The Constitution and the Market for Corporate Control: State Takeover Statutes After CTS Corp.

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In CTS Corp. v. Dynamics Corp. of America the United States Supreme Court upheld Indiana's takeover statute as constitutional, reversing the view of the United States Court of Appeals for the Seventh Circuit that the statute was preempted by the Williams Act and was an unreasonable burden on interstate commerce. A large number of states have enacted takeover statutes as part of their corporate law. These statutes, designed to regulate the market for corporate control, are of different types and represent several models. Some of them provide for collective shareholder voting or increased shareholders' rights in a takeover, whereas others increase the power of management faced with a hostile takeover. If these statutes are constitutional, hostile takeovers will be limited and the market for corporate control will be adversely affected.

The Court's ruling in CTS Corp. did not explicitly validate all state takeover statutes. This Article examines the opinion in CTS Corp. and discusses its implications for other state takeover statutes. In addition, this Article discusses the role of the state in the market for corporate control.

The Article begins by exploring the background of the controversy and the various statutory models enacted. Next, the Article reviews the opinion in CTS Corp. and discusses its future implications for the statutory models in light of the Court's preemption and commerce clause analyses. Although the Court's preemption discussion in CTS Corp. focused on the role of state law in protect-

ing investors and enhancing the role of the shareholders, this Article addresses whether state law must perform that function to avoid preemption. In addition, the Court’s commerce clause analysis emphasized the role of the state of incorporation in providing corporate governance rules. The Article discusses whether those rules must benefit shareholders and whether states other than the state of incorporation have a role to play.

II. Background

A. Hostile Takeovers

A hostile takeover occurs when an outside party seeks control of a corporation despite opposition from the target corporation’s management. Such takeovers have generated a considerable amount of legal, political, and economic debate. Proponents of hostile takeovers adopt the thesis that competition from the market for corporate control should be encouraged and facilitated. This market for corporate control theory builds on the efficient market theory, which assumes that by using all available information, the trading markets work efficiently to price stocks accurately to represent the true value of a corporation. For example, management, which often has a small equity interest in the corporation, may manage the corporation inefficiently or may be motivated by self-interest. Accordingly, incumbent management’s failure to maximize the value of a corporation will be reflected in the price of its stock. Such a failure can attract an offeror to offer a premium to shareholders for a controlling interest, in the belief that it can operate the corporation more efficiently. Thus, the market for corporate control provides a premium that benefits the corporation’s


shareholders, replaces incompetent management, and shifts corporate assets to more efficient use.\(^5\)

The opponents of hostile takeovers vary from those who argue that takeovers are harmful to shareholders to some who argue they are harmful to other corporate constituencies and the economy as a whole.\(^6\) Some critics question the underlying studies of the efficient market theory by pointing out anomalies in the market.\(^7\) Others argue that although the trading markets may be efficient in the daily pricing of securities, such pricing does not reflect the value of the enterprise.\(^6\) Moreover, critics are concerned that in reality, takeovers are aimed not at inefficient companies, but at well-run ones. The fear is that hostile takeovers divert management’s attention from long-run performance to short-term profit making.\(^9\) Others assert that the impact of takeovers on employees and the communities served may be detrimental and that the mere reshuffling of assets does not produce any real economic gains. Moreover, some critics contend that the increased use of debt financing in hostile takeovers may lead to severe economic problems during a recession which could adversely affect both local and national economies.\(^10\)

\(^5\) See Easterbrook & Fischel, supra note 3, at 1173-74; Fischel, Efficient Capital Market Theory, the Market for Corporate Control, and the Regulation of Cash Tender Offers, 57 Tex. L. Rev. 1, 5, 27-28, 45 (1978); Manne, supra note 3.


\(^8\) See, e.g., Lowenstein, supra note 4, at 274-76.

\(^9\) Critics of hostile takeovers often argue that the market does not reflect management’s concern for investing in the long term for the corporation but seeks out short-term results. Drucker, A Crisis of Capitalism, Wall St. J., Sept. 30, 1986, at 32, col. 1. This argument has been criticized as an unrealistic view of the functioning of the market which values both short-term and long-term profits. R. Clark, Corporate Law 18 n.46 (1986). Even if the market values securities by taking into account all available public information, those traders are not necessarily pursuing a sound economic policy. See Margotta, Distorting Corporate Investment, N.Y. Times, Sept. 27, 1987, at F2, col. 3.

\(^10\) For example, in enacting New York’s takeover statute, the Governor, who proposed the bill, stated that the law would “promote the long-term growth of New York resident domestic corporations.” Statement of Governor Cuomo on approving L.1985, c.915 (Dec. 16, 1985), reprinted in 2 McKinney’s 1985 Session Laws of New York 3339. See also Lipton, Takeover Bids in the Target’s Boardroom, 35 Bus. Law. 101, 109-10 (1979).
Both the acquisition techniques utilized by offerors and the defensive strategies employed by management of the target corporation continue to evolve. One court has described the scene as follows:

Contests for corporate control have become ever more frequent phenomena on the American business scene. Waged with the intensity of military campaigns and the weaponry of seemingly bottomless bankrolls, these battles determine the destinies of large and small corporations alike. Elaborate strategies and ingenious tactics have been developed both to facilitate takeover attempts and to defend against them. Skirmishes are fought in company boardrooms, in shareholders' meetings, and, with increasing regularity, in the courts.11

The rise of hostile takeovers has prompted legislative responses. In 1968, the United States Congress responded with the Williams Act,12 which was designed to protect investors by requiring both disclosure of material information13 and adherence to procedural rules that provide targets sufficient time to determine whether to accept a tender offer.14

11. Norlin Corp. v. Rooney, Pace, Inc., 744 F.2d 255, 258 (2d Cir. 1984). The terms used to describe the tactics are as colorful and creative as the tactics themselves. For example, shark repellents are preventive measures devised to make takeovers procedurally difficult. They may include changing the articles of incorporation or bylaws to provide for staggered terms of office for directors, requiring a “supermajority” vote to approve any hostile takeover bid, barring front-end-loaded offers, concentrating voting power in a class of closely held common stock, or issuing new classes of stock. Reiser, Corporate Takeovers: A Glossary of Terms and Tactics, 89 CASE & COM., Nov.-Dec. 1984, at 35, 50.
13. For example, a tender offeror is required to file a disclosure statement that includes such information as the offeror's background and identity, the source and amount of the funds to be used in making the purchase, the purpose of the purchase, including any plans to liquidate the company or make major changes in its corporate structure, and the extent of the offeror's holdings in the target company. See 15 U.S.C. § 78n (d)(1) (incorporating § 78m(d)(1)) (1982); 17 C.F.R. §§ 240.13 d-1, 240.14d-3 (1987).
14. For example, tendering stockholders may withdraw their shares during the first 7 days of the tender offer and, if the offeror has not purchased their shares, any time after 60 days from commencement of the offer. 15 U.S.C. § 78n(d)(5); 17 C.F.R. § 240.14d-7(a) (1986). The tender offer must remain open for at least 20 business days. 17 C.F.R. § 240.14e-1(a). When the number of shares tendered exceeds the number that the offeror sought to purchase, the offeror must purchase on a pro rata basis from each tendering shareholder. 15 U.S.C. § 78n(d)(6); 17 C.F.R. § 240.14d-8. Lastly, the tender offeror is required to pay the same price for all purchases, and if the offering price is increased before the end of the offer,
The states also responded to hostile takeovers by enacting legislation described as first-generation takeover statutes. Their purpose was often to provide target corporation management with additional defenses to delay or even halt a tender offer. The legislatures believed that they were protecting local industry and investors from the disruptions of a hostile offer. However, others believe that the legislatures were acting out of parochial economic interests by protecting incumbent management.

B. Edgar v. MITE Corp.

Typical of the first-generation statutes was the Illinois law struck down by the Supreme Court in Edgar v. MITE Corp. The statute provided that the Secretary of State could hold a hearing to consider the fairness of certain tender offers and whether the offeror had made a full and fair disclosure. The Secretary of State was also empowered to enjoin a tender offer nationwide. For its provisions to apply, the statute required either that the corporation have ten percent of its shareholders in Illinois or that it meet two of the three following conditions: that its principal executive offices were located in Illinois; that it was incorporated in Illinois; or that ten percent of the corporation’s stated capital or paid-in surplus was situated in Illinois. Opponents contended that these requirements unconstitutionally burdened interstate commerce and that the Williams Act preempted the legislation.

The commerce clause provides that “Congress shall have Power those who have tendered must receive the benefit of the increased price. See 15 U.S.C. § 78n(d)(7).

15. Most of the 37 states that enacted the first generation takeover statutes did so after the Williams Act. Edgar v. MITE Corp., 457 U.S. 624, 631 n.6 (1982). Although Virginia had a statute dealing with tender offers prior to the Williams Act, there is no evidence that Congress considered the Virginia statute when passing the Williams Act. Id.


17. E.g., Dart Indus. v. Conrad, 462 F. Supp. 1, 9 (S.D. Ind. 1978) (“delay increases the risks that the offer will not be successful by . . . granting . . . incumbent management [the time] to take various steps in an effort to frustrate the successful completion of the tender offer”).


20. Id.
... [t]o regulate Commerce . . . among the several States."\(^{21}\) The clause does not explicitly restrict state regulation of commerce; instead, the constitutional limitations on state regulation of interstate activities flow from Congress's unexercised commerce clause power.\(^{22}\) Under the so-called dormant commerce clause analysis, the Court attempts to distinguish between direct and indirect state regulation and will strike down a law that regulates interstate commerce directly, discriminates against interstate commerce, or favors intrastate economic interests over out-of-state interests.\(^{23}\) An indirect and nondiscriminatory statute is subjected to a balancing test and is upheld if it "regulates evenhandedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental . . . unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits."\(^{24}\)

The Supreme Court in \textit{Edgar} found that the statute was an "indirect burden" on interstate commerce, excessive in relation to its benefits, and therefore unconstitutional.\(^{25}\) Specifically, the Court's

\begin{footnotes}
\footnote{21. U.S. Const. art. I, \S 8.}
\footnote{23. \textit{E.g., Brown-Forman Distillers Corp. v. New York State Liquor Auth.}, 476 U.S. 573, 579 (1986). Professor Tribe indicates that the direct-indirect distinction is conclusory and misleading and that in its place the Court has substituted a more indeterminate principle. \textit{L. Tribe, American Constitutional Law} 408 (2d ed. 1988). The Court will uphold a state regulation if it is rationally related to a legitimate state end and the burden imposed on interstate commerce and any resulting discrimination are outweighed by the state's interest in enforcing the regulation. \textit{Id.} at 408-09. The Court appears to recognize the difficulty in distinguishing between direct and indirect burden but still uses the distinction. \textit{See Brown-Forman}, 476 U.S. at 579-80.}
\footnote{25. \textit{Edgar}, 457 U.S. at 643. A plurality of four Justices found the Illinois statute to be a direct burden on interstate commerce and therefore invalid. \textit{Id.} The plurality found the statute to be a direct burden because it could preclude the offeror from engaging in interstate commerce with shareholders who were residents of another state. \textit{Id.} at 642. The plurality was concerned that other states could impose similar regulations that would stifle interstate tender offers. The Court indicated that a statute whose application took place}
analysis of the burden focused on the statute’s interference with the market for corporate control. The Court noted that the Illinois statute’s frustration of hostile tender offers was substantial in several respects. First, shareholders lost an opportunity to tender their shares at a premium.26 Second, the statute impeded reallocation of economic resources to their higher value.27 Third, the law diminished an incentive for management to run the corporation efficiently and to keep the stock price high.28

The state claimed that the Illinois legislation protected resident shareholders. The Court noted, however, that “[w]hile protecting local investors is plainly a legitimate state objective, the State has no legitimate interest in protecting nonresident shareholders.”29 The statute exempted self tenders, however, leaving the Illinois shareholders without the protection of the statute. This underinclusiveness undermined the state’s argument that the purpose of the statute was shareholder protection. Furthermore, many of the statute’s provisions also paralleled the Williams Act requirements, a redundancy that further limited the claimed benefit of investor protection.30

wholly outside a state, even if it had effects within the state, was not permissible. Id. at 642-43. The Court also noted that it would look to whether the practical effect of the regulation reached beyond the state. Id. at 643 (citing Southern Pacific Co. v. Arizona ex rel. Sullivan, 325 U.S. 761, 775 (1945)).

26. Id. at 643. Although shareholders generally receive more than the current market price, not all shareholders may in fact benefit from the premium compared to the value of the shares after a thwarted tender offer. Lipton, supra note 10. But see F. Easterbrook & G. Jarrell, Report of Recommendations of the SEC’s Advisory Committee on Tender Offers 48-49 (July 8, 1983) (dissenting statements).

27. Edgar, 457 U.S. at 643. Again, the shareholders of the offeror may not benefit automatically by an acquisition. Studies have indicated that acquiring companies are not benefiting their own shareholders with tender offers. See, e.g., Scherer, Takeovers: Present and Future Dangers, Brookings Rev., Winter/Spring 1986, at 15. In both micro- and macroeconomic terms, the verdict is still out on the benefits of hostile takeovers. 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).

28. Edgar, 457 U.S. at 643. Although the trading markets generally are efficient, the price of a corporation’s stock on a given day may not reflect the intrinsic value of the corporation or its value in the acquisitions market. See supra text accompanying notes 7-8.

29. Id. at 644. The Court in CTS Corp. appeared to limit this broad statement as being applicable to nonresident corporations. See CTS Corp., 107 S. Ct. at 1651-52, and infra text accompanying notes 267-70.

