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KNEELING TO THE SEC RULES: THE VIRGINIA TAKEOVER ACT AND SEC TENDER OFFER RULE 14d-2(b)

In December of 1979, the Securities and Exchange Commission (SEC) announced the adoption of rules, 1 effective January 7, 1980, as an administrative gloss on the Williams Act, 2 the statute governing tender offers. 3 When Congress passed the Williams Act in 1968 only one State, Virginia, 4 had a statutory system that specifically regulated tender offers. Since 1968 thirty-six states also have enacted laws regulating tender offers to fill the gaps left by the federal legislation. 5 The state “takeover” statutes vary considera-

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3. The Senate report on the Williams Act contains the following definition of a tender offer:
   
   This offer normally consists of a bid by an individual or a group to buy shares of a company—usually at a price above the market price. Those accepting the offer are said to tender their stock for purchase. The person making the offer obligates himself to purchase all or a specified portion of the tendered shares if certain specified conditions are met.
   
bly, but most require advance notice of tender offers. The advance notice typically consists of a public filing of the material terms of the offer twenty-one days before the offer may commence.

One of the rules adopted by the SEC in 1979, 14d-2, requires that an offeror make a tender offer within five business days of an announcement specifying the amount and price of the securities sought. The SEC regards the filing of advance notice required by state takeover statutes as an announcement within five days of which an offer must commence. Consequently, by complying with the SEC requirement that an offer commence within five days of the state takeover statute filings, an offeror must violate the state statutory command that an offer not commence until twenty-one days after the announcement. If the offeror complies with the state statute by waiting twenty-one days after the filing to make an offer, the SEC regards the delay as an SEC filing and disclosure violation.

Commenting on the conflict between the SEC rules and state takeover statutes, SEC Commissioner Pollack has stated, “To the extent that our rules are inconsistent with provisions in some state laws, the provisions of our rule would, of course, be applicable rather than the state provisions. To put it another way, the state provision will have to kneel to the rule that we ultimately adopt.” Notwithstanding the Commissioner’s position, several states have refused to “kneel to the [SEC] rule[s].” Although the United States District Court for the Eastern District of Virginia held indirectly that the Williams Act preempted the Virginia Take-Over-Bid Disclosure Act, the United States Court of Ap-
peals for the Fourth Circuit reversed the holding. Similarly, a Kentucky court recently held that the Kentucky takeover statute withstands constitutional attack. In addition, the Commissioner of Securities for Ohio filed suit against the SEC seeking a judgment declaring the Ohio Tender Offer Act constitutional and SEC rule 14d-2 invalid.

This Note will discuss the Williams Act, the Virginia Take-Over-Bid Disclosure Act (Virginia Takeover Act), the new SEC rules regulating tender offers, and the possible preemption of the Virginia Takeover Act by the SEC rules.

on the merits of a declaratory judgment action brought to declare the Virginia act preempted by the Williams Act. Noting probable success on the merits, and stating that the Virginia Act conflicted impermissibly with federal law, the district court granted the injunction. Id.

12. Telvest, Inc. v. Bradshaw, 618 F.2d 1029 (4th Cir. 1980). The Fourth Circuit vacated the order of the district court granting the injunction after discussing the preemption issue and disagreeing with the district court on the probable success of the declaratory judgment action. Id.


14. Ohio v. SEC, [1980] FED. SEC. L. REP. (CCH) ¶ 97,688 (S.D. Ohio Oct. 15, 1980). The court dismissed the suit for lack of standing. Ohio asserted a parens patriae interest in the case, but the court said no important state interest was threatened because the state was free to implement its act until a plaintiff challenged the act legally. Id. at 98,617.

15. This Note focuses exclusively on the question of preemption. State takeover statutes also have been attacked as an unconstitutional burden on interstate commerce. For a discussion of the commerce clause issue, see Boohm, State Interests and Interstate Commerce: A Look at the Theoretical Underpinnings of Takeover Legislation, 36 WASH. & LEE L. REV. 733, 752-53 (1979); Langevoort, State Tender-Offer Legislation: Interests, Effects, and Political Competency, 62 CORNELL L. REV. 218, 242-46 (1977); Note, Commerce Clause Limitations upon State Regulation of Tender Offers, 47 S. CAL. L. REV. 1133 (1974).
Prior to the passage of the Williams Act, regulation of the two major mechanisms for attaining control of a corporation, the proxy contest and the tender offer, sharply contrasted. The proxy contest was the subject of comprehensive federal regulation, whereas few meaningful controls attached to the tender offer process. The absence of tender offer regulation, and other factors, resulted in a burgeoning of tender offers lodged for corporate control in the early 1960's. The rapid increase in tender offers brought to light and magnified abuses latent in the unregulated process. The abuses resulted from acts both by the offerors or "raiders" and by the management of the subject company or "target." Raiders could capture control of the target in a matter of days, catching shareholders and management uninformed and under pressure to act without the opportunity to argue in opposition or to entertain competing offers. Management or others who opposed a tender offer exerted pressure on shareholders of the target corporation to refuse offers on the basis of unsubstantiated arguments. Shareholders bore the brunt of these abuses: if they succumbed to the first raider's offer they missed the opportunity to enjoy greater profit by selling to a competing raider or "white knight"; if they bowed to pressure from management and refused to sell they received no profit at all.

17. See id. § 78n.
19. See E. Aranow & H. Einhorn, Tender Offers for Corporate Control (1973). The authors discuss eight factors contributing to the increase in tender offers in addition to the lack of federal or state regulation. Included among the factors are: inexpensiveness of the tender offer process as compared with the proxy contest; increased corporate liquidity and availability of credit; undervaluation of stocks; and increased respectability of the tender offer method of achieving control of a corporation. Id. at 65-66. See also Boehm, supra note 15, at 734-36.
20. See generally note 157 & accompanying text infra.
21. Senator Kuchel, co-sponsor of the Williams Act, assessed the plight of management and shareholder as follows: "[t]he corporation can be financially raped without management or shareholders having any knowledge of the acquisitions. . . . The corporate raider may thus act under the cloak of secrecy while obtaining the shares needed to put him on the road to a successful capture of the corporation." Proposed Amendments to the Securities
Because of the exploitation of investors by target management and raiders, Congress passed the Williams Act to protect "the shareholders of the target corporation."\(^{22}\) The congressional attitude toward the target management and the raiders is less clear. When Senator Williams first introduced tender offer legislation in 1965, one of the objectives was protection of target management against "industrial sabotage" from "reckless corporate raids."\(^{23}\) By 1967, however, the presumption against tender offers had eroded because of growing awareness that in some instances tender offers promoted "the best interests of society by providing an effective method of removing entrenched but inefficient management."\(^{24}\) In adopting the Williams Act, therefore, Congress opted for regulatory neutrality,\(^{25}\) favoring neither tender offerors nor target management. The Senate Report of the Williams Act stated:

