics, however distorting and then lacking in articulable justification, were entirely consistent with the reigning state law principle of free stock alienability. Even if they succeeded in fending off a hostile offeror, their very success depended ultimately on target shareholders deciding for themselves whether to sell their stock. Thus, even where target company management opposed a hostile tender offer and sought to take steps to block its consummation, its conduct generally left target company shareholders with the final power to decide whether and when to sell their stock.

In the mid-1960s, target company management played a much more limited role, both in legal theory and in practice, in the typical tender offer than it does today; success or failure of an offer was assumed to rest with shareholders. Indeed, it was the would-be acquirer's ability to sidestep management and appeal directly to the shareholders that gave the tender offer its awesome force. Accordingly, the Williams Act's disclosure requirements reflect concern that target company management may attempt to discourage tenders by distributing misleading information to shareholders.<sup>153</sup> Again, however, such defensive tactics by target companies and the congressional response simply assumed — indeed were premised on — shareholders having the ultimate voice in takeover contests as a result of their stock disposition power. In mandating a policy of informed choice, Congress acted to improve the flow of information so as to make the choice more *informed*. It did not consider whether federal law was needed to facilitate *choice* as such, however; the latter, a then-unquestioned attribute of share ownership provided by state law, was simply taken for granted.

## 2. *Shareholder Wealth Maximization as the Primary Object of Corporation Law*

In 1968, legal and economic orthodoxy placed shareholder welfare at the center of corporation law and corporate purpose. State corporation law — statutory and common law — assumed that corporations would be run primarily for the shareholders' financial benefit. Ac-

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152. *Senate Hearings*, *supra* note 1, at 196.

153. *See id.* at 183.



cording to the classic expression of this principle, management was not permitted to sacrifice this objective to other values or policy preferences.

A business corporation is organized and carried on primarily for the profit of the stockholders. The powers of the directors are to be employed for that end. The discretion of directors is to be exercised in the choice of means to attain that end and does not extend to a change in the end itself, to reduction of profits or to the nondistribution of profits among stockholders in order to devote them to other purposes.<sup>154</sup>

That basic idea, articulated as early as 1919, continued to shape state corporation law in the 1960s. At least in theory, state statutory and common law proscribed conduct by management that deviated from that normative principle.<sup>155</sup> Statutes limited the extent to which corporations might make charitable contributions or otherwise devote resources to uses that would not redound to the shareholders' financial benefit.<sup>156</sup> Courts interpreted directors' fiduciary duties of care and loyalty as precluding conduct that could not be justified, however weakly, as congruent with the interests of the "corporation and its shareholders."<sup>157</sup>

Conventional economic thinking generally took for granted this focus on shareholder welfare. It underlay Manne's analysis of hostile takeovers, for example, and it continues today as a central tenet in much of the commentary on takeovers.<sup>158</sup> Various justifications for the principle of shareholder primacy have been offered.<sup>159</sup> Departure from that principle is thought to discourage investment in corporate enterprise. Financial returns to shareholders would decline, theorists warned; moreover, given the modern corporation's separation of ownership from control, and the nagging accountability and legitimacy

154. *Dodge v. Ford Motor Co.*, 204 Mich. 459, 507, 170 N.W. 668, 684 (1919).

155. *See Selheimer v. Manganese Corp.*, 423 Pa. 563, 224 A.2d 634 (1966); *Litwin v. Allen*, 25 N.Y.S.2d 667 (Sup. Ct. 1940).

156. DEL. CODE ANN. tit. 8, § 122(9) (1983); *see Theodora Holding Corp. v. Henderson*, 257 A.2d 398 (Del. Ch. 1969) (power limited to reasonable amounts).

157. Delaware has defined the board's fiduciary duty as owed not merely to the shareholders but to the corporation as well. *See supra* note 81. The meaning of the distinction — if indeed it is a distinction — has never been explained. Instead, Delaware's jurisprudence has traditionally assumed that the interests of the corporation, on the one hand, and the shareholders, on the other, coincide. Corporate takeovers threaten the continued validity of that assumption because the interests of the corporation as a whole — including various nonshareholders — will diverge from those of shareholders in a bust-up bid. *See Johnson, Corporate Takeovers and Corporations: Who are They For?*, 43 WASH. & LEE L. REV. 781 (1986).

158. Most scholarship about corporate takeovers uncritically accepts the shareholder primacy norm as given. Analysis then focuses on the extent to which particular rules or behavior promote or detract from that value. *See, e.g.,* Bebchuk, *supra* note 63; Easterbrook & Fischel, *supra* note 10; Gilson, *supra* note 18; Romano, *supra* note 8.

159. *See Johnson, supra* note 13, at 40-41.

problems that this separation generates, the shareholder primacy norm was considered necessary to provide a clear benchmark against which the performance of powerful corporate management might be assessed.<sup>160</sup> An even more basic concern was that, because the shareholders are the corporation's "owners" or residual risk bearers, managerial policies that benefit others at shareholders' expense represent an illegitimate transfer of wealth from its rightful claimants to some third party.<sup>161</sup> Finally, the supposed linkage between shareholder welfare and the general benefits of efficient resource exploitation served to reconcile a seemingly narrow focus for corporate endeavor with larger social demands on corporate behavior.<sup>162</sup>

Congress passed the Williams Act against this background of basic assumptions about the content and central objective of corporation law and corporate activity. The statute says nothing explicit about the shareholders' economic or legal position in the corporation, just as it says nothing about the power of shareholders to resolve takeover contests by selling or holding their stock. The statute's disclosure and procedural protections were designed to operate within the context of a state law framework that gave shareholders broad power to dispose of stock. Similarly, the preeminence of shareholder economic rights was another deeply ingrained element of that context. There was no need to shore up that framework; it already existed, and was as taken for granted in mainstream economic thought and corporation law as the air we breathe.

### 3. *No Trade-Off Between Shareholder and Nonshareholder Welfare*

In 1968, the immediate goal of the typical hostile takeover was replacement of incumbent management. According to the only empirical study that had been conducted, companies that attracted the attention of tender offerors were inefficiently managed firms not realizing their full economic potential.<sup>163</sup> In theory, this inefficiency was reflected in a target company's stock price, which would be lower than the company's potential value. A potential acquirer that believed itself capable of increasing a target company's efficiency might there-

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160. See Friedman, *The Social Responsibility of Business Is to Increase Its Profits*, N.Y. Times, Sept. 13, 1970, at 33 (Magazine); see also Hetherington, *Fact and Legal Theory: Shareholders, Managers, and Corporate Social Responsibility*, 21 STAN. L. REV. 248, 280 (1969).

161. See M. FRIEDMAN, *CAPITALISM AND FREEDOM* 135 (1982 ed.).

162. See Eisenberg, *Corporate Legitimacy, Conduct, and Governance — Two Models of the Corporation*, 17 CREIGHTON L. REV. 1, 5 (1983); *supra* note 125.