30. Edgar, 457 U.S. at 644-45. Lower federal courts have taken a different view of state statutes that parallel the Williams Act. See, e.g., Cardiff Acquisitions v. Hatch, 751 F.2d
Illinois also contended that its interest in regulating the internal affairs of firms incorporated in that state justified the statute.\textsuperscript{31} The internal affairs doctrine is a conflict of laws principle suggesting that the law of the state of incorporation should govern intracorporate relationships involving the corporation and its officers, directors, and shareholders.\textsuperscript{32} With the use of a single law, the doctrine attempts to prevent conflicting demands from several states and to encourage convenience and predictability of legal application.\textsuperscript{33}

The Court did not address the interplay between the internal affairs doctrine and the commerce clause because it concluded that the doctrine was inapplicable.\textsuperscript{34} First, the Court dismissed the use of the doctrine because the Illinois statute could have applied to corporations that were not incorporated in Illinois and whose principal place of business might be elsewhere.\textsuperscript{35} In addition, the Court noted that tender offers involve the transfer of shares between shareholders, a transaction that does not generally implicate the internal affairs doctrine.\textsuperscript{36}

Although the majority in \textit{Edgar} did not find that the Illinois statute was preempted by the Williams Act, two Justices joined Justice White's plurality opinion that preemption existed.\textsuperscript{37} The issue of preemption arises under the supremacy clause of the Constitution\textsuperscript{38} when Congress has exercised its exclusive power to regulate in an area in which the states have also regulated. Because

\textsuperscript{31} \textit{Edgar}, 457 U.S. at 645. \textsuperscript{32} \textit{Restatement (Second) of the Conflict of Laws} § 302 (1969). When a state other than the state of incorporation has a more significant relationship to a particular issue and to the parties, its law will apply. \textit{Id.} § 302(2). This may result in some problems with the fourth-generation state takeover statutes. \textit{See infra} text accompanying notes 261-300. \textsuperscript{33} \textit{Restatement (Second) of the Conflict of Laws} § 302 comment b. \textsuperscript{34} \textit{Edgar}, 457 U.S. at 645-46. \textsuperscript{35} \textit{Id.} The Court stated that "Illinois has no interest in regulating the internal affairs of foreign corporations." \textit{Id.} This statement raises significant questions concerning the ability of states to impose their laws on foreign corporations. \textit{See infra} pt. IV.B.1.b. \textsuperscript{36} \textit{Edgar}, 457 U.S. at 645. \textit{See infra} note 261. \textsuperscript{37} \textit{Edgar}, 457 U.S. at 630-40. Chief Justice Burger joined the opinion and Justice Blackmun concurred. \textit{Id.} at 625. \textsuperscript{38} \textit{U.S. Const.} art. VI, cl. 2.
Congress has specifically permitted state securities regulation under section 28(a) of the Securities and Exchange Act, the only issue under the Illinois statute was whether "compliance with both federal and state regulations is a physical impossibility . . ." or whether the state law "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress."  

Conceivably, a corporation could comply with both the Illinois statute and the Williams Act. Thus the issue addressed in Edgar was whether the statute frustrated the purposes of the federal law. Justice White, in his plurality opinion, stated that Congress intended a policy of neutrality in hostile tender offers between the offeror and incumbent management. Three of the statutory provisions conflicted with the purpose of the Williams Act by upsetting the "careful balance struck by Congress." First, the Illinois statute provided a twenty-day precommencement period during which management could present its views while the offeror was precluded from publishing the offer. The court found this to be a "powerful tool to combat tender offers" that frustrated the purposes of the Williams Act, especially since Congress had deleted precommencement notice provisions from an earlier draft of the Act. Second, because the hearing provisions within the statute failed to set a deadline, management could "stymie . . . a takeover" indefinitely. This delay upset Congressional intent to per-
mit tender offers to go forward without delay. Finally, the statute’s requirement that the Secretary of State review the fairness of the tender offer conflicted with investor autonomy.46

C. The Next Generations of Statutes

The majority opinion in Edgar recognized the burdens of restricting the market for corporate control by finding that the Illinois statute’s interference with hostile tender offers created a burden on interstate commerce because it precluded the benefits of that market to shareholders and the economy. The majority opinion, however, did not preclude states from enacting statutes when those states had an interest greater than Illinois had in Edgar. If a majority of the Court ever accepts the neutrality view in Justice White’s preemption argument, the role of the states in the market for corporate control would be severely limited because the delays created would often favor management.47

After Edgar many of the states either enacted new statutes or amended their takeover statutes in an attempt to survive constitutional attack.48 The legislators attempted to distinguish their statutes from the Illinois statute and established a greater state interest by using the state of incorporation test, requiring some assets, offices, and shareholders in the state, and providing a regulatory format that was enabling and similar to other corporate governance statutes.

State statutes that affect the tender offer process can be described as the second-generation takeover statutes. They include the shareholder approval, second-tier, share redemption, fiduciary

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46. Edgar, 457 U.S. at 639-40. Although fairness considerations have long been a part of blue sky regulations, those statutes generally apply only to shareholders in the particular state. See id. at 641; T. HAZEN, THE LAW OF SECURITIES REGULATION 221-22 (1985).


48. See generally Profusek & Gompf, State Takeover Legislation After MITE: Standing Pat, Blue Sky, or Corporation Law Concepts?, 7 CORP. L. REV. 3 (1984) (after Edgar v. MITE Corp., states can adopt three basic approaches to tender offer regulation: attempt to continue enforcing existing law, adopt laws predicated on a blue sky jurisdictional model, or adopt laws predicated on a corporate law jurisdictional model); Warren, supra note 16.
duty, and full-disclosure models. Those statutes that allow the completion of the tender offer but severely limit the offeror’s rights in the corporation can be described as third-generation takeover statutes. They include the voting rights and business combination models.

In order to avoid the reach of the Edgar opinion, the second- and third-generation statutes required that the corporation be incorporated in the state. They also required some resident shareholders and the location of the principal executive offices or significant assets in the state. Often the legislation permitted corporations to either opt out of or opt into the statutory requirements and did not involve the state’s administrative authority at all. Recently, state legislatures have enacted some of these statutory models to apply to foreign corporations that have a significant number of assets and shareholders in the state. This new generation of statutes can be described as the fourth generation of statutes.

1. The Second-Generation Statutes

First enacted in Ohio, the shareholder approval model requires a vote of the disinterested shareholders to approve the acquisition of shares at specific thresholds. This type of statute treats the tender offer like any other corporate acquisition that ordinarily requires a shareholder vote.


50. These requirements apparently are attempts to create a stronger nexus to a state to justify the burdens imposed by the regulation. In addition, the regulation may purport to take precedence over a conflicting statutory provisions in another state. See infra text accompanying notes 240-260.

51. The full-disclosure model, however, often involves a state agency in enforcing the statutes and promulgating rules. E.g., N.Y. BUS. CORP. LAW §§ 1600-13 (McKinney 1986). See infra text accompanying notes 62-63.

52. OHIO REV. CODE ANN. § 1701.831 (Anderson 1985). The Ohio Takeover Act applies to corporations incorporated in Ohio when the corporation has 50 or more resident shareholders and its principal place of business, principal executive offices, or substantial assets are located in Ohio. Id. § 1701.01(Y). The act established three thresholds for shareholder voting on acquisitions of one-fifth to less than one-third of the voting power, one-third to less than a majority, or a majority or more. Id. § 1701.01(Z)(1).

The second-tier model is concerned with the effect of a front-loaded two-tier tender offer on the target's shareholders. Such an offer involves a tender offer for a sufficient number of shares to gain control of the corporation at a higher price than will be offered to the shareholders in a follow-up freezeout transaction. This freezeout transaction often involves a merger with the controlling shareholders acquiring complete control of the corporation and the remaining minority shareholders receiving cash. The strategy has been criticized for being coercive because it forces shareholders to tender for the higher price in the tender offer to minimize the impact of the lower priced freezeout transaction. The second-tier model assures the shareholders of either a disinterested supermajority vote on the freezeout transaction or a fair price after the tender offer when the offeror, now in control of the corporation, proposes to freeze out the remaining shareholders.

The share redemption model requires any shareholder who acquires a certain percentage of stock to buy out the remaining shareholders at "fair value." This model avoids the problem of
two-tier front-loaded takeovers and provides an equal opportunity for all shareholders to receive a fair price.\textsuperscript{58}

The fiduciary duty model expands the concept of fiduciary duty to include consideration of interests other than those of shareholders when the corporate directors are acting.\textsuperscript{59} This model may limit successful actions against directors who employ defensive tactics to thwart a tender offer.\textsuperscript{60} In some cases the statute specifically condones directors looking out for the long-term as opposed to short-term interests of the corporations.\textsuperscript{61}

The full-disclosure model requires that information in addition to that required by the Williams Act be given to the shareholders of a specific state,\textsuperscript{62} including information about the tender offer's impact on that state. These statutes are similar to the states' blue

\textsuperscript{58} A similar rule is provided in Great Britain to protect investors in takeovers. After the offering corporation acquires 30\%, the other shareholders are entitled to equal opportunity. DeMott, \textit{Current Issues in Tender Offer Regulation: Lessons From the British}, 58 N.Y.U. L. Rev. 945, 960 (1983).

\textsuperscript{59} See, e.g., \textit{42 PA. CONS. STAT. ANN. § 8363(b)} (Purdon Supp. 1987). The statute provides:

In discharging the duties of their respective positions, the board of directors, committees of the board, and individual directors may, in considering the best interests of the corporation, consider the effects of any action upon employees, upon suppliers and customers of the corporation and upon communities in which offices or other establishments of the corporation are located, and all other pertinent factors.

\textit{Id.}

\textsuperscript{60} See, e.g., \textit{OHIO REV. CODE ANN. § 1701.59(C)} (Anderson 1986), which provides that proof of breach of the duty of care requires a showing of clear and convincing evidence. In addition the director will be liable for damages only if there was a deliberate intent to cause injury or a reckless disregard for the best interests of the corporation. \textit{Id.} \textsuperscript{61}§ 1701.59(D). A considerable amount of legislation has been enacted to deal generally with the potential liability of outside directors for breaches of fiduciary duty that have an effect on tender offers but were not designed solely to deal with that issue. \textit{See infra} note 176.

\textsuperscript{61} See, e.g., \textit{OHIO REV. CODE ANN. § 1701.59(E)(4)}.

\textsuperscript{62} See, e.g., \textit{N.Y. BUS. CORP. LAW § 1600-13} (McKinney 1986); 1984 Minn. Sess. Law Serv. 448 (West). The New York statute provides in part:

\begin{itemize}
\item (c) "Offeror" means the beneficial owner, residing in this state, of securities which an offeror acquires or offers to acquire in connection with a takeover bid.
\item (d) "Target company" means a corporation, organized under the laws of this state and having its principal executive offices or significant business operations located within this state.
\end{itemize}

\textit{N.Y. BUS. CORP. LAW § 1601(c)-(d)}.
sky regulations because a failure to comply usually precludes the tender offer only in that particular state. \(^{63}\)

**2. The Third-Generation Statutes**

The third-generation statutes allow an offeror to tender for as many shares as he chooses, but severely restrict the use of the acquired shares. For example, the voting rights model requires the affirmative vote of the disinterested shareholders before shareholders who acquire a certain percentage of stock can have voting rights in the additional shares. \(^{64}\) The idea is to allow the shareholders to act collectively by voting to ensure a fair tender offer. \(^{65}\)

The business combination model requires a shareholder to seek board approval for the acquisition of additional shares over a specific threshold or for proposed business combinations with the shareholder. \(^{66}\) Failure to receive board approval prevents the shareholder from completing those business combinations for as long as five years even if the shareholder acquires control. \(^{67}\) Because the term "business combination" is defined broadly, \(^{68}\) this restriction effectively limits the use of the assets by the shareholder to finance or leverage the acquisition or to freeze out the minority shareholders in a second-tier acquisition and take com-

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63. An offeror seeking to continue its tender offer in another state may avoid the SEC's all-holders rule, thus allowing an offeror to avoid making an offer in a state in which it has been barred from making an offer due to administrative or judicial action, so long as the underlying statute is constitutional. *Amendments to Tender Offer Rules—All-Holders and Best Price*, Fed. Sec. L. Rep. (CCH) ¶ 94,016 (July 11, 1986).

64. See, e.g., Ind. Code § 23-1-42-1 to -11 (Supp. 1986). The Indiana statute requires a shareholder vote to vest voting rights at three thresholds of ownership: 20%, 33\(\frac{1}{3}\)%, and 50%. Id. § 23-1-42-1. The Supreme Court held this statute constitutional in *CTS Corp.*

65. See, e.g., N.Y. Bus. Corp. Law § 912(b) (McKinney 1986). In New York, an interested shareholder is one who owns 20% of the voting stock. Id. § 912(a)(10).

66. See, e.g., id. § 912(b).

67. Id.

68. Under New York law, the definition of a business combination includes mergers and consolidations, sales or dispositions of assets having a value equal to 10% or more of the aggregate market value of all assets, liquidations and recapitalizations, issuance or transfer to an interested shareholder by the resident domestic corporation of any stock having a market value of 5% or more of the aggregate market value of all the outstanding stock of the corporation, a reclassification of the securities or any other transaction that results in an increase in the interested shareholders' proportionate share of outstanding shares, and any receipt by the interested shareholders of loans, tax credits, or other financial assistance from the resident domestic corporation. Id. § 912(a)(5).
plete control of the corporation. This model places significant power in the board to deal with tender offers and is probably the most effective statutory defensive tactic available to incumbent management. The model encourages offerors to either deal with the board or try to replace the board in a proxy fight prior to acquiring the requisite percentage of stock.

The voting rights and business combination models both permit the offeror to buy as many shares as possible through the tender offer but effectively restrict the use of those shares. The business combination model focuses on the role of the board, whereas the voting rights model looks to the independent shareholders.

3. The Fourth-Generation Statutes

In response to possible hostile takeovers of significant corporations in their state, several states have adopted various statutory models that can be described as fourth-generation takeover statutes because they apply to corporations that are not incorporated in the state. These statutes generally require a substantial nexus between the foreign corporation and the state. The nexus requirement often includes principal place of business or executive offices in the state, a substantial number of assets, and shareholders and employees in the state. This legislation was enacted when large

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70. If permitted under state law, a proxy fight could be avoided by seeking the written consent of a majority of the directors to take action that would pressure the board, such as the reduction of the size of the board. See Carnevale & Lee, Black & Decker Move Escalates Takeover Battle, Wall St. J., Feb. 11, 1988, at 4. If an offeror purchases more than the requisite percentage of shares without board approval, then even after replacing the board the offeror is restricted for five years unless a majority of the disinterested shareholders agree to opt out of the statute by amending the bylaws. E.g., N.Y. Bus. Corp. Law § 912(b). Even that amendment may not be immediately effective; for example, in New York it would not be effective until 18 months after approval. Id. § 912(d)(3)(iii).