> The Committee has taken extreme care to avoid tipping the balance of regulation either in favor of management or in favor of the person making the takeover bid. The Bill is designed to require full and fair disclosure for the benefit of investors while at the same time providing the offeror and management equal opportunity to fairly present their case.\(^{26}\)

That Congress avoided "tipping the balance" in favor of management or raiders does not mean that Congress intended to preclude state regulation that altered a business climate in which corporations lacked defense to takeovers. Although some courts and commentators disagree with the proposition,\(^{27}\) one view is that, by not

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\(^{23}\) E. ARANOW & H. EINHORN, supra note 19, at 64.

\(^{24}\) Id. at 66.


\(^{27}\) See, e.g., Great W. United Corp. v. Kidwell, 577 F.2d 1256, 1274-80 (5th Cir. 1978) (fiduciary approach of Idaho statute conflicts with neutral, market approach of the Williams
tipping the balance, Congress demurred from enacting a federal scheme that favored either raiders or target management, concentrating instead on protection of the target corporation shareholder.28

Congress effected its intent to protect investors by requiring disclosure of material information by tender offerors to target corporation shareholders. The Williams Act added section 13(d) to the Securities Exchange Act of 1934.29 Section 13(d) requires a person or corporation that acquires five percent or more of any class of equity securities of a registered corporation30 to file a schedule 13D with the SEC within ten days of the acquisition.31 Through schedule 13D the offeror discloses the amount and source of the funds used for the purchase, the offeror's background and identity, the extent of the offeror's holdings in the target corporation, and the offeror's purpose in making the purchases.32 If the offeror's purpose is to acquire control of the target corporation, the offeror must disclose whether it plans to liquidate the corporation, sell the corporation's assets, merge the corporation with another company, or effect any major change in the target corporation's business.33

The offeror also must provide the same information to the target

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28. The better view is the latter. In rejecting the argument that the Williams Act implied a private cause of action for tender offerors, the Supreme Court also rejected the argument that neutrality was a purpose of the legislation. See note 122 & accompanying text infra.


32. Id.

33. Id.
corporation. The SEC must receive a schedule 13D filing regardless of how a person acquires five percent of the target's stock; consequently, purchasers of five percent of a corporation's stock on the open market must file the schedule 13D.\textsuperscript{34}

If a tender offer is the means of stock acquisition, the offeror must file a schedule 14D-1 with the SEC in addition to the schedule 13D.\textsuperscript{35} Schedule 14D-1\textsuperscript{36} must disclose, in addition to the same information as schedule 13D, the offeror's past transactions with the target corporation;\textsuperscript{37} the applicability of anti-trust laws;\textsuperscript{38} margin requirements of section 7 of the Securities Exchange Act of 1934\textsuperscript{39} and approvals or regulatory requirements with which the offeror must comply in connection with the tender offer;\textsuperscript{40} any material legal proceedings relating to the tender offer;\textsuperscript{41} and any material financial information about the offeror.\textsuperscript{42} The offeror must publish or send schedule 14D-1 information to the shareholders of the target corporation.\textsuperscript{43}

The Williams Act also provides protection of the target corporation's shareholders by dictating certain procedures that tender offerors must follow. A tendering shareholder may withdraw his shares within fifteen days after receiving the offer or sixty days after the commencement of the offer if the offeror has not purchased the tendered shares.\textsuperscript{44} If the offeror has offered to purchase less than all of the outstanding shares and the shareholders tender more shares than the offeror has offered to purchase within ten days after the offer has commenced, the offeror must purchase the

\begin{itemize}
\item \textsuperscript{34} Id. § 78n(d)(1) (1976).
\item \textsuperscript{35} Id. § 78n(d) (1976).
\item \textsuperscript{36} 17 C.F.R. § 240.14d-100 (1980).
\item \textsuperscript{37} Id. § 240.14d-100(7) (1980).
\item \textsuperscript{38} Id. § 240.14d-100(10)(c) (1980).
\item \textsuperscript{39} Id. § 240.14d-100(10)(d) (1980).
\item \textsuperscript{40} Id. § 240.14d-100(10)(b) (1980). Presumably, the approvals and regulatory requirements referred to in this section include state requirements.
\item \textsuperscript{41} Id. § 240.14d-100(10) (1980).
\item \textsuperscript{42} Id. § 240.14d-100(10)(e) (1980).
\item \textsuperscript{43} 15 U.S.C. § 78n(e) (1976); 17 C.F.R. § 240.14d-100(10)(f) (1980).
\item \textsuperscript{44} 17 C.F.R. § 240.14d-7(a) (1980). But see 15 U.S.C. § 78n(d)(5) (1976) (providing for seven day withdrawal rights). \textit{See also} Boehm, \textit{supra} note 15, at 751-52 (questioning constitutionality of fifteen day withdrawal period in SEC rules because the Williams Act provides for only a seven day period).
shares pro rata.\textsuperscript{45} If the offeror raises the premium over market price, and if he will pay for the shares before expiration of the offer, the offeror must pay the higher price to all tendering shareholders.\textsuperscript{46} The offer must stay open for at least twenty days.\textsuperscript{47} Section 14e of the Williams Act also prohibits the use of any false or misleading statements during the tender offer period.\textsuperscript{48}

Section 14d of the Williams Act applies only to tender offerors who seek to acquire five percent or more of the beneficial ownership of the target company.\textsuperscript{49} In addition, tender offerors are exempt from the requirements of section 14d if: the acquisition of the target corporation's shares together with all other acquisitions by the same person of the same class of securities during the preceding twelve months would not exceed two percent of that class;\textsuperscript{50} the SEC by regulation determines that the tender offeror did not have the intent to change the control of the issuer, and the tender offer did not actually change the control;\textsuperscript{51} or the tender offeror is the issuer of the shares.\textsuperscript{52} In the last instance, however, the issuer is subject to the prohibition in section 14e against misleading and false statements.\textsuperscript{53}