163. Taussig & Hayes, *Are Cash Take-Over Bids Unethical?*, 23 FIN. ANALYSTS J. 107, 108 (1967); see also Brudney, *A Note on Chilling Tender Solicitations*, 21 RUTGERS L. REV. 609, 610 (1967).

fore offer shareholders a premium above current market price in order to gain control over the corporation. The reigning assumption was that, while the acquirer might consolidate or otherwise alter operations, the business of the target would continue, more efficiently of course, and the buyer would recoup its investment and earn a tidy profit.

The Williams Act's legislative history contains occasional expressions of concern that hostile takeovers might result in lost jobs for management, asset liquidations, or other disruptive effects.<sup>164</sup> However, there is little reference to possible adverse impact on various non-shareholder interests such as nonmanagement employees, creditors, local communities, and the like.<sup>165</sup> It is unlikely that such concerns could have been significant, because available evidence — of which there was extremely little — indicated that "bust-up" takeovers of the kind so prevalent in the 1980s were quite rare and, as to those that had occurred, no studies of their effects existed.<sup>166</sup> In the years preceding 1968, only a small percentage of tender offers resulted in significant asset liquidations. Indeed, the tender offer phenomenon was part of the larger wave of conglomerate acquisitions aimed at assembling disparate operations under unitary control.<sup>167</sup> The acquirer often replaced management, but additional job losses or other dislocations were expected to be few.

To the extent that legislators expressed concern about possible adverse effects of takeovers, the principal object of solicitude seems to have been target company shareholders.<sup>168</sup> Other enterprise-dependent interests were not a part of the calculus because they were of no direct concern to federal securities law and its narrow focus on protecting capital providers. Economic orthodoxy and the premises of state corporation law likewise eschewed any explicit regard for non-shareholder interests. Furthermore, for those who saw takeover activity as promoting overall allocative efficiency, tender offers were a vehicle for benefiting rather than threatening noninvestors. Congress simply did not approach takeovers with any empirical evidence or deeply felt alarm about their disruptive effects. Hence, Congress did not consider whether the benefits to shareholders and society generally

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164. See 113 CONG. REC. 857-58, 8236-37, 9338 (1967); *Senate Hearings, supra* note 1, at 43, 48.

165. See *infra* note 168.

166. See Taussig & Hayes, *supra* note 163.

167. See *Senate Hearings, supra* note 1, at 56, 204.

168. See 113 CONG. REC. 855-56, 24,664 (1967); *Senate Hearings, supra* note 1, at 15, 16, 44, 57, 178.

of a robust market for corporate control might involve substantial costs to local interests dependent on the continued existence of target corporations. To the Congress of 1968 and to society at large that trade-off question had not yet emerged.

### III. THE IRRELEVANCE OF THE WILLIAMS ACT

Before addressing the preemption questions presented in Part I.C above, we note in this section that each of the three basic assumptions about state corporation law and the character of takeovers just discussed are no longer valid. Those assumptions formed an integral part of the context in which Congress operated when it considered and passed the Williams Act in 1968. As the context has changed, however, new questions about hostile takeovers and state regulation have arisen. We will argue below that Congress did not address those questions and that the Williams Act therefore does not answer them. To appreciate how the current preemption controversy poses entirely different policy challenges than those that faced Congress in 1968, we first need to see how much the world of takeovers has changed in twenty years.

#### A. *A New Context*

##### 1. *The Role of Target Company Management*

Post-1968 developments in state antitakeover statutes<sup>169</sup> and state common law, as well as the continuing evolution of new defensive measures, have dramatically redefined the role of target company management in hostile takeovers. The post-*MITE* corporatization strategy of state statutes has transmuted tender offers into "corporate" affairs and thrust management onto center stage, usurping from target shareholders their previous unilateral power to decide a hostile bid's success or failure.<sup>170</sup> Business combination statutes and Pennsylvania's director-approval statute in particular are designed to give target company management an effective veto power over hostile bids.<sup>171</sup>

The common law has developed a similar promanagement slant during the two decades since passage of the Williams Act. Indeed, because state antitakeover statutes were routinely struck down prior to

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169. At the time the Williams Act was passed, only the state of Virginia had passed a takeover statute. See 1968 Va. Acts ch. 119, §§ 13.1-528 to -540.

170. See *supra* Part I.B.

171. *Id.*

the 1987 *CTS* decision,<sup>172</sup> up until the *Revlon* decision and its auction mandate, the common law had been an even greater source of comfort to target management than statutory law.<sup>173</sup> It is true that, under certain circumstances at least, common law principles preclude management from denying shareholders the opportunity to receive a tender offer; in fact, under *Revlon, Inc. v. MacAndrews & Forbes Holdings*<sup>174</sup> and its progeny, Delaware law may even require management to facilitate an "auction" of the company.<sup>175</sup> However, until the full reach of this *Revlon* duty to auction is delineated, common law will permit management to deploy powerful defensive measures to block hostile bids.<sup>176</sup> While management must account for how this power is exercised, more strictly now perhaps than in years past, the Delaware Supreme Court's *Unocal* decision<sup>177</sup> and similar decisions from other jurisdictions<sup>178</sup> still allow management to claim the generous protective mantle of the business judgment rule. Thus, while courts are intensifying their scrutiny of target company blocking measures, for the most part post-*Unocal* formulations of judicial review have not changed the fact that defensive behavior continues to be assessed against the rather lax standards developed for reviewing management's exercise of its fiduciary duties outside the takeover context.<sup>179</sup>

Whatever the underlying political and economic motivations of state legislators and judges, management's potentially decisive role in takeover contests is evidence of an intellectual environment that remains somewhat skeptical about the value of tender offers and their place in our contemporary commercial life. Greater appreciation for the broad effects of hostile takeovers on nonshareholders as well as shareholders has forced state legislators and judges to describe takeovers as "corporate" rather than merely shareholder matters. Given

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172. See *supra* note 33.

173. See Johnson, *supra* note 13, at 44-52 (discussing pre-*Revlon* Delaware common law fiduciary duty cases).

174. 506 A.2d 173 (Del. 1985).

175. See Johnson, *supra* note 13, at 52-61.

176. See *supra* note 66.

177. *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985).

178. See, e.g., *Gearhart Indus. v. Smith Intl.*, 741 F.2d 707 (5th Cir. 1984) (applying Texas law); *Crouse-Hinds Co. v. InterNorth, Inc.*, 634 F.2d 690 (2d Cir. 1980) (applying New York law); *Treadway Cos. v. Care Corp.*, 638 F.2d 357 (2d Cir. 1980) (applying New Jersey law); *Berman v. Gerber Prods. Co.*, 454 F. Supp. 1310 (W.D. Mich. 1978) (applying Michigan law). One commentator has described the business judgment rule approach, as opposed to some other that might involve stricter judicial scrutiny, as "the apparent majority view." Steinberg, *supra* note 16, at 14.