71. For example, Massachusetts’s statute is a voting rights model that requires the approval of the shareholders before an acquiror who has passed the 20%, 33%, and 50% ownership thresholds can exercise voting rights. See Massachusetts Adopts Broad Anti-Takeover Law, 19 Sec. Reg. & L. Rep. (BNA) No. 30, at 1099 (July 24, 1987). The new law applies to a corporation that has its executive offices in Massachusetts, has more employees or capital assets in Massachusetts than in any other state, and has either more than 10% of its shareholders residing in Massachusetts or more than 10% of its shares owned by Massachusetts residents. Id.
corporations in these states which were incorporated in Delaware were subject to potential hostile takeovers.\textsuperscript{22}

4. Delaware’s Statute

Delaware’s recently enacted takeover statute is a version of the business combination model. The statute applies to corporations

North Carolina’s statute follows the fair-price model. It requires the approval of 95\% of the shares to authorize certain business combinations unless the fair-price provisions are met. \textit{See North Carolina Legislature Responds to Attempted Takeover of Burlington}, 19 Sec. Reg. & L. Rep. (BNA) No. 23, at 829 (June 5, 1987). The new statute applies to a foreign corporation if it has its principal place of business and more than 40\% of its fixed assets in North Carolina, if more than 10\% of its shares are owned by North Carolina residents, and if more than 40\% of its shareholders are North Carolina residents. \textit{Id.}

Arizona’s statute is a variation of the voting rights model with certain elements of the business combination model. \textit{See Arizona Antitakeover Bill Signed During Special Session}, 19 Sec. Reg. & L. Rep. (BNA) No. 31, at 1138 (July 31, 1987). Except in the election of directors or managers, the acquiror cannot vote its shares without prior approval of the disinterested shareholders. \textit{Id.} The statute also precludes the acquiror from selling the corporation’s assets to liquidate takeover debts for three years. \textit{Id.} In addition to applying to corporations that are incorporated in Arizona, the statute applies to a company incorporated under the laws of another state if it has at least 50 shareholders, its principal place of business or principal executive offices are in Arizona, it has assets of $1 million or more in Arizona, and it has more than 500 employees who are Arizona residents. \textit{Id.}

The Minnesota takeover statute provides elements of both the business combination model and the voting rights model. \textit{See Minnesota Adopts Anti-Takeover Law After Special Legislative Session}, 19 Sec. Reg. & L. Rep. (BNA) No. 27, at 987 (July 3, 1987). When a party acquires more than 20\% of a target’s shares, it cannot vote those shares without the approval of a majority of the disinterested shareholders. \textit{Id.} In addition, the law prevents an acquiror from selling any corporate assets for a period of five years unless the outside directors give their approval.

Washington used the business combination model to bar a party who has acquired 10\% or more of the target’s stock from effecting certain business transactions for five years without prior board approval. \textit{See New Washington Takeover Law Aimed at Protecting Boeing from Pickens Raid}, 19 Sec. Reg. & L. Rep. (BNA) No. 33, at 1266 (Aug. 14, 1987) [hereinafter \textit{Washington Takeover Law}]. The new statute protects a target incorporated in another state if its primary offices are in Washington, it has more property in Washington than elsewhere, the majority of its employees are Washington residents, the majority of its assets are in Washington, and it employs more than 20,000 Washington residents. \textit{Id.}

\textsuperscript{22} The Court’s commerce clause analysis in \textit{CTS Corp.} raises significant questions regarding whether these states can constitutionally regulate such corporations. \textit{See CTS Corp. 107 S. Ct. at 1649.} Notably, at the time the various states had acted, Delaware had not enacted its takeover statute. Now that Delaware has such a statute, its interplay with the fourth-generation statutes raises a problem of inconsistent regulation. \textit{See infra} text accompanying notes 240-260.
incorporated in Delaware. The law requires an offeror, before acquiring fifteen percent of a target's voting stock, to either receive board approval for the purchase or for future business combinations with the offeror or purchase at least eighty-five percent of the target's stock—including stock owned by inside directors and certain employee stock option plans—in the same transaction in which it exceeded fifteen percent. After acquiring the fifteen percent, the offeror can obtain approval for the business combination with a vote by the board and two-thirds of the disinterested stockholders. Failure to meet these requirements restricts the offeror from effectuating a business combination with the target for up to three years. The resulting statute reflects some compromise and

73. The use of only the state of incorporation as the nexus differs from other models, which require that the corporation have assets, shareholders, and principal place of business in the state. From a practical standpoint, Delaware could use only the state of incorporation as the nexus because few of the publicly held corporations incorporated there could meet any of the other tests. An estimated 179,000 companies are incorporated in Delaware, including 56% of the Fortune 500 companies and 45% of the companies listed on the New York Stock Exchange. Fees and taxes generated by these incorporations yield an estimated $156 million, which is 16% of the state's revenue. Barrett, Delaware Moves Closer to Adopting Law to Deter Hostile Takeovers, Wall St. J., Dec. 9, 1987, at 41, col. 4.

74. Del. Code Ann. tit. 8, § 203(a) (Supp. 1988). The 85% provision is similar to the stock redemption model except that it does not require the purchase of the stock. Its intent is to encourage offerors to avoid two-tier tender offers and thus to provide equal opportunity for all shareholders. Only those stock option plans in which the employee participants do not have the right to determine confidentially whether to tender are excluded. Id. § 203(a)(2)(ii). The shares of the inside directors and employee stock plans that are not included in the calculation of the 85% are allowed to vote on the proposed business combination. Id.

75. Id. Delaware's enactment of this statute generated substantial controversy. See Hays, Delaware Effort to Draft Takeover Law Stirs a Debate, Disturbs SEC Members, Wall St. J., Dec. 14, 1987, at 11. Compare D. Bandow, Curbing Raiders is Bad for Business, N.Y. Times, Feb. 17, 1988, at F2 (arguing that the statute helps management and hurts shareholders and the economy) with Veasey, A Statute Was Needed to Stop Abuses, N.Y. Times, Feb. 17, 1988, at F2 (arguing that Delaware took a moderate view to protect shareholders from takeover abuses). However, corporations incorporated in Delaware threatened to incorporate elsewhere unless the legislature afforded them protection. Interestingly, legal scholars have long debated whether state corporate law protects investors. Those on both sides of the debate recognize that states compete for incorporations, creating a market for corporate charters, but disagree about whether the market protects shareholders. Compare Cary, Federalism and Corporate Law: Reflections Upon Delaware, 83 Yale L.J. 663 (1974), with Fischel, The “Race to the Bottom” Revisited: Reflections on Recent Developments in Delaware’s Corporation Law, 76 Nw. U.L. Rev. 913 (1982). Critics of the market for charters view it as a race for the bottom because states will sacrifice shareholder protection for a pro-management bias to attract incorporations and their revenue. State law is a form of eco-
change from the initial proposal and differs substantially from New York’s statute, which first enacted the business combination model.\textsuperscript{76} New York’s version restricts mergers for five years if the board fails to approve the purchase of twenty percent of the stock or a business combination with that purchaser.\textsuperscript{77} A corporation can avoid the Delaware statute if a tender for eighty-five percent of the stock is successful or the tender receives subsequent board and supermajority approval of the business combination. New York has no similar provision and therefore has fewer restrictions on the power of the board. In New York, once a party has acquired twenty percent and has failed to receive board approval, the only way to effectuate a business combination with the purchaser before the five-year restriction is through a bylaw amendment approved nomic protectionism because it protects the state’s interest in attracting and keeping corporations from incorporating elsewhere. Cary, \textit{supra}.

Others view the competition in the market for corporate charters as a healthy development for shareholders. They argue that management generally will seek out those states that are beneficial to shareholders; otherwise the value of the shares of those corporations will be reduced if management is not maximizing the firm’s value. The reduced value of shares increases the corporation’s cost of capital, which places the corporation at a cost disadvantage in the market for its products. A failure to manage in the shareholders’ interests also affects the managers by reducing the value of their services in the market for managers. If the value of the shares is reduced, the market for corporate control will also serve to protect shareholder interests by encouraging the corporation to replace management and reincorporate in another state whose law benefits shareholders. The market for corporate charters thus encourages states to enact laws that are beneficial to shareholders. Under the market for corporate charters thesis, state takeover statutes must be beneficial to shareholders because states are competing to enact laws that enhance shareholders’ wealth. If the statutes adversely affect the value of the corporation’s shares, the markets for products and managers will require reincorporation and states will compete by eliminating laws that deter takeovers. R. Winter, \textit{Government and the Corporation} (1978). See also Fischel, \textit{supra}. See generally Romano, \textit{Law as a Product: Some Pieces of the Incorporation Puzzle}, 1 J.L. Econ. \\& Org. 225 (1985); Romano, \textit{The State Competition Debate in Corporate Law}, 8 Cardozo L. Rev. 709 (1987) [hereinafter Romano, \textit{The State Competition Debate}]. The choice of reincorporation thus remains as a means to opt out of those statutes that harm shareholders.

\textsuperscript{76} The original proposal dealt with a 10% purchaser and required a tender of 90% of the stock to avoid the statute’s requirements. Block \\& Hoff, \textit{Delaware’s Proposed Takeover Statute}, N.Y.L.J., Dec. 17, 1987, at 5. After the CTS Corp. decision, Delaware considered enacting a version of the voting rights model held constitutional by the Supreme Court. The Council of the Corporate Law Section of the Delaware State Bar Association decided against that model because it could make takeovers easier by allowing an offer to go directly to the shareholders for their vote without any role for the board of directors. Goldman, \textit{Delaware Anti-Takeover Legislation Is Needed}, Nat’l L.J., Feb. 8, 1988, at 31, 34.

\textsuperscript{77} N.Y. Bus. Corp. Law § 912(b) (McKinney 1986).
by a majority of the disinterested shareholders. Such an amendment does not take effect until eighteen months after approval.78

III. CTS CORP. V. DYNAMICS CORP. OF AMERICA

In CTS Corp. v. Dynamics Corp. of America, the Supreme Court decided that Indiana’s Control Share Acquisition Chapter,79 which follows the voting rights model, was constitutional.80 A corporation that is subject to the Indiana statute must be incorporated in Indiana, must have a significant number of Indiana shareholders, and must have substantial assets or its principal place of business or office in Indiana.81 Under the statute, once a shareholder acquires a certain percentage of a corporation’s shares, he may be denied voting rights on the additional shares acquired unless the disinterested shareholders approve the purchase.82 The shareholder vote must take place within fifty days of the commencement of the offer.83 If the disinterested shareholders fail to approve the purchase and restore voting rights, the corporation may redeem the shares.84 A corporation can opt out of the statute by a shareholder vote to amend the articles of incorporation or bylaws.85 In effect, a shareholder vote is required before any takeover of a corporation subject to the Indiana statute can occur.

A. The Circuit Court Decision

The United States Court of Appeals for the Seventh Circuit, in an opinion written by Judge Posner, found that the Indiana statute was preempted by the Williams Act and was unconstitutional.
under the commerce clause.\textsuperscript{86} On the preemption issue, the court followed the reasoning of Justice White's plurality opinion in \textit{Edgar} and most of the other cases decided after \textit{Edgar} that the Williams Act was intended to strike a balance between management and the hostile offeror.\textsuperscript{87} The delays for the offeror created by the Indiana statute, which in practice extended the time frame provided by the Williams Act for a tender offer from approximately one month to Indiana's maximum of fifty days, upset this balance.\textsuperscript{88}

The court's commerce clause analysis focused on the fact that the harm to nonresidents from restriction of hostile takeovers outweighed the benefits to Indiana residents.\textsuperscript{89} According to the court,

\begin{quotation}
Even if a corporation's tangible assets are immovable, the efficiency with which they are employed and the proportions in which the earnings they generate are divided between management and shareholders depends on the market for corporate control—an interstate, indeed international market that the State of Indiana is not authorized to opt out of, as in effect it has done in this statute.\textsuperscript{90}
\end{quotation}

Although the court recognized the importance of the internal affairs doctrine, it nevertheless held that corporate law affecting the market for corporate control in a "direct, intended, and substantial" manner would be subject to review under the commerce clause.\textsuperscript{91}

\textbf{B. The Supreme Court's Preemption Analysis}

The Supreme Court reversed the Seventh Circuit decision and upheld the Indiana statute.\textsuperscript{92} Recognizing that the plurality opinion in \textit{Edgar} was not binding because it did not "represent the views of a majority," Justice Powell, writing for the majority, saw

\textsuperscript{86} Dynamics Corp. of Am. v. CTS Corp., 794 F.2d 250 (7th Cir. 1986), \textit{rev'd}, 107 S. Ct. 1637 (1987).
\textsuperscript{87} Id. at 262-63.
\textsuperscript{88} Id.
\textsuperscript{89} Id. at 264.
\textsuperscript{90} Id. at 264.
\textsuperscript{91} Id.
\textsuperscript{92} CTS Corp., 107 S. Ct. 1637.
no need to question the reasoning in Edgar because the Court believed that "the Indiana Act passes muster even under the broad interpretation of the Williams Act articulated by Justice White in [Edgar v. MITE]."93 The Court held that the Indiana statute in fact furthered the goals of the Williams Act by protecting the shareholders against both management and the offeror.94 Because the Indiana statute permits the independent shareholders to vote as a group, it helps avoid the coercive aspects of some tender offers, particularly front-loaded two-tier tender offers.95 The Court viewed the Indiana legislation, unlike the provisions in the Illinois statute, as furthering the federal policy of investor protection.96

The Court also focused on the practical problem of delay. Although the Indiana statute did not preclude an offeror from making a tender offer, the offeror normally would seek shareholder approval in order to have voting rights in the acquired shares. According to the circuit court, the Indiana statute prevented the tender offer itself from taking place within the time frames established by the Williams Act or its rules.97