\textbf{THE VIRGINIA TAKEOVER ACT}

When Congress enacted the Williams Act, only one state, Virginia, had legislation regulating tender offers.\textsuperscript{54} The Virginia Takeover Act largely parallels the disclosure and procedural requirements of the Williams Act.\textsuperscript{55} The operation of the Virginia statute commences at the time of a takeover bid. The statute defines a bid

\begin{itemize}
\item \textsuperscript{45} 15 U.S.C. § 78n(d)(6) (1976). The percentage of each shareholder's shares tendered that is taken up by the offeror pro rata is the total number of shares purchased divided by the total number of shares tendered.
\item \textsuperscript{46} Id. § 78n(d)(7) (1976).
\item \textsuperscript{47} 17 C.F.R. § 240.14e-1(a) (1980).
\item \textsuperscript{48} 15 U.S.C. § 78n(e) (1976).
\item \textsuperscript{49} Id. § 78m(d) (1976).
\item \textsuperscript{50} Id. § 78m(d)(6)(B) (1976).
\item \textsuperscript{51} Id. § 78m(d)(6)(D) (1976).
\item \textsuperscript{52} Id. § 78m(d)(6)(C) (1976).
\item \textsuperscript{53} Id. § 78n(e) (1976).
\item \textsuperscript{55} See generally 12 U. RICH. L. REV. 749 (1978) (comparing the two statutes).
\end{itemize}
as any offer, not otherwise exempt, for ten percent or more of any class of equity securities of an issuer. Exemptions obtain for isolated offers to individual investors, an offer by an issuer to purchase its own shares, offers to purchase shares not registered pursuant to section 12 of the Securities Exchange Act of 1934, brokers' transactions in the ordinary course of business, and offers approved by the directors of the target corporation and accepted by two-thirds of the stockholders of the target after solicitation of proxies. An offeror may not make a tender offer until he has filed a disclosure statement with the State Corporation Commission. The statement must contain: the name, address, and business experience of the offeror; the terms of the tender offer, including the procedural obligations of the offeror; the source and amount of funds used in making the takeover bid; any plans the offeror may have to liquidate the target corporation, sell its assets, merge it with another corporation, or change its business; the number of shares the offeror already owns; and any past transactions between the offeror and the target company. The disclosure statement so parallels the disclosure required by the Williams Act that a federal schedule 14D-1 suffices as a Virginia disclosure statement.

Like the Williams Act, the Virginia Takeover Act contains procedures permitting the security holder to withdraw his securities after the commencement of the tender offer, requiring the tender offeror to purchase securities of security holders pro rata if more are tendered than he offered to purchase, and requiring the offeror to pay all tendering security holders during the offer period the higher premium if the offeror raises the premium during the offer period. The Virginia statute also prohibits the use of any false or misleading statements during the tender offer period.

The Virginia Takeover Act and the Williams Act diverge in two
ways. Unlike the Williams Act, which requires no notification of the tender offer prior to its commencement, the Virginia Takeover Act prohibits making the takeover bid until twenty days after the offeror has filed the disclosure statement with the State Corporation Commission and sent the information required in the disclosure statement to the offerees. 66 Additionally, the Virginia statute provides for a hearing before the State Corporation Commission where good cause exists, 67 ordered either sua sponte by the Commission or at the request of the target company. 68 The Commission determines whether the offeror "propose[s] to make fair, full and effective disclosure to offerees of all information material to a decision to accept or reject the offer." 69 The hearing must begin within forty days of the filing, and the Commission must decide within twenty-five days of the conclusion of the hearing and filing of the post-hearing briefs. 70

The second point of divergence between the Virginia statute and the Williams Act, regulation of certain open market purchases, resulted from a 1979 amendment to the Virginia statute, 71 although the General Assembly modified the amendment in 1980. 72 The 1979 amendment qualified the exemption from the Virginia Takeover Act for offers effected through a broker-dealer on a stock exchange or in the over-the-counter market. The exemption only obtained if the purchaser showed the State Corporation Commission that he did not intend by his purchase to gain control of the issuer; if the purchaser failed to meet the burden, he could not purchase more than one percent of each of the issuer's offered classes of securities each six months. 73 By contrast, the Williams Act regulates

67. Id. § 13.1-531(b)(ii).
68. Id. § 13.1-531(b)(i).
69. Id. § 13.1-531(b)(iii).
70. Id. § 13.1-534(b). Prior to amendment in 1978, the period within which the Commission had to hold a hearing was sixty days; additionally, the statute specified no time limit within which the Commission had to decide. Act of March 23, 1977, ch. 356, 1977 Va. Acts 503 (current version at VA. CODE ANN. § 13.1-534(b) (Cum. Supp. 1980)).
73. The 1979 amendment is italicized below:

An offer to purchase shares to be effected by a registered broker-dealer on a
open market purchases only to the extent that a purchaser must file a schedule 13D if the purchaser acquires five percent of an issuer's stock, regardless of the manner of acquisition. The arguable conflict between the relatively regulation-free approach to open market purchases in the Williams Act and the 1979 amendment's application of the Virginia statute to such purchases gave occasion for judicial assessment of the constitutionality of the Virginia statute in Telvest, Inc. v. Bradshaw, discussed later in this Note in the section on preemption.

The 1980 session of the Virginia General Assembly largely restored the exemption for open market purchases. The Virginia Takeover Act now applies only to open market purchasers who offer to purchase with the intent of changing the control of the issuer. Open market purchasers are exempt from the statute if: 1) the State Corporation Commission determines that the purchaser does not have the intent to change control; or 2) notwithstanding the intent to change control, the purchaser files with the Commission and the issuer a statement disclosing the purpose of the change of control and the method of carrying out the change of control. As a consequence, the 1980 revision operates to exempt

stock exchange or in the over-the-counter market if the broker performs only the customary broker's function, and receives no more than the customary broker's commissions, and neither the principal nor the broker solicits or arranges for the solicitation of orders to sell shares of the offeree company, provided, however, that no more than one percentum of the outstanding shares of such class have been acquired by the offeror pursuant to this clause during the preceding six months.