179. For the suggestion that preemption arguments being advanced with respect to state antitakeover statutes apply with equal force to state common law governing defensive measures, see Johnson & Millon, *supra* note 20.

the orthodox shareholder-centered rhetoric of the prevailing corporation law regime, that malleable, potentially all-inclusive reference to the "corporation" is the only acceptable manner in which to recognize these nontraditional but legitimate concerns. As a result, state law has placed target company management squarely between the bidder and shareholders and conferred on it a dazzling new power to influence and, sometimes at least, block hostile bids. This was not done simply because of political lackeyism,<sup>180</sup> or out of some imaginary desire to "compete" more effectively in the market for corporate charters. Rather, as a practical matter, after *MITE*, management was the only mechanism in the corporation law system that constitutionally had the power to take a broader view of the impact of takeovers on nonshareholders. Thus, the board's traditional duty to look after the interests of "the corporation *and* its shareholders"<sup>181</sup> has become the legal foundation for the states' larger political and economic agendas.

The result of these twin state law developments is a sharp departure from the Williams Act's shareholder-centered universe. By emphasizing the significance of tender offers to the corporate entity and its entire field of relationships, the states have inescapably and radically redefined the "internal" relationship between management and shareholders. As a result, Congress' original assumptions about both the target company management's limited role and the shareholders' decisive power in the tender offer process under state law no longer hold true. Now, though still enjoying the disclosure and procedural protections of the Williams Act, shareholders typically no longer possess the final, exclusive power to resolve takeover contests opposed by incumbent management. Thus, over the past two decades state corporation law has overtly extended the management-centered conception of the corporation that already dominated other spheres of corporation law into the last vestige of the traditional shareholder-oriented perspective — stock disposition decisions, including tender offer responses. In so doing, it has shifted the takeover balance of power from shareholders to management and brought capital market discipline of management within management's own control. In this important respect takeover law joins the rest of contemporary corporation law. As these recent developments indicate, Congress adopted the Williams Act within the context of a very different state law regime.

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180. See *supra* note 8.

181. See *supra* notes 81, 157.

## 2. *State Regard for Nonshareholder Interests*

The continued rise in the incidence of hostile takeovers after passage of the Williams Act resulted in state efforts to curb takeover activity.<sup>182</sup> The primary impetus behind this development has been a legislative perception that hostile takeovers disrupt local economies and harm resident nonshareholders dependent on corporate activity — perceptions that increasingly are explicitly acknowledged in the language and legislative history of these recent statutes.<sup>183</sup> Even where legislators and statutes pay lip service to shareholder welfare goals, opposition to hostile takeovers is implicit in the design and likely effect of these statutes. This is particularly evident in business combination statutes and in expanded duty-of-care statutes that expressly authorize a board of directors to consider the effect of its decisions on the corporate entity and various noninvestor interests, as well as on shareholders.<sup>184</sup>

A parallel development has been state common law rules that sanction management resistance to takeovers. These common law precepts do more than allow target company management to adopt defensive measures to protect the financial interests of shareholders. They also have been interpreted to allow target company directors to resist where necessary to protect the "corporation," including nonshareholders, from the harsh effects of a takeover. State common law, in an apparent effort to restore shareholders to the preeminent place assigned them by economic and legal orthodoxy, may be in the process of requiring management to facilitate a tender offer regardless of its impact on nonshareholder interests.<sup>185</sup> But, to date, that principle has been confined to those circumstances where a "sale" of the company is conceded to be inevitable.<sup>186</sup> More generally applicable is a different rule, a rule that upholds the propriety of target company management's attention to nonshareholders, or, put less strongly, sanctions considerable deviation from single-minded devotion to near-term shareholder interests.

In the *Unocal* decision,<sup>187</sup> the Delaware Supreme Court specified the conditions that determine whether defensive tactics will be entitled to the protection of the business judgment rule. Among the requirements is the duty to evaluate the likely "effect on the corporate enter-

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182. See *supra* note 3.

183. See *supra* notes 76-78 and accompanying text.

184. See *supra* notes 68-75 and accompanying text.

185. See *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986).

186. See *Ivanhoe Partners v. Newmont Mining Corp.*, 535 A.2d 1334 (Del. 1987).

187. *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985).

prise," which includes the discretionary power to weigh "the impact on 'constituencies' other than shareholders (*i.e.*, creditors, customers, employees, and perhaps even the community generally)." <sup>188</sup> The Delaware Supreme Court, wrestling with the knotty issue of how broadly to read the *Revlon* auction mandate, has recently reiterated this principle. <sup>189</sup> Courts applying the common law of other jurisdictions have also recognized, at least obliquely, the relevance of nonshareholder interests in management's response to a hostile takeover. <sup>190</sup>

Shareholders stand to benefit immensely from unrestricted tender offer activity. State law that successfully restricts their opportunity to receive tender offers in order to further other policy objectives — specifically the protection of various nonshareholder interests — represents a profound departure from the orthodox principle of shareholder primacy as the principal focus of corporation law and the chief purpose of corporate endeavor. Thus, in addition to altering the relationship between target company management and shareholders since 1968, the states have reranked the claims of shareholders and local nonshareholder interests. Again, Congress adopted the Williams Act within the context of a very different state law regime.

### 3. *Harmful Effects of Takeovers*

During its consideration and passage of the Williams Act, Congress paid little attention to the possibility that hostile takeovers might seriously harm nonshareholder interests. Moreover, there was no authoritative evidence as to whether takeovers truly served to reallocate resources to higher valued uses, a claim made then and now by their proponents.

Today, the intellectual and political climate has changed radically. It is widely believed by state legislators and the general public that hostile takeovers bring plant closings or transfers, employee layoffs, lost tax revenues and charitable contributions from local firms, disruption of established supplier and customer relationships, and other vaguely articulated economic and social dislocations. <sup>191</sup> While the accuracy of these perceptions is a matter of current dispute, they should not be dismissed out of hand. The character of the hostile takeover

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188. 493 A.2d at 955.

189. *Newmont*, 535 A.2d at 1341-42.

190. *See, e.g.*, *Herald Co. v. Seawell*, 472 F.2d 1081, 1091 (10th Cir. 1972) (applying Colorado law); *Enterra Corp. v. SGS Assocs.*, 600 F. Supp. 678, 687 (E.D. Pa. 1985) (applying Pennsylvania law); *GAF Corp. v. Union Carbide Corp.*, 624 F. Supp. 1016, 1019-20 (S.D.N.Y. 1985) (applying New York law).

191. *See supra* notes 7-8.



has changed thoroughly since 1968. The dominant motive in the typical case is no longer to continue operations under more efficient management, or to generate other synergistic gains within a given corporate structure; instead, many takeovers are now driven by a desire to realize the liquidation or "break-up" value of corporate assets in situations where the cost of target company stock is less than target company asset resale value.<sup>192</sup> Even if corporate restructurings do not result in apocalyptic consequences for nonshareholders, they will often have significant disruptive effects on at least some established stakeholder relationships and require costly readjustments. Indeed, it has been vigorously argued that the primary source of gain in the typical takeover is the acquirer's ability to appropriate nonshareholders' investments of human capital by inducing target company shareholders to breach implicit promises that stakeholders will have a continuing relationship with the target company.<sup>193</sup> Under this interpretation, takeover premiums represent wealth transfers from employees, suppliers, and local communities to target company shareholders. Even if takeovers do serve society's interest in allocative efficiency, the benefits may not be realized in the states in which disbanded corporate operations were previously conducted.