The Supreme Court, on the other hand, did not find such a conflict between the timing requirements of the Williams Act and the Indiana requirement of a shareholder vote within fifty days of the commencement of the offer. That period is within the sixty-day maximum for tender offers dictated by Congress,98 and an offeror would not be precluded from purchasing the shares within the minimum twenty-business-day period provided by the rules of the Securities and Exchange Commission.99 If the shareholders disapproved of the acquisition and denied voting rights, then, according to the Court, a conditional offer would be possible.100 The Court in

93. Id. at 1645.
94. Id.
95. See supra text accompanying notes 54-55. The use of front-loaded two-tier tender offers has lessened over the last several years and now appears to be more of a management device in transactions to go private than an offeror's tactic. Grundfest, Proxmire's Double-talk on Takeovers, Wall St. J., Sept. 16, 1987, at 34, col. 3.
96. CTS Corp., 107 S. Ct. at 1645-46.
99. CTS Corp., 107 S. Ct. at 1647 (citing 17 C.F.R. § 240.14e-1(a) (1986)).
100. Id.
CTS Corp. discussed the concern of the plurality in Edgar that unreasonable delays caused by state regulation would conflict with the Williams Act.\textsuperscript{102} In CTS Corp. the Court did not find such a delay.\textsuperscript{102} The Court indicated that as long as the delay was within the sixty-day maximum provided by Congress, the Court would not find such a delay unreasonable.\textsuperscript{103}

Justice Scalia in his concurring opinion relied on the specific grant of authority given the states in section 28 of the Securities and Exchange Act to find no preemption.\textsuperscript{104} He believed that this legislative grant precluded any argument of preemption based on conflicting purposes between state and federal law.\textsuperscript{105} He emphasized the state's "sacrosanct authority over the structure of domestic corporations" and the traditional state function of prescribing voting rights.\textsuperscript{106} In his dissent, Justice White viewed the Indiana statute as harmful to investors making individual investment decisions, the primary area of protection of the Williams Act.\textsuperscript{107} He distinguished other state corporate law affecting takeovers by describing the Indiana statute as a law designed by its practical effect to prevent tender offers.\textsuperscript{108}

C. The Supreme Court's Commerce Clause Analysis

The majority opinion also found the Indiana statute constitutional under the commerce clause.\textsuperscript{109} According to the Court, the statute did not discriminate against interstate commerce because its impact was felt equally by resident and nonresident offerors.\textsuperscript{110} The fact that most offerors likely would be nonresidents was irrelevant because of the even-handed approach of the legislation. The Court also found that the Indiana statute did not create inconsistent regulation that could result in invalidation under the com-

\textsuperscript{101} The Court in CTS Corp. viewed the plurality in Edgar as being concerned with "unreasonable delays." \textit{Id.} (adding emphasis to Edgar, 457 U.S. at 639).

\textsuperscript{102} \textit{Id.}

\textsuperscript{103} \textit{Id.}

\textsuperscript{104} \textit{Id.} at 1653 (Scalia, J., concurring) (citing 15 U.S.C. § 7866(a) (1982)).

\textsuperscript{105} \textit{Id.}

\textsuperscript{106} \textit{Id.}

\textsuperscript{107} \textit{Id.} at 1654 (White, J., dissenting).

\textsuperscript{108} \textit{Id.} at 1655.

\textsuperscript{109} \textit{Id.} at 1652.

\textsuperscript{110} \textit{Id.} at 1648-49.
merce clause because voting rights generally are prescribed by the state of incorporation.\textsuperscript{111}

The main thrust of the Court's opinion focused on whether the Indiana statute impermissibly hindered tender offers. In finding the statute constitutional, the Court discussed the significance of state regulation of corporate governance and pointed out that the market for corporate securities is dependent on corporations created and organized under state corporate law.\textsuperscript{112} As the Court indicated:

\begin{quote}
It thus is an accepted part of the business landscape in this country for States to create corporations, to prescribe their powers, and to define the rights that are acquired by purchasing their shares. A State has an interest in promoting stable relationships among parties involved in the corporations it charters, as well as ensuring that investors in such corporations have an effective voice in corporate affairs.\textsuperscript{113}
\end{quote}

The Court concluded that the Indiana statute reflected these concerns by providing for a shareholder vote that permitted the shareholders to act collectively on a possible change in management and to protect themselves from coercive tender offers.\textsuperscript{114} Because the concerns of the Indiana legislature were not groundless, the Court would not "second-guess the empirical judgments of lawmakers concerning the utility of legislation."\textsuperscript{115} In addition, the Court appeared to retreat from its wholesale adoption of the benefits of the market for corporate control in \textit{Edgar} to a more balanced view that the Constitution "does not require the States to subscribe to any particular economic theory."\textsuperscript{116} Although the statute would limit some tender offers, it was not unconstitutional because it did not prohibit the offer itself, the actual purchase of shares, or the acquisition of control. According to the Court, the shares and the corporation are creations of the state and the state does not need to regulate these creations in the same manner as

\begin{itemize}
\item \textsuperscript{111} \textit{Id.} at 1649 (citing \textit{Restatement (Second) of the Conflict of Laws} § 304 (1969)).
\item \textsuperscript{112} \textit{Id.} at 1650-52.
\item \textsuperscript{113} \textit{Id.} at 1650-51.
\item \textsuperscript{114} \textit{See id.} at 1651.
\item \textsuperscript{115} \textit{Id.} at 1651.
\item \textsuperscript{116} \textit{Id.}
\end{itemize}
other states as long as both residents and nonresidents have equal access to the shares and the corporations.\textsuperscript{117}

The Court also limited the broad statement in \textit{Edgar} that a state had "no legitimate interest in protecting nonresident shareholders."\textsuperscript{118} That statement may hold true for the Illinois statute that applied to nonresident corporations, but Indiana had an interest in protecting all shareholders of Indiana corporations. In addition, the Court pointed out that the Indiana statute applied only to corporations with substantial numbers of Indiana resident shareholders.\textsuperscript{119}

In his concurrence, Justice Scalia abandoned the balancing test and limited the Court’s inquiry in dormant commerce clause cases to issues of discrimination against out-of-state interests or the creation of inconsistent regulation. According to Justice Scalia, whether the Indiana statute protected management or shareholders should not have supplied the basis for a constitutional question because such a judgment and the attendant balancing should have been left to Congress, not the courts. He pointed out that “a law can be both economic folly and constitutional.”\textsuperscript{120}

Justice White, joined by Justices Blackmun and Stevens, dissented on commerce clause grounds. He looked at the practical effect of the legislation and found that it would restrict the transfer of shares in an interstate market. According to White, this was exactly what the commerce clause was designed to prevent states from doing.\textsuperscript{121}

\section*{IV. Future Implications}

The decision in \textit{CTS Corp.} raises the issue of the extent of the constitutional limitations on the role of the states in the regulation of the market for corporate control. Two major themes in the \textit{CTS Corp.} opinion leave the decision’s effect on the remaining statutory models uncertain.\textsuperscript{122} One theme found in the Court’s preemption

\begin{enumerate}
\item Id. at 1652.
\item \textit{Edgar}, 457 U.S. at 644. \textit{See CTS Corp.}, 107 S. Ct. at 1651, for limiting language.
\item \textit{CTS Corp.}, 107 S. Ct. at 1652 (citing \textit{Ind. Code} § 23-1-42-4(a)(3) (Supp. 1986)).
\item Id. at 1653 (Scalia, J., concurring).
\item Id. at 1656 (White, J., dissenting).
\end{enumerate}
and commerce clause analysis is that the state in which the corporation is incorporated can play a role in protecting investors in the tender offer context without offending the constitution on preemption or interstate commerce grounds. Another theme expressed in the Court's analysis, particularly in the commerce clause discussion, is the great emphasis placed on a state's power to enact corporate laws governing resident corporations even though those laws could interfere with tender offers and interstate commerce. These two themes may in fact conflict if some state corporate law is found to be unprotective of investors or is designed to protect other corporate interests such as those of employees. In addition, a situation may arise in which a state other than the state of incorporation attempts to protect investors or other interests.

The themes expressed in the *CTS Corp.* opinion fail to resolve some basic questions raised by the various state statutory models. What constitutes investor protection and what other interests can the state protect through corporate law without being preempted or impermissibly burdening interstate commerce? To what extent will delays of tender offers conflict with federal policy? How necessary is it for the shareholders to have a role in the state regulation? Is the state of incorporation the only state that has a role to play in corporate governance; that is, can states regulate the internal affairs of foreign corporations? Is the act of incorporation merely a private activity that should not be scrutinized under the commerce clause? These are the questions this Article addresses.

A. Preemption

1. Investor Protection

All the statutory models should withstand attack on preemption grounds because these models do not interfere with the notion of investor protection provided by the Williams Act. The protection of investors was a significant factor in the Court's analysis of whether the Indiana statute was preempted under the Williams Act. Because the Court found that the Indiana statute protected investors, it reasoned that the statute was consistent with the purpose of the Williams Act. Significantly, the majority opinion did not accept or reject the plurality view in *Edgar* that the Williams Act was designed by Congress to protect investors through a policy
of neutrality between the hostile offeror and incumbent management. A majority of the Court believed that the Indiana statute was consistent with that view. That same neutrality policy has been advanced successfully in many of the challenges to state takeover statutes after Edgar.

The Court also did not accept or reject Justice Stevens' view, expressed in his concurrence in Edgar, that the concept of neutrality in the legislative history of the Williams Act applied only to the Williams Act and was not aimed at state law. Nor did the court accept or reject Justice Scalia's view that section 28 of the Securities and Exchange Act was indicative of Congressional intent to permit most state regulation. Although ultimately it is not clear which approach the Court will take, the thrust of the opinion emphasized investor protection. This leaves open a challenge to state takeover statutes on preemption grounds if the statutes fail to protect investors.

The issue of investor protection is complex and raises fundamental questions of corporate law that continue to be debated. It involves significant policy questions about the role of the corporation

123. Edgar v. MITE Corp., 457 U.S. 624, 632-34 (1982). In Piper v. Chris-Craft Indus., 430 U.S. 1 (1977), the Supreme Court stated that “[n]eutrality is, rather, but one characteristic of legislation directed toward a different purpose—the protection of investors.” Although the unanimous opinion of the Court in Schreiber v. Burlington Northern Inc., 472 U.S. 1 (1985), again emphasized neutrality, it did so in interpreting the Williams Act, not in questioning whether states have a role to play in tender offers. In a recent decision holding a precommencement requirement of the Massachusetts Take-Over Bid Regulation Act to be preempted by the Williams Act, the United States Court of Appeals for the First Circuit indicated that a court should identify the “principal result” of a statute to see if it significantly alters the balance between management and the offeror, but that the “focus should remain on determining whether the disclosure provisions are beneficial to the investors caught between management and offerors.” Hyde Park Partners, L.P. v. Connolly, 839 F.2d 837, 850 (1st Cir. 1988).


125. Edgar, 457 U.S. at 655 (Stevens, J., concurring). “I am not persuaded, however, that Congress’ decision to follow a policy of neutrality in its own legislation is tantamount to a federal prohibition against state legislation designed to provide special protection for incumbent management.” Id.

126. CTS Corp., 107 S. Ct. at 1653 (Scalia, J., concurring).
in society and the responsibility of directors in public corporations when the owners of the corporation are divorced from control. These questions become particularly pertinent in the tender offer context, in which the impact of such offers on society, the corporate constituencies, and the shareholders remains controversial. These controversial policy questions should not be resolved in federal courts using a preemption analysis. The Williams Act was not enacted specifically to resolve these questions or adopt any particular theory regarding corporations but rather to protect investors in a manner consistent with federal securities law. Investor protection under federal securities law traditionally has focused on full disclosure. Generally, state law has determined the substantive rights of investors. This tradition was continued in the Williams Act through the tender offer procedural rules. These rules were designed to facilitate the receipt and use of information

127. Professor Clark describes the five major clusters of views concerning the corporation's proper role in society in terms of the major strands of philosophical thought: dualism, monism, modest idealism, high idealism, and pragmatism. R. CLARK, supra note 9, at 677. Dualism regards the private and public spheres as having functions that ought to be kept distinct. Id. at 677-78. Monism views many public and private interests as complementary in the long run. Id. at 681. Modest idealism holds that corporations should voluntarily comply with applicable laws. Id. at 684. High idealism holds that corporations ought to pursue residual goals, such as achieving accommodation with interest groups or furthering the public interest. Id. at 688. Pragmatism holds that corporations should seize opportunities to perform public services on a profit-making basis. Id. at 694.


129. See Coffee, supra note 27. Congress has held several hearings on these issues during the last year. See, e.g., Supreme Court Decision on Indiana Law Remains Prime Topic at Takeover Hearings, 19 Sec. Reg. & L. Rep. (BNA) No. 28, at 1011 (July 10, 1987).

130. No evidence indicates that Congress adopted the market for corporate control in enacting the Williams Act. To the contrary, advocates of that market believed that the Williams Act impinges on it and should be repealed. E.g., Manne, Cash Tender Offers for Shares—A Reply to Chairman Cohen, 1967 DUKE L.J. 231. The notion of neutrality in the legislative history of the Williams Act cannot mean neutralizing state corporate law, because although Congress may not have been aware of state takeover statutes in 1968, it was aware of other state law provisions that could affect takeovers. See infra note 156.