75. 618 F.2d 1029 (4th Cir. 1980).
76. See text accompanying notes 134-141 infra.

provided, however, that this exemption shall not apply to any such offer made by a person who intends to change the control of the offeree company unless such person shall have filed with the Commission and with the registered agent of the offeree company a statement setting forth the purpose of such change, the method of carrying out such intention and such other information as the Commission may require as necessary in the public interest or for the protection of investors; and any person who, at the time he makes such offer, owns in excess of ten percentum of any class of the equity securities of the offeree company and has purchased more than one percentum of such class during the twelve month period preceding such offer shall be presumed to have such in-
open market purchases from the Virginia statute unless the State Corporation Commission determines that the intent of the purchaser is to change control of the issuer and the purchaser refuses to make the limited disclosure of purpose and method of change of control.\textsuperscript{78}

The Virginia statutory system regulating takeover bids is distinctive in two respects. The Virginia Takeover Act applies only to Virginia corporations doing business in the state.\textsuperscript{79} The protections of the statute do not attach to target companies that merely incorporate in Virginia without having substantial assets or activities in the state.\textsuperscript{80} Another unusual feature of the Virginia statute is that the State Corporation Commission, as part of its mandate to enforce the Virginia Takeover Act, has judicial as well as administrative powers.\textsuperscript{81} Thus, the Commission has authority to issue injunctions and orders, punish\textsuperscript{82} violations of its orders and injunctions with contempt proceedings, and punish all violations of the Act by fines of up to $5000\textsuperscript{83} or prison terms of up to one year.\textsuperscript{84}

**The SEC Rules**

The new SEC rules\textsuperscript{85} state that an offeror commences a tender offer by a public announcement, through a press release, newspaper...
per advertisement, or public statement, that identifies the offeror, the target company, the offering price, and the number of shares sought. The date that the tender offer commences is significant because the commencement date triggers operation of the SEC rules. Obligations imposed by the rules on the tender offeror or "bidder" comprise four categories. The first group of obligations is the filing requirements. The bidder must file a schedule 14D-1 with the SEC and hand deliver the initial filing and any amendments to the target company or "subject company" as soon as practical after the commencement date. Second come the dissemination provisions. The three alternative methods of disseminating a cash offer to security holders are long-form publication, summary publication, and the use of shareholder lists by either the bidder or the subject company, at the latter's election.

The third category of obligations imposed by the SEC rules is the disclosure requirements. Although the disclosure requirements vary depending upon the dissemination method selected, generally the offeror must disclose: the identity of the bidder and subject company; the amount and class of securities sought and the amount and type of consideration given for the securities; the scheduled expiration date of the tender offer; whether the offeror may extend that date and, if so, the procedures for extension; the dates when security holders who deposited securities can withdraw them; the period within which the offeror will take up pro rata securities deposited; if dissemination is by summary publication, whether the purpose of the tender offer is to acquire or change the business of the subject company; and, summary financial information about the bidder.

The last category of obligations imposed on the tender offeror is substantive. A tender offer must remain open for at least twenty business days from the date of its commencement and for ten business days from the date of any increase in the consideration offered. If the offeror has not purchased the shares, a tendering

86. Id. § 240.14d-2(b) to (c).
87. Id. § 240.14d-2(a).
88. Id. § 240.14d-3.
89. Id. § 240.14d-4 to -5.
90. Id. § 240.14d-6.
91. Id. § 240.14e-1(a).
shareholder may withdraw his shares within the first fifteen business days of the offer period or after sixty calendar days from commencement.92 The withdrawal period extends ten days after the commencement of any competing offer.93 The bidder must pay for, or return, the deposited securities promptly after the termination or withdrawal of the tender offer.94

The subject company becomes subject to three rules. First, if the bidder chooses dissemination by shareholder list, the subject company must either give the list to the bidder or use the list to distribute the bidder’s offering material at the subject company’s election.95 Second, the subject company must disclose its position regarding the tender offer, with the reasons for its position, within ten business days of the date of first publication of the offer or its transmittal to the security holders. The statement by the subject company must either recommend acceptance or rejection of the offer, express no opinion and remain neutral, or state that the subject company cannot take a position regarding the tender offer.96 Third, the subject company must file a schedule 14D-957 disclosing: any material contract or understanding and any conflict of interest between the bidder and the subject company or their respective officers, directors, or affiliates; whether any of the subject company’s officers, directors, or affiliates intend to sell or tender their shares in the subject company; and whether negotiations have occurred in response to the tender offer dealing with mergers or reorganizations, the sale or transfer of a substantial amount of the subject company’s assets, any material change in the subject company’s capitalization or dividend policy, or a tender offer or other acquisition of the subject company’s securities.98 Commencement of the tender offer, the date of the public announcement, triggers operation of the rules.99 The date of the public announce-

92. Id. § 240.14d-7(a)(1). Cf. text accompanying note 44 supra (same 15 day withdrawal period under the Williams Act).
93. Id. § 240.14d-7(a)(2).
94. Id. § 240.14e-1(c).
95. Id. § 240.14d-5.
96. Id. § 240.14d-9.
97. Id. § 240.14d-101.
98. Id.
99. See note 86 & accompanying text supra.
ement will not remain the date of commencement of the tender offer, however, if within five business days of the public announcement the offeror either withdraws its offer or files a schedule 14D-1 with the SEC and complies with the other dissemination, disclosure, and substantive provisions contained in the aforementioned rules. The SEC, effectively, requires that the offeror elect either the withdrawal or compliance "option," because "[i]f the bidder exercises neither option, the tender offer commences on the date of the initial announcement, resulting, however, in filing and disclosure violations. As a result, it is not anticipated that a bidder making such a public announcement will select the 'do nothing' alternative."

The consequence of the SEC rules is the creation of a five day time limit after a public announcement within which a tender offeror must either withdraw its offer or comply with the SEC rules. By incorporating the five day time limit in the regulatory regime, the SEC imposes on tender offerors a mechanism by which compliance with both the SEC rules and the state takeover statute provisions for pre-offer notice and hearings is impossible. To ensure the point is lost on no one, the SEC says as much in its report on the tender offer rules:

These requirements of the state statutes will trigger the commencement of the tender offer under Rule 14d-2(b) despite the fact that the state statutes do not permit the offer to commence until the conclusion of any applicable waiting period and hearing process. Moreover, by deeming commencement to occur on the date of the publication or filing required by these statutes, the minimum periods, best price, and withdrawal and pro rata rights provided under these statutes could not function since they are usually predicated on the effective date of the tender offer which cannot occur until after the conclusion of the waiting period and hearing process.