Debate about the extent to which nonshareholders suffer from takeovers will continue. So too will disagreement over the net benefits to shareholders and the extent of allocative efficiency gains and even as to the causes of takeovers. In the meantime, the states have made concern for nonshareholder interests the basic objective of their anti-takeover legislation. They can be expected to maintain that course. That objective necessarily conflicts with shareholder interests and possibly even larger societal interests, and thus requires controversial "trade-off" judgments. States, for obvious political and economic reasons, have struck the balance in favor of local nonshareholder interests at the expense of generally nonresident shareholders. Today, the assumptions about the harmful effects of takeovers that compel these "trade-off" judgments raise important questions about the respective state and federal roles at the intersection of corporate and capital mar-

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192. See Coffee, *supra* note 6, at 2-7. There is no agreement about the causes of asset under-valuation or, more generally, bidder motivations. The question is an important one because whether takeovers should be encouraged or discouraged may depend on the answer. See Black, *Bidder Overpayment in Takeovers*, 41 STAN. L. REV. 597 (1989); Kraakman, *Taking Discounts Seriously: The Implications of "Discounted" Share Prices as an Acquisition Motive*, 88 COLUM. L. REV. 891 (1988).

193. A. SHLEIFER & L. SUMMERS, *HOSTILE TAKEOVERS AS BREACHES OF TRUST* (National Bureau of Economic Research Working Paper No. 2342, 1987).

ket matters. Such trade-off concerns were not part of Congress' thinking in 1968.

## B. *Resolving the Preemption Controversy*

### 1. *Shareholder Autonomy Versus Shareholder Protection*

As discussed above,<sup>194</sup> one aspect of today's preemption debate is the distinction between what we have called "shareholder autonomy" and "shareholder protection." This question has been formulated in terms of whether meaningful target company management involvement in the tender offer process is a permissible means toward achievement of the shareholder welfare objective. A broader issue underlies this part of the debate, however. This is the question whether the Williams Act embodies a general federal policy mandating that state law promote the interests of shareholders in takeover contests (whether by autonomy or protection means). The debate has implicitly yielded an affirmative answer. We argue, in this section, that the Williams Act offers no basis for choosing between autonomy or protection and, in the following section, that there is no basis for reading into the Williams Act a federal policy against state law restrictions on tender offer opportunities.

Judicial analysis has focused on whether the Williams Act allows states to establish procedures that assign management a significant degree of responsibility for protecting shareholder welfare in takeovers, or, alternatively, whether shareholder welfare requires shareholder self-determination. When it comes to shareholder well-being, are states free to deploy management to serve shareholder interests, or must shareholders, for better or worse, enjoy the process value of autonomy? This is how the Delaware and Wisconsin federal courts formulated the preemption question, reaching, as we have seen,<sup>195</sup> different conclusions. Presented in this manner, however, the question of legislative intent is meaningless. Congress adopted the Williams Act early in the life cycle of the current takeover wave, within the context of several basic, unspoken and now unfounded assumptions about state law and takeover practice.<sup>196</sup> Thus, it assumed that shareholders, not management, decide stock disposition matters and hence play a decisive role in resolving takeover contests. That assumption is no longer accurate. Through statutory and common law, states have empowered target company management to play a central role in the

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194. See *supra* section I.C.1.

195. See *supra* section I.C.1.

196. See *supra* section II.B.

takeover process. Was the Williams Act designed as a "shareholders' bill of rights" to receive and resolve tender offer opportunities, with that goal to be attained, if need be, by freezing takeover law and practice in its 1968 configuration? Or did Congress have the more modest aim of imposing limited investor-oriented requirements on the conduct of tender offers, while leaving states free to define their character in other ways?

One might argue that, after all, federal securities regulation has traditionally limited its concerns to disclosure. It is unlikely that Congress in 1968 would redefine the basic thrust of federal securities regulation in the tender offer area, and substantially alter its relationship to state corporation law, by intruding upon traditional state law concerns in such a tacit and subtle, rather than express, fashion. Likewise, if Congress intended to proscribe any substantive state law interference with the tender offer process, one would expect a clear statement of that objective. Ultimately, these arguments about intent are misguided because today's preemption question involves policy choices about the respective governance roles of directors and shareholders that Congress never addressed when it passed the Williams Act. To claim now that Congress decided the issue in 1968 is patently inaccurate.

## 2. *Shareholder Welfare Versus Nonshareholder Welfare*

There is a second, potentially much more important, dimension to the preemption controversy which the participants on both sides have largely overlooked. This is the relationship of the general shareholder welfare idea to the overall vitality of the market for corporate control. This issue was addressed forthrightly, though cryptically, by the *MITE* plurality,<sup>197</sup> and it resurfaced briefly but unsatisfactorily in *CTS*.<sup>198</sup> It troubled the Delaware and Wisconsin courts as well, and greatly influenced the timbre of their opinions. Does shareholder welfare mean simply that, *if and when* a takeover opportunity presents itself, shareholders must be allowed to enjoy its rewards? Or, alternatively, does federal policy have a more affirmative side, representing a coherent, comprehensive decision in favor of a robust takeover market unhampered by state regulation? The issue, in other words, is whether the Williams Act allows the states to impose restrictions on the tender offer process that have the effect of denying tender offer opportunities to shareholders. To put the question more firmly within the context of

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197. *Edgar v. MITE Corp.* 457 U.S. 624, 633-34 (1982).

198. *CTS Corp. v. Dynamics Corp.*, 481 U.S. 69 (1987).

current antitakeover legislation, do the apparently straightforward goals and language of the Williams Act carry a latent meaning that requires shareholder interests to take precedence over competing non-shareholder interests in hostile takeovers — that all takeover questions turn solely on the financial interests of shareholders? If not in the language itself, is such a meaning to be found in the structure of the Act, or perhaps in what Congress did not do? Or did Congress do very little and intend only as much, leaving room for the states to decide for themselves the circumstances under which shareholders would enjoy the benefits of tender offers?

Choosing between these readings of the Williams Act involves more than a preference or distaste for takeovers and their economic and social outcomes. More deeply, it implicates the relationship between state corporation law and federal securities regulation. Corporate shareholders are and have been for many decades subjects of both regimes. They are the chief beneficiaries of federal securities laws. At the same time, they also are dependent on state corporation law for the very existence of their holdings, as well as for the definition and content of their stock's attributes. Accordingly, state efforts to deprive shareholders of the unilateral power to decide whether to tender their stock, by redefining the contours of share ownership, necessarily implicate Congress' proper concern with the workings of national capital markets. Thus, on the one hand, it might be argued that in 1968 Congress was determined to fulfill its goal of shareholder welfare through the medium of unfettered capital markets, regardless of whether that goal is of considerably less importance to state legislators. From this view, the federal shareholder welfare policy looks like a pervasive federal policy favoring takeovers, which are themselves taken as natural indicators of the healthy, well-functioning market Congress set out to achieve. Consequently, state law that reduces takeover activity *ex ante* by limiting shareholders' opportunities to sell stock to tender offerors necessarily impinges on the vitality of the capital markets and thereby frustrates the purposes of federal regulation. The result is preemption. This is how the SEC has approached the preemption question,<sup>199</sup> and it was also the view of the *MITE* plurality and those scholars whose work is cited in that opinion.<sup>200</sup>

It might be countered that Congress simply intended the Williams

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199. See *infra* Part IV.