131. See T. HAZEN, supra note 46, at 492-95.

in order to promote informed decisions.\textsuperscript{133} State law that interferes with this policy would be preempted. The Court in \textit{CTS Corp.}, however, did not limit its inquiry to whether the shareholders received and used information; instead, it analyzed investor protection in terms of the Indiana statute facilitating shareholder decisionmaking. Specifically, the Court evaluated whether the statute provided the shareholders the means for a collective response to coercive tactics.\textsuperscript{134} Presumably, the courts will continue to analyze the statutory models according to whether these statutes protect shareholders by facilitating their individual or collective decisions.\textsuperscript{135} When a state statute such as the Indiana statute either facilitates or at least does not significantly interfere with the shareholders’ decision, it probably will not be preempted even though the statute’s effect interferes with the tender offer and may preclude an economically beneficial transaction.\textsuperscript{136}

Although facilitation of investor decisionmaking is a significant aspect of the Williams Act, it does not follow that a state corporate law which does not facilitate such decisionmaking will necessarily be preempted. If the Court ultimately adopts the neutrality argument it avoided in \textit{CTS Corp.}, then those statutes that limit the shareholders’ role probably will be preempted. Accepting the broad implications of the neutrality policy, however, will undermine the Court’s concern for state corporate law. Thus, so long as the state

\begin{flushright}

134. \textit{CTS Corp.}, 107 S. Ct. at 1646. The need for collective action resulted from the coercive aspects of front-loaded two-tier tender offers. Thus the statute was similar to the Williams Act in allowing for protection of the investors’ response to avoid the pressure of trying to gain the higher amount offered in the first tier.

135. \textit{Id.} Justice White’s dissent indicated that the Williams Act was designed to protect individual shareholder autonomy as opposed to shareholders as a group, a position rejected by the majority. \textit{Id.} at 1654 (White, J., dissenting).

136. Significantly, the Court in \textit{CTS Corp.} viewed the Indiana statute as protective of investors because it allowed them to avoid the coercive aspects of two-tier tender offers. Under the view of some commentators, such offers are not necessarily contrary to shareholders interests if the amount offered in both of the tiers at least equals the market price of the stock prior to the tender offer. Easterbrook & Fischel, \textit{Corporate Control Transactions}, 91 YALE L.J. 698 (1982). These authors advocate an approach to corporate control transactions that posits that “those who produce a gain should be allowed to keep it, subject to the constraint that [the] other parties to the transaction be at least as well off as before the transaction.” \textit{Id.} at 698.
\end{flushright}
law does not significantly interfere with the tender offer or actually conflict with the Williams Act, it should not be preempted.\textsuperscript{137}

All the statutory models previously described either facilitate or do not significantly interfere with investor decisionmaking in the tender offer. Four of the models facilitate shareholder decisionmaking; the voting rights, shareholder approval, and second-tier models directly provide for collective shareholder voting as part of the regulatory mechanism, and the full-disclosure model provides for disclosure to assist the shareholders in their decisionmaking. The remaining share redemption, fiduciary duty, and business combination models have no direct shareholder role,\textsuperscript{138} but nevertheless should not be preempted under the rationale of \textit{CTS Corp}. They should still be viewed as protective of investors even though the role of the shareholders is limited. The fact that some of these models increase the power of the board does not mean investors are injured.

\textit{a. Statutes That Facilitate Decisionmaking}

In light of the decision in \textit{CTS Corp.}, the voting rights model remains valid.\textsuperscript{139} However, the SEC may effectively preempt the

\textsuperscript{137} In Hyde Park Partners, L.P. v. Connolly, 839 F.2d 837 (1st Cir. 1988), the United States Court of Appeals for the First Circuit concluded that a Massachusetts statute that required an offeror to disclose his intent prior to acquiring 5% of the stock probably was preempted. The court analyzed the issue of preemption by indicating that the law was detrimental to shareholders and that its deterrent effect to tender offers outweighed any benefits. The court indicated that any detailed economic analysis was unnecessary and that normally the courts would be reluctant to decide if shareholders were hurt. But because Congress carefully considered the issue and the Williams Act allowed an offeror to wait 10 days to file the required disclosure, the state could not "second guess[] the balance struck by Congress." \textit{Id.} at 850. In a broad sense the court seemed to suggest a balancing approach to the preemption issue, using a cost benefit approach. According to a more narrow view of the opinion, the court concluded that Congress was concerned with disclosure of purchases, and thus the state law was in actual conflict with the Williams Act. The court conceded that the Williams Act is not "an exclusive scheme for regulating takeover bids." \textit{Id.} at 852.

\textsuperscript{138} Many of these models that do not involve the shareholders directly in their protection have opt-out provisions that permit shareholders to decide not to be subject to the statute's protection.

\textsuperscript{139} The opinion in \textit{CTS Corp.} limits the SEC's ability to use the Williams Act to preempt state takeover statutes unless they conflict directly with provisions or purposes of the Williams Act and its rules. Because the Supreme Court has not yet embraced the neutrality view, the SEC should be wary of using this rationale to preempt state law. In one instance that merits comparison, the SEC did show a willingness to preempt state common law. By
statute if it adopts proposed rule 19c-4, which is intended to deal with the problems of corporations creating two classes of common stock with unequal voting rights. Typically, the voting control of a corporation is placed in one class of stock that is owned either by management or by a family group, whereas the public owns a class of stock with inferior voting rights. This capital structure effectively eliminates a hostile takeover because control cannot be purchased without the approval of the control group. The effect of the voting rights model is to deny voting rights when the shareholders vote against the offeror, and this creates unequal voting rights in the common shares. Under the proposed rule, corporations with disparate voting rights between classes of its outstanding stock usually would be delisted from trading on the exchanges or in the over-the-counter market. Since both the corporation and its shareholders would be harmed if the corporation were delisted, the proposed rule should severely limit the use of the voting rights model. In proposing the rule, the SEC is using its authority under section 19(c) of the Securities and Exchange Act of 1934, which permits it to amend the rules of self-regulatory organizations in furtherance of the purposes of the Act. Interestingly, the SEC did not also invoke section 14(e) of the Williams Act in support of its rule or indicate in its release the proposed rule’s impact on the voting rights model.


142. Id. at 23,674. “The Commission believes that in proposing Rule 19c-4 it has met the statutory standards necessary to add to the rules of [a self regulatory organization] as set forth under section 19(c) of the Act.” Id. The Commission also stated that it believes the proposed rule to be “necessary and appropriate in furtherance of the purposes of sections 6, 15A and 14[(a)-(b)] of the Act.” Id. at 23,675.

143. See Letter from Roberta S. Karmel, Professor of Law, Brooklyn Law School, to Jonathan G. Katz, Secretary, Securities & Exchange Commission (July 9, 1987) (responding to the SEC's proposed rule).
The shareholder approval model requires a shareholder vote when purchasers reach certain thresholds and allows the disinterested shareholders to determine whether they approve of further acquisition of the shares. Although this model can actually preclude the tender offer with this vote of approval, it was designed to treat the tender offer like other control transactions, such as mergers, and to protect the shareholders from coercive takeovers. This model treats the offeror differently than the voting rights model, which allows the offer to take place when the offeror gambles on the chances of a successful shareholder vote, but it does protect the shareholders in a similar fashion by providing for their vote. If the Court is focusing simply on investor protection and collective action, then this model, which facilitates the shareholder decision, probably is not preempted.

The second-tier model, which has been enacted to deal with two-tier tender offers, is consistent with the CTS Corp. rationale of furthering investor protection by avoiding coercive two-tier tender offers. This model protects the remaining shareholders, whose shares have not been purchased in the tender offer, by allowing them to act collectively with a supermajority vote to approve the second-tier freezeout transaction. This freezeout transaction eliminates the minority's equity position and gives the offeror complete control of the corporation. To avoid a supermajority vote on the freezeout, the offeror can pay the remaining shareholders at least as much as was offered in the original tender offer.\(^1\) In either case, the coercion is avoided and the shareholders are protected by acting collectively.

Given the explicit statutory permission for state blue sky regulation in section 28 of the Securities and Exchange Act of 1934,\(^2\) the full-disclosure model, which is similar to such regulation, should not be preempted.\(^3\) In most cases, disclosure facilitates

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146. But cf. Comment, Beyond CTS: A Limited Defense of State Tender Offer Disclosure Requirements, 54 U. Chi. L. Rev. 657 (1987) (state disclosure laws should apply only to target corporations that are not subject to the disclosure requirements of the Williams Act).
the investor’s decisionmaking. In addition, providing for disclosure is one of the fundamental purposes of federal securities regulation. In some cases this model requires the same disclosure of information that the Williams Act demands.\textsuperscript{147} In other cases, this model requires additional disclosure, which arguably is unnecessary and burdensome.\textsuperscript{148} Because the impact of the model is limited to shareholders residing in the state, the fact that a state agency can seek an indefinite delay in that state should not be the basis for preemption.\textsuperscript{149}

b. Statutes Without Direct Shareholder Role

The remaining statutory models do not involve the shareholders directly in the protection provided by the statutes. The share redemption model is designed to protect shareholders after an offeror gains control. The fiduciary duty and business combination models give additional power to the directors to protect shareholders and the corporation in a tender offer. None of these models prevents the tender offer from taking place.\textsuperscript{150}

\textsuperscript{147}See, e.g., N.Y. Bus. Corp. Law § 1603(a)(6) (McKinney 1986). Section 1603(a)(6) and SEC rule 14d-100 (schedule 14D-1) require similar information about the offeror’s interest in the target company’s securities.

\textsuperscript{148}See supra note 30.

\textsuperscript{149}It has been suggested that if the Court adopts the Edgar plurality’s neutrality approach, which supports the market for corporate control, such a statute might still be open to a commerce clause challenge. For example, a significant number of shareholders residing in the state could in effect block the offer. See Karmel, Blue-Sky Merit Regulation: Benefit to Investors or Burden on Commerce?, 53 Brooklyn L. Rev. 105, 112 (1987). But in Edgar the Court was concerned about the extraterritorial effect of the Illinois statute because a state agency could seek an injunction against the tender offer nationwide. Edgar v. MITE Corp., 457 U.S. 624, 643-44 (1982). Further, the Court suggested that blue sky regulation that is intended to protect resident shareholders would survive a commerce clause challenge. Id.

\textsuperscript{150}The Court in CTS Corp., comparing the Indiana statute with the Illinois statute in Edgar, indicated that the Indiana statute did not impose indefinite delays on tender offers. CTS Corp., 107 S. Ct. at 1646. Although the directors may be able to impose indefinite delays by adopting defensive tactics under the fiduciary duty model, this does not necessarily imply harm to the shareholders or the lack of a remedy against the directors.
The Court in *CTS Corp.* emphasized the Indiana statute's provisions that protect the "independent shareholder against both the contending parties."151 These provisions allow the "shareholders to evaluate the fairness of the offer collectively."152 Although this emphasis suggests that statutes not involving the shareholders directly may be preempted, the courts should be wary of preempting those models on such a narrow view of investor protection. The Court in *CTS Corp.* was faced with a statute that involved shareholders directly but, significantly, it never indicated that other statutory protection would be preempted. The Court specifically referred to provisions of state corporate law that permit staggered voting for directors and cumulative voting. These provisions, which do not facilitate shareholder decisionmaking during the tender offer, were held valid even though they can delay an offeror from gaining control.153

The share redemption model, like the voting rights model, has been designed to deal with coercive two-tier tender offers. The share redemption model, however, goes further than a shareholder vote by requiring that on acquiring a certain percentage of stock, the offeror purchase all shares of the remaining shareholders.154 Although the shareholders do not play a direct role, the model is consistent with the Williams Act, which protects investors by assuring them an equal opportunity to receive the premium in the tender offer.155 This protection not only aids decisionmaking by providing sufficient time but also creates a substantive right to receive the premium.156 The share redemption model provides shareholders with more rights of equal opportunity beyond the initial tender of-

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151. *Id.* at 1645.
152. *Id.* at 1646 (emphasis in original).
153. *Id.* at 1647-48. The Court noted that a state's cumulative voting laws can delay the ability of tender offerors to acquire complete control over the target's corporate affairs. *Id.* at 1648. See Hochman & Folger, *Deflecting Takeovers: Charter and By-Law Techniques*, 34 Bus. Law. 537, 538-39 (1979).
154. E.g., Pa. Stat. Ann. tit. 15, § 1910 (Purdon Supp. 1987) (shareholders subject to a control transaction are entitled to statutory rights and remedies when a controlling group holds at least 30% of the voting shares that are entitled to be cast in an election for directors).
156. See Pryor v. United States Steel Corp., 794 F.2d 52 (2d Cir.), cert. denied, 107 S. Ct. 445 (1986). Congressional creation of a substantive right that normally would arise under state corporate law suggests that when Congress wanted to affect state corporate law, it did
fer. Arguably, the requirements of this model may conflict with the provision of the Williams Act if the model's requirement of equal opportunity is viewed as exclusive. The Williams Act provides for equal opportunity only in the tender offer, however, and should not preclude a state from providing greater rights that protect investors and insure that shareholders are not left with minority status.

The fiduciary duty and business combination models place significant power in the hands of the board of directors if the board is faced with a hostile tender offer. Because these models arguably do not facilitate the decision of the investors but instead appear to replace this decision with the decision of the board, they may have more difficulty withstanding a preemption attack. However, these models should not be viewed as inconsistent with the Williams Act because they do not necessarily harm investors.

The fiduciary duty model, which broadens the interests to be considered by the board to include corporate constituencies other than the shareholders, could be viewed as not being in the interests of investors. Protecting other constituencies, however, does not necessarily mean that the shareholders will be harmed. Only in the rarest situations could management institute policies that ar-

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so explicitly. This interpretation conflicts with the implicit preemption argument based on neutrality.

157. Prior to the Williams Act, the issue of equal opportunity had always been the province of state law. See Hazen, Transfers of Corporate Control and Duties of Controlling Shareholders—Common Law, Tender Offers, Investment Companies—and a Proposal for Reform, 125 U. Pa. L. Rev. 1023 (1977). But cf. Hyde Park Partners, L.P. v. Connolly, 839 F.2d 837 (1st Cir. 1988) (Congressional concern with disclosure of ownership meant that a state law changing the timing of such disclosure was likely to be preempted).