Thus, the conflict between Rule 14d-2(b) and such state statutes is so direct and substantial as to make it impossible to comply with both sets of requirements as they presently exist. While recognizing its long and beneficial partnership with the states in the regulation of securities transactions, the Commission never-

100. 17 C.F.R. § 240.14d-2(b) (1980).
theless believes that the state takeover statutes presently in effect frustrate the operation and purpose of the Williams Act and that, based upon the abuses in current tender offer practice discussed above, Rule 14d-2(b) is necessary for the protection of investors and to achieve the purposes of the Williams Act.

Although the SEC does not assert directly that its rules have preempted the state takeover statutes, SEC commentary on the rules and SEC arguments before the Supreme Court manifest a disposition that the rules preempt state takeover statutes. The phrase "abuses in current tender offer practice," cited by the SEC, refers to "pre-commencement public announcements [that] cause security holders to make investment decisions with respect to a tender offer on the basis of incomplete information and trigger market activity normally attendant to a tender offer, such as arbitrageur activity." The SEC posited two rationales to support the five day time limit: (1) the limit curtails precommencement announcements that lead security holders to make investment decisions on the basis of inadequate information; (2) the limit restricts activity in advance of the actual offer that disadvantages the target shareholder. This Note will analyze these rationales in its discussion of policy.

**Preemption**

*The "Force and Effect of Law" Doctrine*

The SEC adopted Rule 14d-2(b), which establishes the five day period following a public announcement within which tender offers must commence, pursuant to a broad grant of authority by Congress to the SEC "to make such rules and regulations as may be necessary or appropriate" to implement the provisions of the Securities Exchange Act of 1934. Courts have interpreted this grant as a delegation to the SEC of the "primary responsibility for pro-

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102. Id. at 70,329-30 (footnotes omitted).
105. See text accompanying notes 142-153 infra.
tection of investors in securities.” 107 Properly promulgated,108 substantive109 SEC rules have the “force and effect of law” and, consequently, are binding on courts110 if the congressional “grant of authority contemplates the regulations issued.”111

If a reviewing court framed the issue of preemption of the Virginia Takeover Act by the SEC rules as whether Congress in its grant of rulemaking authority to the SEC contemplated Rule 14d-2(b), the five day time limit, the SEC rules would subordinate the Virginia statute because, under the force and effect of law doctrine, “agency regulations implementing federal statutes have been held to pre-empt state law under the Supremacy Clause.”112 If, however, a court frames the issue of SEC rule preemption of the Virginia statute as whether the congressional grant of rulemaking authority to the SEC contemplated preemption of state statutes, the legislative history of the Williams Act indicates that a conclusion of pre-emption is less likely.113

107. Quinn and Co. v. SEC, 452 F.2d 943, 947 (10th Cir. 1971) (citing Stead v. SEC, 444 F.2d 713, 716 (10th Cir. 1971)).


109. A substantive rule or “legislative type” rule is one “affecting individual rights and obligations.” Id. at 232. "Legislative, or substantive, regulations are 'issued by an agency pursuant to statutory authority and . . . implement the statute, as, for example, the proxy rules issued by the Securities and Exchange Commission. . . . Such rules have the force and effect of law.'” Batterson v. Francis, 432 U.S. 416, 425 n.9 (1977) (quoting U.S. DEP’T OF JUSTICE, ATTORNEY GENERAL’S MANUAL ON THE ADMINISTRATIVE PROCEDURE ACT 30 n.3 (1947)). A substantive rule or regulation differs from interpretive rules, which are “issued by an agency to advise the public of the agency’s construction of the statutes and rules which it administers.” Chrysler Corp. v. Brown, 441 U.S. 281, 302 n.31 (1979) (quoting U.S. DEP’T OF JUSTICE, ATTORNEY GENERAL’S MANUAL ON THE ADMINISTRATIVE PROCEDURE ACT 30 n.3 (1947)). See United States v. Mersky, 361 U.S. 431, 437-38 (1960). See generally 1 K. DAVIS, ADMINISTRATIVE LAW TREATISE § 5.03 (1958 & Supps. 1970, 1976).


111. Id. at 308.


113. See note 115 & accompanying text infra.
Congressional Intent to Preempt

Preemption of a state statute will occur if Congress expressly declares an intent to vitiate state regulation of a particular area or if a court can infer such intent.114 No explicit statement of intent to preempt state regulation of tender offers appears in the Williams Act or the Securities Exchange Act of 1934, which the Williams Act amended.117 The only statement governing the relationship between federal and state regulation in the securities area appears in section 28 of the Securities Exchange Act of 1934: "Nothing in this chapter shall affect the jurisdiction of the securities commission (or any officer performing like functions) of any state over any security or any person insofar as it does not conflict with the provisions of this chapter or the rules and regulations thereunder."118 The Supreme Court has stated that section 28 "was plainly intended to protect, rather than to limit, state authority."119

116. Telvest, Inc. v. Bradshaw, 618 F.2d 1029, 1035 (4th Cir. 1980); A Response to Great Western, supra note 25, at 910.
117. Leroy v. Great W. United Corp., 443 U.S. 173, 182 & n.13 (1979) (indicating that § 28 was intended to leave as much flexibility with the states as was possible).