200. See, e.g., Fischel, *Efficient Capital Market Theory, the Market for Corporate Control, and the Regulation of Cash Tender Offers*, 57 TEXAS L. REV. 1 (1978). Scholars like Fischel, who prefer market mechanisms to legal regulation, are of course Manne's intellectual descendants. Ironically, however, while Manne opposed the Williams Act, 20 years later and in the name of "investor protection," that very statute is seized upon as the vehicle for achieving what

Act to be an overlay on the substantive rights state law provides to shareholders. State statutory and common law are presently in turmoil on the takeover issue, and there are signs that the two may be moving in opposite directions.<sup>201</sup> Nevertheless, those laws and doctrines, with varying degrees of success, have generally been designed to empower management to preclude shareholder consideration of tender offers in many situations, harming shareholders as a result. The fact that the substantive rights of shareholders being tampered with involve the right to sell stock is irrelevant, even though aspects of stock alienation are also subject to federal regulation. The shareholder unavoidably has become the point of intersection between state corporation law and federal securities law. Federal law, like a kind grandparent, confers benefits but makes few demands, while state law, like a parent, imposes stricter limits on share ownership rights. In any boundary dispute between federal securities and state corporation laws where a matter traditionally subject to state jurisdiction is at stake — like the meaning of share ownership — federal law, being derivative and dependent on state law for the subject matter of its regulation, must yield in the absence of clear congressional intent. Thus, once the states have shaped the decisionmaking attributes of share ownership in the takeover setting, federal law will seek only to ensure that such transactions as do occur pursuant to the state law regime are entered into with adequate disclosure. But federal securities law itself makes no prior determination about what types of transactions should occur nor about their desired level of frequency.

We have argued above that the claim that the Williams Act preempts management involvement in tender offers cannot be supported by resort to legislative intent.<sup>202</sup> Analysis of legislative intent also does not establish that the Williams Act's shareholder welfare focus carries with it a federal ban on state efforts to curb takeovers, such as those found in the burgeoning business combination statutes. Congress had no reason to consider this question because, as we have seen,<sup>203</sup> under the then-existing state corporation law regime, neither management nor anyone else could place significant roadblocks in the way of tender offers. Congress' assumptions about the limited obstacles in the path of hostile takeovers and the absence of significant trade-off concerns no longer apply. Thus, to make of the Williams Act

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Manne sought in denouncing the legislation — a vibrant, unencumbered market for corporate control.

201. This idea is developed fully in Johnson, *supra* note 13.

202. See *supra* section III.B.1.

203. See *supra* section II.B.1.

a shareholders' "bill of rights" to receive tender offer opportunities is, at best, to argue that Congress' assumptions about the largely unrestricted existence of tender offer opportunities for shareholders in 1968 amounted to an intention to guarantee the continuance of such opportunities in the future. Yet one could just as well say that Congress' assumptions in 1968 about the states' primary role in structuring corporate governance and defining the attributes of investment instruments and about the limited ambitions of federal securities law demonstrate an intention to allow broad regulatory authority for the states. The error in both sorts of argument is to try to read a particular statutory effort to address a particular problem as much more. Congress had no such intentions. Thus, the Williams Act offers no comfort to those who seek to use it to promote policies that Congress never endorsed.

Like the language itself, the statute's legislative history indicates that neither Congress nor the SEC intended to take a position in favor of or against takeovers.<sup>204</sup> Instead, the Williams Act merely conferred on target company shareholders some limited protections not previously available, while disclaiming any intent to strengthen or weaken the hands of bidders or their opponents. Whatever salutary benefits they provide to shareholders with respect to coercive takeover bids, present state law regimes, viewed *ex ante*, probably disserve shareholders by creating a chilling effect on tender offers, though how much so is unclear. Policy debate rages around the question of whether this is a good thing, and spills into and animates the preemption controversy, but Congress itself did not address that issue in the Williams Act and has yet to do so.

#### IV. CONGRESSIONAL INTENT VERSUS CONGRESSIONAL ASSUMPTIONS, AND THE SEC'S MISREADING OF THE WILLIAMS ACT

The SEC, opposing the business combination statutes in its briefs, reads the Williams Act as mandating a shareholder autonomy policy, the essence of which is unimpaired shareholder decisionmaking, that precludes state law restraints on takeover activity. That is, to be meaningful, Congress' supposed commitment to shareholder autonomy must imply an essentially unrestricted right both to receive and respond to tender offer opportunities. In order to preserve the right to respond, such tender offers must not be channeled through third parties, be they state bureaucrats or corporate directors. Consequently,

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204. See *supra* section II.A.

state takeover laws — “corporate” or otherwise — that obstruct shareholder consideration of hostile bids are preempted.

In urging its views on preemption, the SEC seeks to achieve a particular policy objective, the removal of state law restraints on tender offer activity. The goal is thus a reading of the Williams Act as a protakeover statute, one reflecting an informed, considered congressional judgment about the economic and social value of a market for corporate control unimpeded by state law — a policy judgment from which the states are powerless to dissent. The SEC’s shareholder-autonomy construction was heartily endorsed by the *MITE* plurality, which is not surprising given that the majority’s commerce clause analysis in that opinion revealed the Court’s naive acceptance of a very one-sided conception of the benefits of takeover activity.<sup>205</sup> This reading of the Williams Act also may have been tacitly assumed in *CTS*, even though under Indiana’s statute shareholders as a body were empowered at the expense of individual autonomy, and even though Justice Powell did not overtly acknowledge the antitakeover bias of the statute. Finally, even the recent Delaware decisions upholding Delaware’s law, taking a cue from Justice Powell’s opinion in *CTS*, seem to assume that the Williams Act sets an outer limit on the power of states to reduce the level of takeover activity, a limit that, if exceeded, will render the statutes invalid. The Supreme Court, however, has yet to endorse the SEC’s claims.

Since the states sought to “corporatize” tender offers after *MITE*, the strategic response of bidders and the SEC has been to view tender offers as securities transactions properly subject to federal regulation of capital markets. In essence, to the states’ assertion that the tender offer “glass” is half-empty (and therefore a state corporate matter), the SEC responds that it is half-full (and therefore a federal securities matter). The opposing stances are matters of judgment and characterization, not empirical fact. Tender offers simultaneously involve private securities transactions and significant corporate effects. Other sorts of corporate events share this dual aspect. Typically, state corporation law and federal securities law will regulate different features concurrently. For example, state law determines whether, when, where, and how annual directors’ elections will be conducted, and whether voting may be by consent or proxy; federal law, recognizing the need for adequate information in proxy solicitations, imposes certain disclosure obligations on the solicitor. The two regimes generally co-exist peacefully because of the dual citizenship conferred on shareholders

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205. *Edgar v. MITE Corp.*, 457 U.S. 624, 643-44 (1982) (citing articles by Professors Easterbrook and Fischel).

by state corporation and federal securities law. Certain features of a transaction are deemed "corporate" in nature and therefore subject to state law, while "securities" aspects receive federal attention. But to ask whether the transaction itself is a "corporate" or a "securities" transaction is pointless because it is often both at once. The key question therefore concerns the terms of the balance that Congress sought to strike between state and federal tender offer regulation.