158. Interestingly, when discussing the collective action of the shareholders, the Court in CTS Corp. twice referred to them as acting in the “corporation’s best interest” rather than their own “best interests.” CTS Corp., 107 S. Ct. at 1646. In Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985), the Supreme Court of Delaware, in upholding a self tender that excluded a hostile offeror, stated that “the board’s power to act derives from its fundamental duty and obligation to protect the corporate enterprise, which includes stockholders.” Id. at 954. But cf. Revlon, Inc. v. MacAndrews & Forbes Holdings, 506 A.2d 173 (Del. 1986), in which the Supreme Court of Delaware indicated that a lockup option could violate a director’s fiduciary duty when an auction for the company had begun. The court indicated that the decision in Unocal Corp. permitted consideration of other constituencies provided that “rationally related benefits accrued to the stockholders.” Id. at 182.
guably were not in the interests of investors. Even if management were more concerned with constituencies other than the shareholders, the Williams Act does not concern itself with defining the parameters of fiduciary duty, which traditionally is a state law issue.

In some cases the fiduciary duty model explicitly protects directors who implement defensive mechanisms by limiting an action under state law against the directors. This model also should pass muster under the protection of investors concept since the implementation of defensive mechanisms does not mean that all offers are precluded or that a higher price may not result. Moreover, the courts have not given management unfettered control to

159. The courts traditionally have invoked the fiduciary duty of management to determine that it has not served the interests of the shareholders. E.g., Dodge v. Ford Motor Co., 204 Mich. 459, 170 N.W. 668 (1919) (ordering payment of dividend when controlling shareholder acted unreasonably in refusing to declare special dividends).


161. E.g., Ohio Rev. Code Ann. § 1701.59(D) (Anderson Supp. 1986). The statute provides that "[a] director shall be liable . . . only if it is proved by clear and convincing evidence . . . that his action or failure to act involved an act or omission undertaken with deliberate intent to cause injury to the corporation or undertaken with reckless disregard for the best interests of the corporation." Id. The statute further provides:

[A] director, in determining what he reasonably believes to be in the best interests of the corporation, shall consider the interests of the corporation's shareholders and, in his discretion may consider . . .:

(1) The interests of the corporation's employees, suppliers, creditors, and customers;
(2) The economy of the state and nation;
(3) Community and societal considerations;
(4) 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.
Id. § 1701.59(E).

162. Those who favor the market for corporate control disagree on the role of the board in a hostile takeover. Compare Easterbrook & Fischel, supra note 3, at 1165-74 (management should be passive when faced with a tender offer) with Gilson, A Structural Approach to Corporation: The Case Against Defensive Tactics in Tender Offers, 33 Stan. L. Rev. 819 (1981) (management should bargain with offeror to secure higher price or seek a competitive bid) and Bebchuk, The Case for Facilitating Competing Tender Offers, 95 Harv. L. Rev. 1028 (1982) (same). The idea that directors should in some cases auction their company when facing a takeover is gaining some acceptance by the courts. See, e.g., Revlon, Inc. v. MacAndrews & Forbes Holdings, 506 A.2d 173 (Del. 1986) (directors' duties to an auctioner changed when sale of the company was inevitable).
thwart all takeovers. The courts have shown a willingness to use the fiduciary duty analysis to meet the changing legal environment in takeovers. Thus, as long as some monitoring of management’s response to hostile takeovers is present, the courts should not invalidate the law on preemption grounds.

The business combination model, which also places the power in the board, operates differently from the fiduciary duty model. Although an offeror is free to tender for as many shares as he chooses, the model effectively requires an offeror to negotiate with the board and receive board approval. Without such approval, the model limits the offeror’s ability to use the corporation’s assets to help finance the acquisition or to eliminate minority shareholders for as long as five years. As in the fiduciary duty model, no direct shareholder role exists, but the shareholders may opt out of the statute by amendment to the corporation’s bylaws. Such an amendment, however, may not take effect until eighteen months after the vote. An offeror is faced with three possible choices: acquire a percentage of the stock below the threshold and begin a proxy fight, negotiate with the board, or acquire as much stock as possible and wait until the requisite period has elapsed. In Dela-

163. See, e.g., Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 954 (Del. 1985) (concluding that when confronted by a pending takeover bid, the board’s duty is “enhanced” by “the omnipresent specter that a board may be acting primarily in its own interests, rather than those of the corporation and its shareholders”). In fact, the business combination model may create closer judicial scrutiny of the board’s actions. See infra note 173.

164. E.g., Hanson Trust PLC v. ML SCM Acquisitions, 781 F.2d 264 (2d Cir. 1986) (under New York law, directors may have violated their fiduciary duty when they favored one bidder with a lockup option on corporate assets at an unfair price). See also Revlon, Inc. v. MacAndrews & Forbes Holdings, 506 A.2d 173 (Del. 1986) (directors violated duty of loyalty when they favored a bidder in an auction situation with a lockup option).

165. Investors have several mechanisms to eliminate management insulation from hostile takeovers: for example, litigation based on fiduciary duty, the proxy system, which allows shareholder to voice their concerns, and the proxy fight to replace management. Investors have used these mechanisms with varying success. Arguably, if management uses state law to create an environment without some monitoring or shareholder role that precludes all hostile takeovers, preemption may be available because the corporation has misappropriated an opportunity created by Congress.


167. If the shareholders opt out of the statute’s coverage, the offeror must wait 18 months before it can complete the stock acquisition. Id. If the shareholders do not opt out and the board does not approve the stock acquisition, the offeror must wait five years before any subsequent corporate transaction. Id. § 912(b). In addition, the statute requires a fair price in any freezeout transaction. Id. § 912(c)(3)(D).
ware an offeror has an easier time avoiding the statute because he can tender for eighty-five percent of the shares or seek board approval and a two-thirds disinterested-shareholder vote approving the business combination.168

An important policy question for the fiduciary duty and business combination models is whether they are in the best interests of investors. The Williams Act does not necessarily resolve this issue. If the models provide a mechanism for management to maximize the value for shareholders by negotiating a higher price, finding a higher bidder, or taking defensive measures that result in increased efficiency, then investors will be protected.169 On the other hand, if the models provide an absolute defense to takeovers, then management is left less accountable, which may be harmful to investors.170 The probable outcome for these models is somewhere in the middle; in some cases shareholders will benefit and in others they will be harmed.171 Ultimately, the directors' fiduciary duty is


169. Cf. Romano, The State Competition Debate, supra note 75. Professor Romano sees the statutes, like other defensive tactics, as increasing premiums at the cost of a reduced number of bids. Id. at 737-38. But cf. Dynamics Corp. of Am. v. CTS Corp., 794 F.2d 250, 255 (7th Cir. 1986), rev'd, 107 S. Ct. 1637 (1987), in which Judge Posner conceded that the evidence of whether particular defensive tactics could increase or decrease shareholders is mixed.

170. When management does not control the ownership of the shares it is rarely able to insulate the corporation from a permanent takeover. Although most hostile takeover attempts are successful, even those that fail usually result in some form of buyout for the corporation. Coffee, supra note 27, at 1149.

171. Two recent studies have concluded that the New York business combination model and the Ohio fiduciary duty model resulted in a decrease in the wealth of shareholders of corporations subject to those models. Bur. of Econ., Fed. Trade Comm'n, State Regulation of Takeovers and Shareholder Wealth: The Effects of New York's 1985 Takeover Statutes 45-46 (Mar. 1987) [hereinafter N.Y. Takeover Statutes]; Office of the Chief Economist, Sec. & Exch. Comm'n, Shareholder Wealth Effects of Ohio Legislation Affecting Takeovers 22 (May 18, 1987) [hereinafter Ohio Takeovers]. In New York the overall decline was estimated at $1.2 billion, based on the decline in all covered corporations when the law was announced. N.Y. Takeover Statutes, supra, at 45-46. The actual rate of decline was under 1%. Id. at 45. An Ohio study estimated a 1.68% to 3.24% market decrease. Ohio Takeovers, supra, at 22. These results should not control a preemption analysis; both studies were based on stock price data, which do not always reflect a direct relationship between the event and the market reaction. Courts should be wary of using market price studies as the basis for concluding that shareholders are harmed. See R. Clark, supra note 9, at 542. As the Ohio study indicated, stock market returns are merely the market's first guess as to the impact of the law; the sampling may not be the best indicator, and other factors may influence the pricing. Ohio Takeovers, supra, at 22-23. Without looking at the
the issue. In fact, the models may place a greater burden on the directors to deal with a potential acquiror than is normally the case without the statutes. For example, Delaware's concern in enacting its statute appeared to be the abuses of some offerors, such as those proposing front-loaded two-tier offers. If a target were faced with an all-cash offer deemed to be fair, whether the

actual use of these statutes in the context of a takeover, it is hard to conclude that the statutes in fact have hurt shareholders.

172. The New York statute requires all the directors to vote, whereas the Minnesota law requires only the vote of the disinterested directors. Compare N.Y. Bus. Corp. Law § 912(b) (McKinney 1986) with Minn. Stat. Ann. § 302A.673(1)(d) (West Supp. 1988). Although generally a vote by disinterested directors may be preferable, such a vote should not be mandated by federal law because state courts have the ability to determine whether a given transaction involves a conflict of interest. See, e.g., Revlon, Inc. v. MacAndrews & Forbes Holdings, 506 A.2d 173 (Del. 1986). In Delaware, the courts are less deferential when interested directors are involved. See, e.g., Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985). In Unocal Corp. the court stated that the burden on directors in takeovers is "materially enhanced" when a majority of the board is comprised of outside independent directors. Id. at 995.

173. For example, the New York statute raises interesting questions regarding its interplay with the business judgment rule. See N.Y. Bus. Corp. Law § 912(b). The statute provides that the shareholder who seeks advance approval of the interested business combination must make a good-faith proposal to the board in writing. The board must respond to the offer in writing, "setting forth its reasons for its decision regarding such proposal," within 30 days or a shorter period if required by the Securities and Exchange Act. Rejection affects a future board's business judgment because it may not approve business combinations with the shareholder for five years thereafter. Whether the significance of this decision or the requirement of a written response will result in closer judicial scrutiny of the decision itself as opposed to the decisionmaking process is unclear. The legislation may also shift the burden to the directors. A memorandum issued by the governor's counsel when the legislation was proposed indicated that the directors

would have the burden of assuring that the provisions of the section are not used to the detriment of the resident domestic corporation's shareholders or employees or the other constituencies that the board represents. . . . The business judgment rule could be applied in a new context—given the proposed legislation, certain defensive tactics might no longer be subject to the protection of the [rule]. . . .

N.Y. State Exec. Dept. Memorandum Ch. 915, 208th Sess., reprinted in 2 McKinney's 1985 Session Laws of New York 3184, 3192 [hereinafter Memorandum Ch. 915]. The enactment of section 402(b) of the New York Business Corporation Code, N.Y. Bus Corp. Law § 402(b) (McKinney Supp. 1988), which was designed to limit liability for breaches of some fiduciary duties, could, however, undercut this protection. See infra note 176.

174. Goldman, supra note 76.
directors would be able to use the statute is unclear. Using the statute might invite increased judicial scrutiny.\textsuperscript{175} In order to find a preemption, the courts will have to assume that the board will act only in its own interests when negotiating, that the courts are unable to monitor management's role effectively under fiduciary duty standards,\textsuperscript{176} and that the Williams Act was designed to provide unrestricted access to the tender offer. The Supreme Court repeatedly has rejected the use of federal securities law to impinge on the corporate governance and fiduciary duties traditionally imposed under state law.\textsuperscript{177} In its preemption analysis, the Court should not conclude that directors will use their

\textsuperscript{175} The Delaware courts usually apply the business judgment rule to actions taken by the board and test it by whether the tender offer is in the best interests of the corporation and the shareholders. According to the Delaware Supreme Court, "[i]f a defensive measure is to come within the ambit of the business judgment rule, it must be reasonable in relation to the threat posed." Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985). If the directors use the statute and are not faced with a coercive offer it may not be reasonable in relation to the threat.

\textsuperscript{176} Recent statutory enactments that were designed to limit or eliminate some of the directors' liability may have a significant impact on the ability of courts to review the activities of directors in hostile tender offers. See Hanks, States Move to Adopt Statutory Limitations on Director Liability, Legal Times, Oct. 12, 1987, at 19, col. 1. Although some of the statutes were designed to deal with tender offers, many were enacted in response to the decision in Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985). In Van Gorkom, the Delaware Supreme Court found a breach of the duty of care by directors who approved the acquisition of a corporation at a substantial premium in a friendly transaction without being fully informed. Id. at 881. The decision and the rising costs of directors and officers liability insurance were the impetus for statutes permitting the elimination of liability or money damages for certain breaches of fiduciary duty, increasing the standard of care from negligence to gross negligence, or expanding the use of indemnity by the corporation. Hanks, supra. These statutes normally focus on breaches of the duty of care as opposed to the duty of loyalty. Most of the litigation involving hostile tender offers involves a breach of the duty of care because the courts rarely view the defensive mechanisms of the target's directors as a conflict of interest. Thus, unless the courts change their view of these statutes, they may effectively eliminate the monitoring effect of the derivative suit in the context of hostile tender offers. However, some statutes, such as the Delaware statute, eliminate monetary damages and do not preclude equitable relief, which may be effective in monitoring the directors' activities during a tender offer. See, e.g., Del. Code Ann. tit. 8, § 101(b)(7) (1988). In addition, many states, including Delaware, require a shareholder vote before its limitations on liability are effective. Id. Those corporations that seek a shareholder vote to eliminate damages for duty of care liability would be expected to have to disclose under federal securities law the interplay between that elimination of liability and the state takeover statutes that give the board more power.

power under the models to the detriment of investors. Such a conclusion precludes the courts from using a case-by-case fiduciary duty analysis to determine whether management is using the models to benefit investors. In its discussion of the preemption issue in *CTS Corp.*, the Court indicated, in dictum:

In the unlikely event that management were to take actions designed to diminish the value of the corporation's shares, it may incur liability under state law. But this problem does not control our pre-emption analysis. Neither the [Williams] Act nor any other federal statute can assure that shareholders do not suffer from the mismanagement of corporate officers and directors.178

In addition, some of the models should not be preempted because several of them have provisions allowing the shareholders to opt out of a particular model.179 These provisions may have been intended to allow further shareholder involvement. Such involvement promotes shareholder protection and makes the law less regulatory and more supplementary. Although some commentators would prefer an opt-in regimen as opposed to an opt-out,180 given management's ability to lobby for particular legislation and the costs of the statute,181 this choice should not make a difference

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179. The idea of opting into a statute by a shareholder vote as opposed to opting out arguably is more in line with the idea of shareholder rights and corporate law as enabling. Yet shareholders have shown a willingness to amend their certificates by adding antitakeover amendments viewed as harmful to shareholders. *See Shark Repellents: The Role and Impact of Antitakeover Amendments*, [1984-1985 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,714 (Sept. 7, 1984). This evidence could be used to suggest that shareholder voting is meaningless or that shareholders are willing to accept defensive mechanisms because they increase their premiums. *Cf.* articles by Romano, *supra* note 75.