In the majority opinion, the Court in Leroy referred to a statement by Thomas Corcoran, a principal draftsman of the Securities Exchange Act, in which Corcoran indicated that "the purpose of § 28(a) was to leave the States with as much leeway to regulate securities trans-
Neither does the legislative history of the Williams Act evidence an intent to preempt state takeover statutes. The only tenable argument for inferring an intent to preempt from the legislative history of the Williams Act rests on the purported objective of Congress to maintain neutrality between tender offeror and management of the target company. According to this argument, state statutes favor management, thus upsetting congressionally mandated neutrality. In other words, Congress intended neutrality between offeror and management, but state statutes favor management; therefore, Congress intended state takeover acts to yield to the Williams Act.\footnote{120}

The Supreme Court rejected the inference that Congress intended raider-management neutrality in the Williams Act when the Court addressed the issue of tender offerors’ standing to sue in actions as the Supremacy Clause would allow them in the absence of such a provision."\footnote{Id. at 182 n.13 (citing \textit{Hearings on S. Res. 84} (72d Cong.), 56, and 97 (73d Cong.) \textit{Before the Senate Comm. on Banking and Currency}, 73d Cong., 1st Sess. 6577 (1934) (statement of Thomas Corcoran)).}

Justice White, dissenting, agreed with the Fifth Circuit which held that \textsection 28 not only does not protect state authority but imposes an affirmative duty on states not to legislate inconsistently with the Act. 443 U.S. at 191 & n.4 (White, J., dissenting) (citing \textit{Great W. United Corp. v. Kidwell}, 577 F.2d 1256, 1271 (5th Cir. 1978)). After disagreeing with the majority on the issue of venue, Justice White concluded:

[T]he only question, then, is whether the Williams Act imposes on state officials, expressly or impliedly, the duty not to enact or enforce legislation inconsistent therewith. In my view, the answer to this question must be in the affirmative. The Supremacy Clause of the Constitution provides that if state law conflicts with federal law, federal law prevails. \textit{Given} this command, the very enactment and existence of the Williams Act pre-empts and invalidates all conflicting state efforts to regulate cash tender offers.\footnote{Id. at 190 (White, J., dissenting) (emphasis added).}

Most commentators agree that Congress enacted \textsection 28 in order to preserve state blue sky laws that are based on the jurisdictional nexus of shareholder situs rather than to address state takeover statutes. The section, however, supports the assertion of federal-state cooperation in the context of tender offer regulation. \textit{See A Response to Great Western, supra note 25, at 909-10 n.271.}

Piper v. Chris-Craft Industries, Inc. The SEC argued that the Court should infer standing for tender offerors from the Williams Act in furtherance of the congressional policy of neutrality. The Supreme Court denied the inference that neutrality was a purpose of the Williams Act, holding, "neutrality is, rather, but one characteristic of legislation directed toward a different purpose—the protection of investors." Because the Court views management-raider neutrality as a byproduct, rather than a purpose, of the Williams Act, the argument that state takeover statutes favor management by delaying takeover bids, even if true, is an insubstantial basis for inferring congressional intent to preempt state takeover statutes pursuant to a congressional policy of neutrality.

Judicial Consideration of the Preemption Doctrine

The judiciary only reluctantly has found federal preemption of state law based on mere inferences of congressional intent. The Supreme Court recently concluded that the Robinson-Patman Act did not preempt a Maryland statute requiring that refiners give gasoline allowances to all Maryland retailers. Although the federal act did not address allowance allocation by refiners, this omission failed to support an inference of preemption. Similarly, the Fourth Circuit refused to find that federal law preempted a statute prohibiting automobile manufacturers from granting franchises unless the manufacturer first notified all area dealers in that line of automobile, even though Congress rejected incorporation of a similar proposal in the federal Dealer's Day in Court Act. Preemption meets with even more disfavor in the area of securities regulation. The Supreme Court articulated this disfavor, say-
ing, "Absent a clear indication of congressional intent, we are reluctant to federalize the substantial portion of the law of corporations that deals with transactions in securities, particularly where established state policies of corporate regulation would be overridden." 130  Equally compelling is the approach outlined by the Court in areas of conflict between state law and the Securities Exchange Act of 1934. Despite an actual conflict between California law and New York Stock Exchange rules promulgated pursuant to the 1934 Act, the Court upheld the California statute. 131  The Court stated that the proper approach in preemption cases is "to reconcile 'the operation of [federal and state] statutory schemes with one another rather than holding one completely ousted.' " 132

One must conclude from the corpus of judicial and legislative commentary on the relation between state takeover statutes and the Williams Act that, in its grant of rulemaking authority to the SEC, Congress did not contemplate, expressly or impliedly, preemption of state regulation. The Fourth Circuit found support in the congressional and judicial presumption against preemption of state takeover statutes when it vacated a district court injunction against enforcement of the Virginia Takeover Act. 133

In Televest, Inc. v. Bradshaw, 134  the district court granted an injunction, stating that the 1979 amendment to the Virginia Takeover Act 135  "conflicts with the structure and objectives of the Exchange Act and the Regulations and Rules promulgated thereunder. The Virginia Act is in conflict therewith—in any number of ways . . . ." 136  The district court hinted that "other infirmities" of the Virginia Act rendered it unconstitutional. 137  The Fourth Cir-

132. Id. at 127 (quoting Silver v. New York Stock Exch., 373 U.S. 341, 357 (1963)).
133. Televest, Inc. v. Bradshaw, 618 F.2d 1029 (4th Cir. 1980).
135. See notes 73-76 & accompanying text supra.
137. Id. at 96,371.
court, although addressing only the issue of whether the district court ought to have granted the injunction, digressed on the question of federal preemption of the Virginia Act. The court refused to base preemption on the contention that the Virginia Takeover Act favors the target’s management, reasoning: “Doubtless, most of the holders of [the target’s] stock had invested in that company on the faith of its then present management.”

Assuming that the aim of the Virginia statute was to protect target management, the court stated that the protection purpose “seems consistent with, rather than antagonistic to, the purpose of the Williams Act.”

The court further stated that, although a possible conflict inhered in the delay engendered by the opportunity for a hearing granted by the Virginia Act, an opportunity not afforded by the Williams Act, this potential conflict did not serve as an adequate basis for a finding of preemption.

138. 618 F.2d at 1034.
139. Id.
140. Id. at 1035.
141. Id. (citing Leroy v. Great W. United Corp., 443 U.S. 173 (1979) (indicating that the states have not been precluded from legislating in the securities field)). Although the SEC rules became effective more than two months prior to the decision, see 44 Fed. Reg. 70,325, 70,326 (1980), the Fourth Circuit refused to consider the effect of the new rules on the validity of the Virginia Takeover Act because the court mistakenly assumed the rules were not yet in effect. 618 F.2d at 1036 n.10. Significant, however, is the action by the Virginia General Assembly to accommodate the new SEC rules by deleting the Virginia statute’s provisions for advance notice of an offer and a hearing. See note 73 supra.