The starting point for the SEC's preemption argument is the proposition that the Williams Act was designed to assure shareholder autonomy in tender offers — *i.e.*, that shareholders rather than someone else (like management or a state agency) should decide a bid's success or failure. This is the position taken by the SEC in the *MITE* litigation and also in its more recent attacks on the "business combination" statutes.<sup>206</sup> Building from this premise, the SEC makes a further claim. It interprets the shareholder autonomy objective as signifying a congressional judgment in favor of unrestricted takeover activity.<sup>207</sup> The SEC's argument thus can be reduced to the following syllogism: Congress sought to protect shareholder autonomy (*i.e.*, decisionmaking) through the Williams Act; potent state laws interject target company management and limit the frequency of takeovers and thus deny to shareholders opportunities to receive and decide whether to accept tender offers; therefore, to make shareholder autonomy meaningful, the Williams Act preempts such laws.<sup>208</sup>

To prove its claims, the SEC must first overcome a seemingly insurmountable hurdle. How could it be that the Williams Act's narrow disclosure and shareholder protection provisions<sup>209</sup> actually state a general federal policy in favor of an unrestricted market for corporate

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206. See *supra* note 84.

207. "The history of the Williams Act shows, in short, that Congress believed that tender offers could serve a useful purpose in promoting corporate efficiency. . . . The Act . . . does not allow the states to rig the rules heavily in favor of one side or another in the contest, and to frustrate investor choice." Brief of the Securities & Exchange Commission, *Amicus Curiae*, at 22, *RTE Corp. v. Mark IV Indus.*, No. 88-C-378 (E.D. Wis. 1988). Besides its misinterpretation of apparent shareholder autonomy language in the legislative history, the SEC also claims that "Congress explicitly found that 'takeover bids should not be discouraged because they serve a useful purpose in providing a check on entrenched but inefficient management.'" *Id.* at 18-19 (citing SEN. REPORT, *supra* note 118, at 3). The full passage from which this quotation was taken reveals how seriously the SEC distorts the record. For the full quotation, see *supra* text accompanying note 127. See also HOUSE REPORT, *supra* note 127, at 2813 (identical language). In other words, far from making an "explicit finding" in favor of takeovers, Congress merely heard arguments on both sides of the question and then expressly declined to reach a conclusion one way or the other.

208. The argument comes close to a claim that, in passing the Williams Act, Congress has "occupied the field," precluding state legislative activity. The Supreme Court has, at least implicitly, rejected such an interpretation, however. See *Edgar v. MITE Corp.*, 457 U.S. 624, 631-32 (1982) ("... Congress did not explicitly prohibit states from regulating takeovers.").

209. See *supra* section II.A.



control? Further, what about the apparently unambiguous evidence that Congress deliberately chose to take no position on the merits of hostile takeovers?<sup>210</sup> The claim that texts (including, of course, statutes) have no inherent, self-revelatory, or fixed meaning is fast achieving general acceptance even among lawyers.<sup>211</sup> That is, the meaning of language is a matter of contingent social convention, and generally accepted definitions, while critical to communication, are nevertheless artificial and arbitrary (rather than essential and universal). A corollary to this observation is that the meaning of words can and does change over time. What now appears to us to be the "plain meaning" of a literary text or statute may not have been plain to those who created it. The question is a hermeneutical one: does one strive to divine the intentions of the text's writer, or is the reader free (or even obligated) to bring a contemporary understanding to the text?

Perhaps the SEC is claiming that legislators acting only twenty years ago used language in a manner that is no longer readily recognizable — that the statute and the texts comprising its legislative history meant something very different than their apparently plain meaning today. The SEC makes no sustained effort to establish such a position. Instead, in essence, the SEC seems to adopt the "reader-centered" approach to interpretation as its technique for construing the Williams Act. Thus, whatever may have been the statute's original meaning, to be useful in resolving today's problems the words must be understood in today's, not yesterday's, context. However, one does not read a legal text the way one reads a literary text, where one's response may be legitimate however distant from that intended by the author.<sup>212</sup> Because legal activity is different from literary activity, one is not free to pour whatever meaning one wishes into the words of a statute as if into so many empty vessels.<sup>213</sup>

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210. See *supra* text accompanying notes 126-30.

211. In addition to the proliferating law review literature, see the recent anthology *INTERPRETING LAW AND LITERATURE: A HERMENEUTIC READER* (S. Levinson & S. Mailloux eds. 1988). Stanley Fish's writings on the understandings shared by "interpretive communities" as the source of textual meaning have been particularly influential in the "law and literature" movement. See S. FISH, *IS THERE A TEXT IN THIS CLASS?* (1980).

212. See R. POSNER, *LAW AND LITERATURE* 209-68 (1988).

213. In other words, it is incorrect to conclude that, because meaning is ultimately arbitrary, "anything goes" when one offers an interpretation of an old text. In interpreting the Williams Act, the SEC and everyone else must limit their efforts to whatever the statutory text meant to those who created it. The goal is to reconstruct the set of meanings — meanings of specific words as well as broader normative considerations — that informed the legislators' own use of language. Otherwise, one is likely to end up with a reading that has little or no relation to their thinking about what they were doing. The difference between the two approaches is whether or not the reader takes seriously the legislators' intentions. Robert Bork's reading of the Sherman Act as embodying a neoclassical efficiency policy (based on an economic theory that had not yet been invented when Congress enacted the law) is a classic example of misinterpretation through

Not only does the SEC disregard what Congress seems to have meant when it adopted the Williams Act, the SEC's approach to statutory interpretation reveals a fundamental misunderstanding of the legislative process. Statutory interpretation is not just a matter of reconstructing the general linguistic and ideological conventions that gave meaning to the language used by the legislators. Once one seeks to apply a statute to a concrete problem (like the preemption question at issue here) that the statute does not directly address, it is also necessary to consider the purpose of the statute in relation to the circumstances under which it was enacted. All statutes are passed within a complex context of political, social, and economic beliefs and assumptions, as well as an existing legal regime, most of which is taken for granted most of the time. The legislators determine that a particular problem (or set of problems) requires redress. They seek to change some small part of the world in which they live, while continuing to take the rest of the context for granted and leaving it untouched. Words are the tools by which the objective is to be accomplished and of course we have to understand the meaning of the words to understand the statutes. We need also, however, to understand what the legislators sought to change and what they were content to leave alone. In other words, the statutory language, which must be read in light of the general ideas that give it meaning, must also be analyzed in the context of the particular problem that the legislators sought to address.<sup>214</sup>

Once we see this, important interpretive consequences follow. It seems fair to conclude that legislators are temporarily satisfied with (or at least indifferent toward) that part of the context left untouched by the statute in question. When deliberation is finished and action is taken to correct a particular problem through the legislative process, concern for how the statutory solution will affect other areas of social life plays a very limited role. Necessarily, little attention is paid to the relationship between the enacted statutory response and hypothetical developments that might present novel problems in the future. Certainly there is no warrant for concluding that, having attempted to make a small adjustment in the existing legal regime, the legislators also intended to preserve intact the background circumstances within which they acted; a particular legislative effort does not imply a desire

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disregard for context. See Bork, *Legislative Intent and the Policy of the Sherman Act*, 9 J. L. & ECON. 7 (1966). For a critique of Bork's analysis and an attempt at an accurate reading, see Millon, *The Sherman Act and the Balance of Power*, 61 S. CAL. L. REV. 1219 (1988).