180. Interestingly, recent enactments that limit damages against directors for breaches of fiduciary duty require a corporation to opt into the rule, whereas usually one needs to opt out of the protection provided by the takeover statutes. *Compare* DEL. CODE ANN. tit. 8, § 102(b)(7)(19-1) with id. § 203.

181. *See* Romano, *The State Competition Debate*, *supra* note 75, at 754. In another article, Professor Romano discusses the political activity of major corporations in the enactment of takeover statutes. Romano, *supra* note 56. She concludes that the legislatures are reacting to the concerns of a local firm in situations free of discernible political costs. *Id.* at 188. This appears to be true of the fourth-generation statutes—firms incorporated in Delaware have lobbied for protection in states in which they have a major presence. Professor Romano's description of Connecticut's takeover statute, where little activity occurred by groups either in support of or against the legislation, was not the experience in New York. The presence
from a preemption point of view.\textsuperscript{182} In order for the choice to be significant, the court would have to determine that the model was not protective of investors and further that the opt-out was illusory and did not provide the necessary investor protection.\textsuperscript{183} Given that the trading markets are becoming increasingly dominated by institutional investors, who may be able and willing to challenge management, the ability to opt out of the regulation may not be insignificant.

2. Conflicts with the Williams Act

None of the statutory models, except possibly the shareholder approval model, appears to have provisions that conflict directly with the Williams Act. In light of the Court's analysis in \textit{CTS Corp.}, the fact that the other types of statutes may cause delays of the tender offer or increase the costs of takeovers should not be significant.\textsuperscript{184}

\textbf{a. Actual Delays}

The shareholder approval model differs from the voting rights model that was found constitutional in \textit{CTS Corp.} because this model actually replaces the tender offer with the shareholder vote by requiring a vote before the acquisition of shares at certain thresholds. Although this model can also be used to avoid the coercive aspects of two-tier tender offers,\textsuperscript{185} it presents more problems than the other models because it actually precludes the offeror from making the tender offer. The other statutory models allow

\begin{footnotesize}
\begin{enumerate}
\item[183.] It is interesting to note that the SEC has presented for public comment the idea that shareholders should be allowed to opt out of certain Williams Act provisions. \textit{Concept Release on Takeovers for Corporate Control: Advance Notice of Possible Commission Actions, [1986-1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84.018} (Mar. 9, 1987).
\item[184.] If the delays are indefinite and go beyond Congressional mandate in the Williams Act, however, or if the costs relate to unreasonable regulation that clearly does not protect investors, a preemption problem may arise. \textit{CTS Corp.}, 107 S. Ct. at 1646.
\end{enumerate}
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the offers to take place, albeit subject to limitations and conditions that may in practice preclude the offer.

In \textit{CTS Corp.}, the Court distinguished the Indiana voting rights statute from the Illinois statute in \textit{Edgar} because the Indiana law did not impose an indefinite delay on tender offers or prohibit the offer after twenty business days—the earliest period in which the offer could be consummated.\footnote{186. \textit{CTS Corp.}, 107 S. Ct. at 1646.} The shareholder approval model does not allow any purchases to proceed without shareholder permission. This is clearly different from the Indiana statute. Arguably this statutory replacement of the tender offer with a shareholder vote could be preempted. Although an offeror should be able to have a shareholder vote within the maximum tender offer period of sixty days, the actual purchase of shares normally would not be completed within twenty days, the minimum time frame provided in the rules.\footnote{187. The Court in \textit{CTS Corp.} concluded that the Indiana statute, which required a vote within 50 days, did not conflict with the timing requirements of the Williams Act because it did not impose an absolute 50-day limit or preclude the purchase as soon as federal law permitted. \textit{Id.} at 1647. The shareholder approval model would not permit purchases within the earliest permissible time—50 business days—but a tender offeror could make the offer conditional on shareholder approval. The Court in \textit{CTS Corp.} indicated that an offeror could tender conditionally, based on the shareholder vote. \textit{Id.} A conditional tender should be possible under the shareholder approval model as well, even though the shares could not be purchased legally until after the vote. If in fact such an offer could not be made, this might be instrumental to the issue of preemption.} With this model, however, the delay would be caused by a shareholder vote that implements their decision-making, whereas under the Illinois statute, a state agency had the approval power that could have resulted in unreasonable delay.\footnote{188. In \textit{CTS Corp.}, the Court indicated that the Indiana statute did not prohibit an offer within 20 days or allow the state to determine the fairness of the offer; “[r]ather, the Act allows shareholders to evaluate the fairness of the offer collectively.” \textit{Id.} at 1646 (emphasis in original).}

The shareholder approval model presents a court with a statute that is designed for investor protection and permits collective action similar to the voting rights model, but which interferes directly with the nationwide tender offer process.\footnote{189. According to the Court’s commerce clause analysis in \textit{CTS Corp.}, the Indiana statute protected the shareholders by giving them the right to collectively decide if a change of control was desirable. \textit{Id.} at 1651. “A change of management may have important effects on the shareholders’ interests; it is well within the State’s role as overseer of corporate governance to offer this opportunity.” \textit{Id.}} If the statute is
preempted because tender cannot be made within the twenty-day minimum, then form triumphs over substance. That is, under the voting rights model, a tender offer could be made, but in practice it would wait for a shareholder vote.

b. Practical Delays

Although the other statutory models permit a tender offer to be made, the tender offeror will usually refrain from doing so until the requirements of the statute are met. For example, under the Indiana statute, an offeror who acquires stock but fails to get shareholder approval will own a substantial number of shares without voting power. In CTS Corp., the Court analyzed the delays caused by the practical effect of the Indiana statute to see whether a tender offer could be accomplished within the time frames provided by the Williams Act. However, whether the court will apply the same analysis to determine the practical impact of other statutory models is unclear.

The Court in CTS Corp. began its discussion of this practical impact by “assuming that the Indiana Act imposes some additional delay.” If, however, such delays or limits on the power to control are the basis of future preemption, then the Court’s concern for other state corporate law, such as staggered board elections, which has the same effect would also be upset. According to the Court, the possibility of delay was insufficient, and “[t]he longstanding prevalence of state regulation in this area suggests that if Congress had intended to preempt all state laws that delay the acquisition of voting control following a tender offer, it would have said so explicitly.” Thus, courts should first determine if the regulation permits the actual tender offer to proceed within the time frame of the Williams Act. If it does, then the fact that the statute may also delay or limit ultimate control under the guise of state corporate law should not matter for preemption purposes. All the models ex-

190. Id. at 1647.
191. Id. at 1647-48. Although Judge Posner was able to distinguish traditional state corporate law that may delay takeovers from those state takeover statutes whose effect on tender offers is “direct, intended and substantial,” it is obvious from the Supreme Court’s view that the distinction was unacceptable. Dynamics Corp. of Am. v. CTS Corp., 794 F.2d 250, 264 (7th Cir. 1986), rev’d, 107 S. Ct. 1637 (1987).
192. CTS Corp., 107 S. Ct. at 1648.
cept the shareholder approval model permit the actual tender offer to be completed. 193

The fact that the fiduciary duty and business combination models give increased power to the board and may in practice replace the tender offer with the proxy fight should not be a ground for preemption. Under both models, an offeror can purchase shares within the time frame provided by the Williams Act. 194 Although the failure to get board approval may make it unlikely that a tender offeror would choose to make the offer, replacing the board always remains a possibility. 195 The five-year restriction under the business combination model may be unreasonable to an offeror in operating or financing the corporation, but that delay does not directly prevent the tender offer from going forward. The Court in CTS Corp. was fearful that a concern for delays in seeking control after a successful tender offer might be extended to preempt state law that had always been considered valid. 196

B. Commerce Clause

The commerce clause of the Constitution clearly gives Congress authority to regulate interstate commerce. However, it does not explicitly restrict state regulation when Congress has not acted. If Congress has taken no action in an area, then the extent to which a state can regulate interstate activities rests on the application of the “dormant” or unexercised commerce clause. 197 According to

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193. The full-disclosure model may preclude the offer in a given state, but that should not create problems under preemption given explicit permission for blue sky legislation in the Exchange Act. See supra text accompanying notes 145-49.
194. A New York corporation’s board must decide on the proposal within 30 days. N.Y. Bus. CORP. LAW § 912(b) (McKinney 1986).
195. When instituting a proxy fight to replace the board under the business combination model, the hostile bidder’s chances of success are reduced because the bidder can acquire and thus vote only the threshold number of the outstanding shares. In New York that would be only 19%, which means the bidder would have to convince at most another 32%, assuming all shareholders vote. See Moran v. Household International, Inc., 500 A.2d 1346 (Del. 1985). The Delaware Supreme Court was faced with a poison pill that was effective upon the purchase of 20% of the stock. The court did not believe that the plan would restrict a proxy fight because “many proxy contests are won with an insurgent ownership of less than 20%... very large holdings are no guarantee of success.” Id. at 1355.
196. CTS Corp., 107 S. Ct. at 1647.
197. See G. Gunther, supra note 22. See also Tushnet, Rethinking the Dormant Commerce Clause, 1979 WIS. L. REV. 125 (1979). According to Professor Tushnet, the dormant
Professor Tribe, the Court in *Cooley v. Board of Wardens*\(^{198}\) established the theme that state activity affecting interstate commerce will “be judged in light of the desirability of permitting diverse responses to local needs and the undesirability of permitting local interference with such uniformity as the unimpeded flow of interstate commerce may require.”\(^{199}\)

When analyzing state economic regulation, the Court has employed various tests.\(^{200}\) Generally, the Court will strike down a statute that regulates interstate commerce directly, discriminates against interstate commerce, or favors state economic interests over out-of-state interests.\(^{201}\) When a nondiscriminatory statute has an indirect effect on interstate commerce, it will be upheld “[w]here the statute regulates evenhandedly to effectuate a legitimate local public interest, and its effects on interstate commerce

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\(^{198}\) 53 U.S. (12 How.) 299 (1851).

\(^{199}\) L. Tribe, *supra* note 23, at 407. According to Tribe, the idea in *Cooley* of classifying the regulation as “national” or “local” has become less important and the focus is on how the state proposes to regulate. *Id.*

\(^{200}\) According to the Court in *CTS Corp.*, “as the volume and complexity of commerce and regulation has grown in this country, the Court has articulated a variety of tests in an attempt to describe the difference between those regulations that the Commerce Clause permits and those regulations that it prohibits.” *CTS Corp.*, 107 S. Ct. at 1648. The Court cited *Raymond Motor Transportation v. Rice*, which reviews the various considerations the Court has employed to determine what is permissible, such as the direct-indirect distinction, the need for a single rule versus the need for diversity, and the regulation of state police power versus regulations of commerce. *Raymond Motor Transp. v. Rice*, 434 U.S. 429, 491 n.15 (1978), cited in *CTS Corp.*, 107 S. Ct. at 1648. The Court in *Raymond Motor Transportation* indicated that it had employed various tests, but that no single conceptual approach identifies all the factors that may bear on a particular case. Our recent decisions make clear that the inquiry necessarily involves a sensitive consideration of the weight and nature of the state regulatory concern in light of the extent of the burden imposed on the course on interstate commerce. *Id.* at 441.

are only incidental . . . unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits.”

In analyzing the Indiana statute under the commerce clause, the Court in CTS Corp. did not discuss whether the regulation was direct or indirect. Instead, it looked at whether the statute was discriminatory, created inconsistent regulation, and unduly hindered or limited tender offers. Under the Court's analysis in CTS Corp., none of the models described should be found to be discriminatory. The models have the same effects on tender offers whether or not the offeror is a resident of the particu-

202. Pike v. Bruce Church, Inc., 397 U.S. 137, 142 (1970) (citing Huron Cement Co. v. Detroit, 362 U.S. 440 (1960)). Professor Regan argues that the dormant commerce clause should be used to prevent the states from engaging in purposeful economic protectionism as opposed to regulation that merely has a protectionist effect. Regan, The Supreme Court and State Protectionism: Making Sense of the Dormant Commerce Clause, 84 Mich. L. Rev. 1091, 1094-95 (1986). He rejects the use of balancing, particularly if it looks to the costs to any private party as an argument against the statute, and would find a statute to be protectionist if it had been adopted to improve the competitive position of local economic actors relative to out-of-state competitors and it used a traditional protectionist device such as a tariff or quota. Id. Justice Scalia cites the article with approval in his concurrence in CTS Corp., 107 S. Ct. at 1653 (Scalia, J., concurring).

203. A plurality of four Justices in Edgar found the Illinois statute to be a direct burden on interstate commerce and therefore invalid. Edgar v. MITE Corp., 457 U.S. 624, 643 (1982). The plurality found the statute to be a direct burden because it could preclude shareholders who were residents of another state from transacting in interstate commerce with the offeror. Id. at 642. If the post-Edgar statutes burden interstate commerce directly, then a court could find them invalid without weighing their benefits. Most of the models may in fact defeat or deter a tender offer, but they do not directly prohibit it. All the models except the full-disclosure model do not involve a government entity but deal instead with corporate governance. See Fleet Aerospace Corp. v. Holderman, 637 F. Supp. 742, 762 (S.D. Ohio) (discussing state's authority to regulate corporate control as indirect burden), aff'd, 796 F.2d 135 (6th Cir. 1986). The shareholder approval model may have more of a direct impact on interstate commerce than do other statutory models. It does not follow, however, that such regulation is per se invalid and not subject to the balancing test used when an impact is indirect. In Edgar, the Illinois statute gave a governmental agency the power to stop a tender offer, whereas the determination of whether a tender offer is accepted under the shareholder approval model depends on the nongovernmental action of the shareholders. In Brown-Forman Distillers Corp. v. New York State Liquor Auth., 476 U.S. 573 (1986), the Supreme Court referred to Edgar when it stated that seeking “regulatory approval in one State before undertaking a transaction in another directly regulates interstate commerce.” Id. at 582 (citing Edgar, 457 U.S. at 642). Thus, the shareholder approval model is not an example of direct state regulation of interstate commerce; rather, it regulates corporations and allows shareholder voting, which may have an effect on interstate commerce. It should be considered at most an indirect regulation.