Other states have taken steps to accommodate their takeover statutes to the time limit in Rule 14d-2(b). Wisconsin has omitted from its takeover regulation the requirement of disclosure of price and class of securities sought. Wis. Stat. Ann. §§ 552.01-.25 (West 1980). Thus, the disclosure falls outside of the definition of a public announcement triggering the commencement period and the SEC rules. Wisconsin also permits conditional takeover offers, a device that allows commencement of offers without disclosure although the offer is conditioned on state approval. Wis. Stat. Ann. §§ 552.01-.25 (West 1980). The Indiana Securities Division has vitiated the pre-offering period required under the Indiana statute if the offer is subject to the Williams Act. Fogelson, Recent Developments in Defensive Strategies and Tactics, Second Ann. Sec. Update 405 (1980).

In addition to the legislative history of the Williams Act and judicial assessment of the relation between federal and state securities regulation, policy considerations support the Fourth Circuit's refusal to find that the Williams Act or the rules issued pursuant thereto by the SEC preempt the Virginia Takeover Act.

**Policy Considerations**

The SEC has advanced two arguments in support of the five day time limit of Rule 14d-2(b): (1) the five day time limit curtails precommencement announcements that "cause security holders to make investment decisions with respect to a tender offer on the basis of incomplete information"; and (2) the time limit restricts activity in advance of the actual offer that disadvantages the target shareholder, specifically "arbitrageur activity." Because the protections of the Williams Act do not become effective until the offer commences, according to the SEC, investors lack protection during the precommencement stage of the tender offer process. Precommencement activity, therefore, should remain minimal, and Rule 14d-2(b) accomplishes this objective. An additional justification for the time limit in the SEC rule, proffered by courts and commentators, is that, by preempting state takeover statutes, the rule vitiates the bias in favor of target management inherent in state statutes.

**Precommencement Shareholder Decisions Without Adequate Information**

The SEC contention that state takeover acts force precommencement decisions by the target shareholder without adequate information ignores the purpose and effect of state takeover legislation. The purpose of the Virginia Takeover Act is to "protect the interests of offerees, investors and the public by requiring that an

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143. Id.
144. Id.
offeror make fair, full and effective disclosure to offerees of all information material to a decision to accept or reject a take-over bid.\textsuperscript{146} The requirement of a twenty day period after announcement but before commencement of the tender offer provides this protection.\textsuperscript{147} During the precommencement period target shareholders can determine, on the basis of required disclosures by the offeror, whether: (1) to sell and hence realize an immediate profit; (2) to wait for a competing bid hoping to realize a larger profit; (3) not to sell in contemplation of the failure of the takeover bid, reflecting a confidence in present management and corporate philosophy; or (4) not to sell in contemplation of a successful takeover bid, reflecting satisfaction with the tender offeror's disclosed purposes in pursuing the takeover bid. The Virginia Takeover Act also provides for a hearing, if good cause exists, to ensure the accuracy of the required disclosures.\textsuperscript{148} The complex of factors considered by target shareholders requires time and accurate, complete information before shareholders can decide intelligently whether to tender their shares. Contrary to the arguments of the SEC, the Virginia Act provides both the necessary time, through its required waiting period, and the essential information, through its mandatory disclosure provision, which is buttressed by a possible hearing to ensure accuracy and thoroughness of information.

\textit{Arbitrage Activity}

The SEC contention that state takeover statutes allow the triggering of arbitrage activity to the detriment of target shareholders is flawed.\textsuperscript{149} The detriment to target shareholders results from arbitrageurs buying target stock on the open market at the market price and then selling the stock to the tender offeror at the higher tender offer price. Consequently, arbitrage activity reduces the number of tendering shareholder shares accepted in prorated cash offers.

\begin{footnotes}
\item[147] Id. § 13.1-531(a).
\item[148] Id.
\item[149] Arbitrage is the purchase of shares in one market and sale in another market shortly afterwards at a higher price. See Note, \textit{Should Tender Offer Arbitrage be Regulated?}, 1978 Duke L.J. 1000.
\end{footnotes}
The relation between state takeover acts and arbitrage activity, however, avoids damage to tendering shareholders. The greatest disincentive to arbitrage activity is state takeover legislation because the state statutes pose a threat to consummation of the tender offer. The greater the risk that the takeover bid will fail, the greater the risk that the arbitrageur cannot find a buyer offering a higher price than the arbitrageur paid for the stock.\(^{150}\) State takeover acts increase the risk of takeover failure, thus discouraging arbitrage activity.\(^{151}\) The argument that state tender offer legislation encourages arbitrage activity ignores the realities of arbitrageur decisionmaking.

**The Virginia Takeover Act, Delay, and Target Management**

Additional support for Rule 14d-2(b) lies in the argument that the preemptive effect of the rule cures the disruption that state takeover statutes can cause to “the neutrality indispensable for the proper operation of the federal market approach to tender offers regulation.”\(^{152}\)

**The Virginia Takeover Act Does Not Operate to the Benefit of Target Management**

Maintenance of neutrality between target management and raiders was not an objective of the Williams Act;\(^{153}\) rather, neutrality was a byproduct of the Williams Act subject to adjustment by the implementation of state policies.\(^{154}\) The incorrect assumption that state takeover statutes favor target management compounds the error of attributing to Congress the objective of neutrality. Empirical evidence disputes the assumption of management bias in the state statutes.

The provision in the Virginia statute for a hearing, the source of the greatest potential for delay, is difficult to trigger.\(^{155}\) The Vir-


\(^{151}\) Id.


\(^{153}\) See text accompanying notes 121-122 supra.

\(^{154}\) See notes 121-124 & accompanying text supra.

\(^{155}\) Buford, *The Virginia Takeover Statute, State Takeover Statutes and New Take-
Virginia Act requires a showing of good cause as a prerequisite for a hearing. As a result, in the majority of takeover bids the "delay" caused by the statute is only three weeks. Moreover, if the state takeover statutes were pro-management, one would expect the state statutes to have a chilling effect on tender offers. The number of tender offers, however, has increased as the number of states with takeover statutes has increased. In 1970, when only two states in addition to Virginia had takeover statutes, thirty-four tender offers occurred. By 1976, twenty-three states had takeover legislation, and 107 tender offers were lodged that year. The number of states with tender offer statutes in 1978 was thirty-three, and the number of acquisition proposals for public companies announced in 1978 was 325.