214. For a discussion of the need to read statutes in relation to the problem the legislators sought to address, see LaRue, *Statutory Interpretation: Lord Coke Revisited*, 48 U. PITT. L. REV. 733 (1987).

to suspend the larger context for all time. Efforts to impute views to the legislators about how they would have reacted to events that have occurred since passage of the statute are purely hypothetical and thus fictitious. In other words, it is an error to conclude that a statute aimed at a particular problem also had the broader aim of preserving features of the legislators' world that they took for granted and did not intend to alter by their activity.<sup>215</sup>

Viewed in this light, it is apparent that the SEC's claims about the Williams Act's shareholder autonomy policy are based on nothing more than statements in the legislative history referring to target company shareholders' power to accept or reject tender offer bids.<sup>216</sup> As argued above,<sup>217</sup> these statements are mere acknowledgements that — in 1968 — shareholders typically enjoyed the power to decide the fate of tender offers. The SEC's reading of the statute, and thus its pre-emption argument, cannot be justified because Congress did not foresee or consider the possibility that state law might later empower target company management to protect shareholder (or non-shareholder) interests. Accordingly, the Williams Act does not preclude state legislation restricting shareholder autonomy.

Like its initial premise about the Williams Act's endorsement of shareholder autonomy, the SEC's claim that the statute represents a congressional judgment in favor of unrestricted takeover activity is also incorrect. While one can insist that shareholder autonomy implies a right to receive takeover bids, one can as readily respond that the autonomy norm applies only in situations in which state corporation law has made a prior determination to accord shareholders a role in responding to takeover bids. Consistent with the underlying philosophy of the federal securities laws, the Williams Act requires only that *if* shareholders possess the power to decide who wins whatever contests take place, they have the benefit of specified disclosure and procedural safeguards. The disclosure system aims to provide prospective investors (or prospective "disinvestors") with sufficient information to make informed investment decisions. Necessarily, this regulatory scheme is an overlay on state law. That is, state law largely determines the substantive rights of the parties to securities transactions. The types and frequency of securities transactions are ultimately mat-

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215. Another way to think about this is to distinguish between what the legislators did and did not do. We can infer that what they did in passing a particular law in some way reflects their intentions. However, what they did *not* do implies nothing about their intentions. What the legislators chose to do is law and policy; what they chose to ignore is not.

216. See Brief of the SEC, *supra* note 207, at 19.

217. See *supra* Part II.A.

ters for private decisionmaking within the legal structures established by state law. Again, reference to congressional intent offers no solution to this quandary because Congress passed the Williams Act at a time when there were no significant state law impediments to takeovers. Naturally, Congress had no occasion to debate the merits of such laws or appropriate federal policy toward them.

In the name of "investor protection," the SEC and other takeover proponents are now engaged in a campaign on behalf of hostile takeover activity and, more subtly and enduringly, on behalf of a decisive federal role in displacing state law on the most divisive corporation law and policy issue in recent memory. The SEC — together with many scholars sharing the goal of market-driven solutions to corporation law problems — relies on familiar arguments that tender offers are good, on balance, not only for target company and bidder shareholders, but also for general economic prosperity; consequently, it seeks to facilitate increased numbers of tender offers. This campaign represents a departure from the traditional, disclosure-only philosophy of federal securities regulation. There is no basis for this remarkable development in the Williams Act or its legislative history.<sup>218</sup> In 1968, it would have been unthinkable.

The challenge now is to apply this old statute to new conditions and problems that Congress never anticipated. Unfortunately, what has passed for arguments about legislative intent have been nothing more than efforts to convert evidence about *assumptions* about the present into claims about *intentions* for the future. Such efforts are historically wrong and analytically unsound, yet arguments about the Williams Act's preemptive force ultimately reduce to claims such as these: (1) that because in 1968 shareholders, not management, typically decided whether takeover bids should succeed, Congress intended that should always be the case; or (2) because in 1968 nonshareholder interests could not be used to deny target shareholders the opportunity to receive tender offers, Congress intended they could never be so used. This form of argument reveals a basic misunderstanding of the legislative process.

There may or may not be wisdom in the policy preferences that

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218. While arguing against preemption, advocates of a shareholder protection reading of the Williams Act seem to make the same error as the SEC. They begin from the premise that Congress' shareholder welfare goal amounts to a protakeover policy, differing only on whether management may intervene for the good of shareholders. While such intervention may, on limited occasions, be genuinely beneficial for shareholders, their argument never rings quite true. There is a reluctance among these advocates to "come clean" and confess that the antitakeover statutes are not enacted with shareholders in mind. Instead they vainly strive to harmonize two quite different legal regimes: a federal regime with a limited purpose and a single constituency and a state regime with more complex goals and multiple constituencies.

underlie such claims. Our point is that those preferences have never been endorsed by Congress. As the nature of hostile takeovers has changed, so has thinking about the appropriate relationship between target company management and shareholders, and about the costs and benefits of takeover activity. These political questions should be debated candidly and on their merits, not according to whether they conform to some mythical legislative intent.

The need to understand clearly what Congress did and did not do in the Williams Act is made painfully evident by a recent federal district court decision upholding the Wisconsin Business Combination Act against a preemption challenge.<sup>219</sup> The court began its preemption analysis with a brief description of the Williams Act's legislative history as recounted by the Supreme Court in *Piper v. Chris-Craft Industries*.<sup>220</sup> Concluding that the sole purpose of the Williams Act was to ensure adequate disclosure to target company shareholders in a way that would not provide an informational advantage to either bidders or management, the Wisconsin court stated that other dimensions of the balance of power between bidders and target management can be regulated by state laws such as the Wisconsin antitakeover statute.

Had the court stopped there, its preemption analysis, while quite brief, would have been clear and correct. As we have argued, the Williams Act is properly understood as a limited overlay on the structure of rights and duties established by state law. The court went on, however, to muddy the issue by trying to square the Wisconsin Act with what it perceived to be the preemption analysis of the *MITE* plurality and the *CTS* majority. Thus, it stated that the "fundamental question implicated by the Williams Act analysis in *CTS* and *MITE* is whether the Wisconsin Act impairs shareholder autonomy, providing management with an an [undue] advantage that could hinder the shareholder's exercise of an informed choice concerning the tender offer."<sup>221</sup> Here, the court asserted that preservation of shareholder self-determination in resolving takeover contests is an important ele-

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219. *Amanda Acquisition Corp. v. Universal Foods Corp.*, 708 F. Supp. 984 (E.D. Wis.), *aff'd*, 21 Sec. Reg. & L. Rep. (BNA) 856 (7th Cir. 1989). This Article was completed before the court of appeals' opinion became available. Recently, in an oral opinion, Judge John Sprizzo, a federal district judge for the Southern District of New York, ruled that the New York business combination statute is not preempted by the Williams Act. Judge Sprizzo concluded that he saw "nothing in the statute or its legislative history to indicate that Congress had any concern with the decision-making process of the tender offeror to make or not to make a tender offer, even though the incidental effect of the statute . . . may be to prevent a tender offer from being available to the shareholder in the first place." *Vernitron Corp. v. Kollmorgen Corp.*, No. 89 Civ. 241 (JES), 21 Sec. Reg. & L. Rep. (BNA) 315 (1989).

220. 708 F. Supp. at 998.

221. 708 F. Supp. at 999.

ment of any statute passing preemption muster. In assessing the Wisconsin Act against this standard, the court noted the statute's purpose is to deter takeovers but nevertheless states that "[t]he Act cannot reasonably be said to impair shareholder decision-making in the tender offer process. The Act neither affects disclosure or timing, nor forbids tender offers themselves."<sup>222</sup>

Not only does the court err in introducing a shareholder autonomy requirement into its preemption analysis (and in finding that the Wisconsin Act satisfies that requirement), it also fails to see the inconsistency between such a reading and its previous statement of the Williams Act's limited disclosure objective. What follows from these errors is a confusing amalgam of the various arguments for and against business combination statutes, all of which seems to boil down to a substantive determination about the Wisconsin statute's impact on shareholder well-being. Thus, recognizing that bidders might in fact fail to receive the board approval needed for a business combination under the Wisconsin Act, the Court responds that "[s]hareholders who feel the board is responding inappropriately to bidders maintain their power to effect changes in corporate control, thereby enhancing receptivity to offers."<sup>223</sup> Continuing in this vein, the Court, while criticizing the *BNS* court's "meaningful opportunity for success" standard as unworkable, states that "meaningful opportunity for success under the Wisconsin Act can be controlled by a shareholder vote in the light of board response to potential suitors."<sup>224</sup> The reference here is to the shareholders' power to elect a new board if frustrated by the incumbent directors' rejection of a favorable bid. Reducing the question of shareholder autonomy to this issue then leads the Court to note that "foreclosing a proxy contest opportunity could frustrate or even preclude shareholder autonomy and the exercise of informed choice."<sup>225</sup> The Court then proceeds to a mysterious analysis of the effect of the Wisconsin Act on proxy contests, stating that question to be "a close one," but finding on balance that the statute does not preclude proxy contests.<sup>226</sup> If prevention of proxy contests is the standard, it is hard to imagine that any state antitakeover law could fail to pass constitutional muster. Thus, despite its potentially fierce rhetoric (implying a federal ban on state impairment of shareholder autonomy), the court reduces the shareholder autonomy idea to a meek inquiry into whether

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222. 708 F. Supp. at 1000.

223. 708 F. Supp. at 1001.

224. 708 F. Supp. at 1001.

225. 708 F. Supp. at 1002.

226. 708 F. Supp. at 1002-03.

the statute eliminates the shareholders' already puny powers to elect a new board.

Having set off down the shareholder-autonomy trail in its preemption analysis, the court adds to the confusion by periodically shifting into the shareholder-protection mode of analysis. It thus buttresses its holding against preemption by adding that the Wisconsin Act *protects* shareholders against coercive two-tier bids.<sup>227</sup> Thus, the propriety of empowering the board of directors to protect shareholders against the coercion of certain kinds of tender offers is also made relevant to the preemption analysis, but without any explicit consideration of the potential inconsistency between the shareholder protection and shareholder autonomy standards.

The district court's opinion in *Amanda* is thus a compendium of most of the arguments that have been mustered pro and con on the Williams Act preemption question. Under these approaches, the question ends up being whether, on balance, shareholders come out better or worse off under the Wisconsin Act. While initially the court saw such a substantive inquiry as foreign to and no concern of the Williams Act because of Congress' deference to states' authority to regulate the balance of power among bidders, target company management, and shareholders, the beguiling rhetoric of the current preemption debate — both pro and con — proved irresistible to the court, which proceeded to address the issue in those misleading terms. The result is a preemption analysis bogged down in the workings and possible effects of the Wisconsin Act, made by a court that, at the same time, seems to sense both the irrelevance and the futility of its own protracted inquiry. What convincing resolution of the preemption issue requires now more than anything else is a court with the courage to refrain from the unnecessary and tiresome rehearsal of arguments that wrongly dominate contemporary formulations of the preemption question.

### CONCLUSION

The preemption controversy deals with an issue that recurs with some frequency: whether state or federal law will govern a particular subject—here, hostile takeovers. In the abstract, of course, the question has no necessary importance. What counts is the substance of law, not its source. In the reality of takeovers, however, it is crucially important whether the SEC and other proponents of Williams Act preemption succeed. Many preemption advocates have a particular

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227. 708 F. Supp. at 1000.

substantive agenda in mind. They are engaged in a crusade to create a robust market for corporate control unhindered by restrictive state laws, a market that is the centerpiece of a larger vision of corporate endeavor as the engine of economic efficiency, and corporation law the mechanism for achieving that goal. Accordingly, they — and, perhaps unwittingly, the SEC on their behalf — read the Williams Act as requiring exclusive devotion to shareholder welfare, regardless of competing nonshareholder claims on corporate activity. Furthermore, in the takeover area at least, they conceive of shareholder welfare as a function of unfettered opportunity to receive and act on tender offers. Thus, we witness an effort to craft a federal law of corporate takeovers out of the Williams Act's relatively modest provisions. But the ultimate aim of many is not to establish effective federal regulation of takeovers. Rather, the minimal requirements of existing federal law become the ideal vehicle, by virtue of the supremacy clause, for ridding market phenomena such as takeovers of state interference, thus fully realizing their market-centered conception of corporate activity and law. Once that purpose is served, the minimal demands of federal law will not be expanded; far from it, they can instead be quietly abandoned, the states being denied the power to step into the breach.

The jury is still out on such important questions as the net welfare and efficiency effects of takeovers and the extent to which they impose costs on nonshareholders. Furthermore, there is no consensus on the political question of whether states act appropriately when they seek to protect local nonshareholder interests by denying typically nonresident shareholders the financial benefits of takeover activity. Indeed, that debate is barely underway, as judges, legislators, and commentators begin to acknowledge that shareholders are not the intended beneficiaries of antitakeover laws. The full implications of that discussion for the deeper issue of corporate purpose and governance in our society will unfold in the years to come.

These are the fundamental empirical and theoretical questions that policy debates in this area necessarily presuppose. Lacking anything approaching certainty on these matters, it seems unduly hasty and imprudent to foreclose further inquiry. Yet, perhaps sensing a turning of the intellectual tide against them, that is the object that many proponents of Williams Act-preemption seek to achieve. Not only does such a result seem ill-considered in light of current disagreements about facts and policy; it can only be based on a profoundly mistaken reading of the Williams Act.