**Promanagement State Statutes Effect Legitimate State Policies and Benefit Target Shareholders**

Even if tender offer statutes benefit target management, the result effects legitimate state policies. Any protection afforded by the state statutes is directed less at making local industry profitable or retaining incumbent management than at keeping local industry locally controlled. The state is the source of the corporate charter, and consequently, the state should have the right to regulate the attributes of a resident corporation's stock. Furthermore, states have a legitimate interest in the effect a takeover has on the economic well-being of the state. Evidence suggests that states are concerned justifiably about the potential adverse consequence of takeovers and that the efforts at substantive regulations to mitigate the adverse consequences are logical products of this

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over Strategies—A Panel, 32 Bus. Law. 1469 (1977). Information from the Securities Division of the Virginia State Corporation Commission that only two hearings have been held since the hearing mechanism was established in 1968, although eight takeover bids have been lodged in that period, supports Mr. Buford's contention that the State Corporation Commission has "shown some reluctance to require a hearing," id. at 1470.


158. Id. See A Response to Great Western, supra note 25, at 909 n.270.


160. See Boehm, supra note 15, at 744-46.
concern.\footnote{161}

Regarding shareholders, states have a legitimate interest in assuring resident shareholders adequate time to reach an informed decision on the basis of complete and accurate information. Evidence indicates, moreover, that shareholders usually win when the target corporation rejects an initial takeover attempt.\footnote{162} A study of thirty-six unsolicited tender offers that the target company rejected between the end of 1973 and June 1979 "show[s] that the shares of more than 50 per cent of the targets are either today at a higher market price than the rejected offer price or were acquired after the tender offer was defeated by another company at a price higher than the offer price."\footnote{163} In addition, in virtually every company that initially resisted the takeover and was acquired subsequently, the company’s shareholders received a higher price than the original offer.\footnote{164}

\footnote{161. The Commissioner of the SEC has stated that $100 billion has been spent rejuggling existing corporate assets through mergers and takeovers, an amount "that could have been devoted [sic] to new production and employment opportunities," but because the billions are spent instead on acquiring existing corporate structures, the amount "does not flow back as new capacity, improvements in productivity, innovation, new products or new jobs." Mintz, \textit{Playing the Corporate Takeover Game}, Wash. Post, April 18, 1980, at A11, col. 1. The testimony of a potential target’s chief executive officer before the Senate Select Committee on Small Business illustrates the negative effects of a takeover on the community of the subject company. The officer estimated that the dollar loss to the corporation’s state, Wisconsin, in the event of a successful takeover and consequent closing of the firm’s local headquarters would have been $3,481,134, half of its remuneration for 71 employees. He valued the contribution to a variety of state and city community causes that would disappear at $411,359, including $71,101 to the United Way, $77,665 to the University School of Milwaukee, $60,000 to the Milwaukee Children’s Hospital, $17,500 to the Milwaukee Symphony, and $7,500 to the Milwaukee Performing Arts Fund, and $7,500 to the Milwaukee Symphony. Additional losses would include: $319,268 to local insurance companies for corporate coverage; $35,194 to two local banks for interest charges; $383,783 to local professional firms for accounting and legal fees and other services. Mintz, \textit{The Takeover Game}, Wash. Post, April 20, 1980 at A2, col. 1. See also Herald Co. v. Seawell, 472 F.2d 1081 (10th Cir. 1972) (discussing adverse impact of takeover on target’s employees and community). For the proposition that locally based industries tend to be more involved in community affairs than their counterparts that are branches of large corporations, see Boehm, supra note 15, at 741-46.}

\footnote{162. Lipton, \textit{Takeover Bids in the Target’s Boardroom}, 35 \textit{Bus. Law.} 101, 106 (1979).}

\footnote{163. \textit{Id.}}

\footnote{164. \textit{Id.} at 108 n.30 (based on an unpublished study by Goldman, Sachs & Co. of 85 takeover bids between January 1, 1976 and June 8, 1979).}
The new SEC rules, specifically Rule 14d-2(b), directly conflict with the Virginia Takeover Act because they provide a time limit of five days after the public announcement of a tender offer within which the offer must commence, whereas the Virginia Act requires a twenty-one day waiting period after the announcement of a tender offer before the offer may commence. The reasons proffered by the SEC for promulgating the rules, curtailing precommencement market activity and reducing the risk of target investor decisions without adequate information, do not justify the sacrifice of state interests resulting from federal divestment of state regulation. Neither does the Virginia statutory scheme contribute to the adverse effects of precommencement offers cited by the SEC. Rather, the Virginia statute discourages adverse precommencement market activity and uninformed decisions by target shareholders. An additional reason advanced for promulgation of the rules, preemption of state statutes, contradicts the legislative history of the Williams Act, judicial assessment of the relation between federal and state securities regulation, and the policy objectives of the Virginia Takeover Act and the Williams Act.

Speculation as to the actual reason why the SEC promulgated the time limit provision in Rule 14d-2(b) is justified because the reason for the rule proffered by the SEC collapse under analysis. Perhaps the Commission read the report of the American Bar Association, which concluded in part that the nature of tender offer litigation renders unlikely judicial resolution of the preemption question in the near future and, seizing the initiative, issued the rule for the sole purpose of preempting state takeover statutes. Speculation as to why the SEC is so adamant a champion of preemption ranges from ascription to the Commission of malevolent ambitions to ascription of malevolent ignorance. Perhaps the SEC is haunted by the spectre of “old boy” networks of corporate managers pulling strings in state capitals across the country and wangling legislation to keep management entrenched. Perhaps the SEC is using the rule as a lever with which to magnify its power by engulfing an entire area of regulation traditionally left to the state.

165. State Takeover Statutes and the Williams Act, supra note 27.
Whatever the actual reason behind the SEC attempt to preempt state statutes, the Commission likely will suffer disappointment because preemption of the state takeover statutes contradicts the history of the Williams Act, offends judicial assessment of the relation between federal and state regulation of securities, and disrupts the policy objectives of the federal and state statutory schemes.

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