204. CTS Corp., 107 S. Ct. 1648-49.
lar state. The fact that most offerors tend to be out-of-state corporations is unimportant given the evenhanded regulation of the models, which imposes no greater burden on nonresidents than on residents.

The Court in CTS Corp. had little difficulty concluding that the Indiana statute would not adversely affect interstate commerce by subjecting activities to inconsistent regulations. Most of the second- and third-generation statutory models, such as the Indiana statute, use the nexus of the state of incorporation and consequently should “not create an impermissible risk of inconsistent regulation” because corporations do not incorporate in more than one state. As the Court in CTS Corp. indicated, “so long as each state regulates voting rights only in the corporations it has created, each corporation will be subject to the law of only one State.” The enactment of the fourth-generation statutes, in which certain states are attempting to regulate corporations that have a significant presence in the state but are incorporated elsewhere, raises the possibilities of inconsistent regulation and whether the Court will apply only the law of incorporation.

The majority opinion in CTS Corp. raises significant questions about the interplay between the commerce clause and state corporate law. Although the Court did only minimal balancing, it probably has not abandoned that test. In balancing the benefits of the regulation with the burdens, several questions arise. First, in balancing, is the role of the incorporating state the significant factor or should that law also benefit shareholders? Second, can other states constitutionally regulate corporations incorporated in another state?

205. Id. at 1649.
206. Id.
207. This issue is discussed in pt. IV.B.2.b. infra.
1. Balancing

a. The Role of the Incorporating State

The Court's discussion of the commerce clause and state corporate law suggests a hands-off approach to the second- and third-generation statutes, even if these statutes burden interstate commerce because of their potential to hinder tender offers and the market for corporate control. Most of the Court's discussion of the commerce clause in *CTS Corp.* focused on the importance of state corporate law. That law necessarily affects interstate commerce, but according to the Court, the trading market, which facilitates the participation of shareholders and provides capital for corporations, "depends at its core upon the fact that a corporation—except in the rarest situations—is organized under, and governed by, the law of a single jurisdiction, traditionally the corporate law of the State of its incorporation."\(^{209}\) The Court's commerce clause analysis in *CTS Corp.* rested heavily on the notion that state corporate law is important in both the creation of corporations and their governance.\(^{210}\) The Court indicated that "[n]o principle of corporate law and practice is more firmly established than a State's authority to regulate domestic corporations...."\(^{211}\) Although the opinion appeared to make a strong statement in support of state law, and particularly the law of the

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209. *CTS Corp.*, 107 S. Ct. at 1650. The Court gives examples of state laws that directly affect corporate transactions that are interstate in character, such as voting requirements on mergers or dissenters' rights statutes that give shareholders the right to "fair value" if they vote against certain fundamental transactions such as mergers. *Id.*

210. Although the primary focus of the Court's opinion on the preemption issue was investor protection, the Court did recognize the "longstanding prevalence of state regulation in this area." *Id.* at 1648. *See also id.* at 1647 n.9 (fiduciary duty issues are a state law concern).

211. *Id.* at 1649. The Court quotes Chief Justice Marshall's definition of the corporation as follows:

A corporation is an artificial being, invisible, intangible, and existing only in contemplation of law. Being the mere creature of law, it possesses only those properties which the charter of its creation confers upon it, either expressly, or as incidental to its very existence.

Trustees of Dartmouth College v. Woodward, 17 U.S. (4 Wheat) 514, 636 (1819), cited in *CTS Corp.*, 107 S. Ct. at 1649. *But cf.* First Nat'l Bank of Boston v. Bellotti, 435 U.S. 765 (1978) (restricting the ability of a state to limit the free speech rights of the corporation because of the needs of the listeners). Interestingly, the Court in *CTS Corp.* cites the dissent by Justice Rehnquist in *Bellotti*, which emphasized the role of the state in the creation of
state of incorporation, it also indicated that the Indiana statute was intended to protect the shareholders.\(^{212}\)

The Court's emphasis on the role of the state in creating corporations was significant in its commerce clause analysis. The Court afforded a strong presumption in favor of state corporate law that burdens interstate commerce.\(^{213}\) This presumption lessened the Court's traditional inquiry of nondiscriminatory indirect state regulation, which balanced the burdens of the legislation with the "putative" local benefits.\(^{214}\) In \textit{CTS Corp.}, the Court did minimal balancing and found that the state has an interest in promoting the "stable relationships among parties involved in the corporations it charters, as well as in ensuring that investors in such corporations have an effective voice in corporate affairs."\(^{215}\) The Court emphasized that the Indiana statute promoted these interests and even protected shareholders by allowing collective action to avoid coercive takeovers.\(^{216}\) The burdens of the Illinois takeover statute on the market for corporate control present in \textit{Edgar}\(^{217}\) received corporations. \textit{CTS Corp.}, 107 S. Ct. at 1650 (citing \textit{Bellotti}, 435 U.S. at 822-24 (Rehnquist, J., dissenting)).

\(^{212}\) \textit{CTS Corp.}, 107 S. Ct. at 1651.

\(^{213}\) In the past, the Court has given the safety concerns of states significant deference when states were regulating interstate highways. See \textit{South Carolina Highway Dept. v Barnwell}, 303 U.S. 177 (1938). This deference derived from the lack of discrimination and a recognition that the states are primarily responsible for the construction and maintenance of the highways. \textit{Raymond Motor Transp., Inc. v. Rice}, 434 U.S. 429, 444 n.18 (1977). The Court no longer seems to give the same deference to the states in highway regulation. See \textit{Kassel v. Consolidated Freightways Corp.}, 450 U.S. 662 (1981). This change of attitude provides an interesting parallel with the Court's view in \textit{CTS Corp.} of state regulation of corporate governance. In \textit{CTS Corp.}, the strong support of state corporate law appears to be similar to the Court's earlier approach to state regulation of highways because state regulation of corporate governance creates no discrimination and the states have primary responsibility in creating the corporation and the relationships involved.

\(^{214}\) The Court did not even cite its opinion in \textit{Pike v. Bruce Church, Inc.}, 397 U.S. 137 (1970), which provides the often quoted test on balancing. The Court does not seem to have abandoned its balancing test, as suggested by Justice Scalia in his concurrence in \textit{CTS Corp.}, 107 S. Ct. at 1653 (Scalia, J., concurring). Instead, it seems to be giving greater deference to the state to regulate a state-created entity.

\(^{215}\) \textit{CTS Corp.}, 107 S. Ct. at 1651.

\(^{216}\) \textit{Id.} The Court dismissed the argument that the prospect of coercive tender offers was illusory and found the state's concern not groundless. \textit{Id.}

\(^{217}\) Compare the strong support in \textit{Edgar}, 457 U.S. at 643-44, for the benefits of the market for corporate control with the Court's position in \textit{CTS Corp.}:

It is appropriate to note when discussing the merits and demerits of tender offers that generalizations usually require qualification. No one doubts that
little attention in *CTS Corp.* According to the Court, Indiana's
care with coercive tender offers was not groundless and states
were not required to adopt any "particular economic theory."\(^{218}\)
Thus, the states have a role to play in tender offers and in regulat-
ing the market for corporate control.\(^{219}\) According to the Court, as
long as the statute did not prohibit offers, purchases, or attempts
to gain control and provided residents and nonresidents with equal
access, the state's imposition of limitations on tender offers did not
mean the law was unconstitutional under the commerce clause.\(^{220}\)

The Court's strong support for state corporate law suggests that
all the second- and third-generation models, including the Dela-
ware law,\(^{221}\) should pass muster under the rationale of *CTS Corp.*
because they all require the state of incorporation as a nexus. How
the Court in *CTS Corp.* views the corporation and the purpose of
corporate law is unclear. Initially, the Court strongly emphasized
the role of the states as creators of these entities. The Court also
looked to corporate law's promotion of stability of those who are
involved in the corporation to justify the regulation. It went on to
categorize the Indiana statute as one that protected investors
and provided for their effective voice. Which view predominates
may be significant in a future analysis of the various takeover
statutes.\(^{222}\)

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\(^{218}\) *See infra* text accompanying notes 301-303.

\(^{219}\) Id.

\(^{220}\) Id.

\(^{221}\) Some language in the *CTS Corp.* opinion arguably limits Delaware's ability to enact
a takeover statute. *See infra* text accompanying notes 301-303.

\(^{222}\) The cases raised the issue of how the corporation should be viewed under the com-
merce clause. If the corporation is viewed as a separate, artificial entity, the state that regu-
If protection of investors is the key issue under the commerce clause, then arguably some of the statutory models may not be viewed as protecting investors. This could lessen the state’s interests compared to the burdens on tender offers. Some of the state takeover statutes can be viewed as consistent with Indiana’s attempt to protect investors. The shareholder approval and second-tier models are designed to avoid coercive tender offers and allow collective shareholder action, a factor that the Court found significant in upholding Indiana’s voting rights model in *CTS Corp.* The share redemption model further protects shareholders from coercive tender offers by increasing their rights to participate in the tender offer premium. None of these models denies access to control of the corporation; instead, each provides regulatory procedures to protect shareholder interests. Although the full-disclosure model permits a state agency to enjoin a takeover in that state, it provides for disclosure to protect investors and in this respect is similar to other permissible state regulation of intrastate securities.

The fiduciary duty and business combination models give increased power to the board to deal with the tender offer. As discussed previously in the preemption section of this Article, the fiduciary duty and business combination models do not involve the shareholders directly. In addition, these models often were enacted to protect interests beyond those of the shareholders. If, however, investor protection is the significant issue under the commerce clause then these models may be subject to attack because they arguably do not protect investors.

Protection of investors should not be the significant issue in a commerce clause analysis, however, because the Court emphasized the role of the states in creating corporate relationships. The Court’s discussion of investor protection in *CTS Corp.* reflected Indiana’s announced purpose of protecting shareholders. Thus, in ap-


\footnote{223. This model may face problems if the Court decides that only internal affairs type statutes are subject to the deference accorded state statutes by the Court in *CTS Corp.* because the statute deals with transaction in shares, which is not normally covered by the internal affairs doctrine. See infra note 261.}
plying its balancing test, the Court analyzed whether the statute reflected those concerns. Although states may have an incentive to make law that protects investors, the Constitution does not mandate such protection. The states create corporations, and their law usually applies to issues of corporate governance. The states' policies determine the allocation of power and the interests that are protected within that framework.

The Court in CTS Corp. found that Indiana was justified in affecting interstate commerce because of the state's interest not only in protecting shareholders but in “defining the attributes of shares in its corporations. . . .” The Court was not inclined “to second-guess the empirical judgments of lawmakers concerning the utility of legislation.” The commerce clause was designed to protect the interstate market from undesirable local interference, not to establish a theory of the firm or insure shareholder autonomy. The key question in CTS Corp. was whether corporate law created by the state of incorporation effectively denied equal access to that market, especially when what was traded, in this case the corporation and its shares, was created by that law.

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224. CTS Corp., 107 S. Ct. at 1651.
225. Id. at 1652.
226. Id. at 1651 (citing Kassel v. Consolidated Freightways Corp., 450 U.S. 662, 679 (1981)) (Brennan, J., concurring). In APL Ltd. Partnership v. Van Dusen Air, Inc., 622 F. Supp. 1216 (D. Minn. 1985), vacated as moot, No. 85-5346 (8th Cir. Nov. 25, 1985), the court invalidated Minnesota's shareholder approval model. The United States Court of Appeals for the Eighth Circuit vacated the judgment after the case had been settled. According to the district court, “[t]he Commerce Clause, as interpreted by the Supreme Court, requires a court to balance benefits against burdens; not interests against burdens.” 622 F. Supp. at 1221 (emphasis in original). A state's desire to accomplish a certain result is an interest, but if a statute that is burdensome fails to further the result, there is no benefit. The state must demonstrate that its legitimate interests are served by the statute. Courts have “the constitutional duty to determine whether State-desired benefits can, in fact, result from the statute and only those which are not 'speculative' may be placed in the scale to be balanced against the burden on interstate commerce.” Id. Given the minimal balancing and the strong presumption in favor of the legislative judgment in CTS Corp., the court's commerce clause analysis in Van Dusen Air, Inc. appears to have been rejected at least in the areas of internal affairs of corporations.
229. See CTS Corp., 107 S. Ct. at 1652.
The Court in *CTS Corp.* acknowledged that the state has the right to allocate power within the corporate structure. Consequently, the fact that some of these statutes shift power to the board of directors should be permissible under the commerce clause. In addition, this shift of power does not necessarily mean that shareholders are harmed. For example, the board has the potential power to negotiate a more favorable deal. The shareholders also have the power to monitor management by replacing the board, bringing an action under fiduciary duty principles, and in some cases opting out of the statute.

The fact that the fiduciary duty and business combination models may be directed at interests other than those of the shareholders also should not be a problem under the commerce clause. When New York enacted the first business combination statute, the goal of the law was to "promote the long-term growth of New York resident domestic corporations." The legislature was concerned about highly leveraged takeovers that resulted in the substitution of debt for equity, which shifted the risk to creditors. According to the legislative findings, these takeovers adversely affect employees and communities. They restrict the ability of the affected businesses to grow, to invest for long-term return and to provide increased productivity and employment. . . .

New York State has a significant interest in regulating the relationships among or between corporations organized in New York and their officers, directors and stockholders.

Moreover, as a major industrial state, New York was intimately concerned about avoiding the adverse effects that these types of takeovers might have on the state and its citizens.

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230. *Id.* at 1651.
231. See generally *Coffee*, *supra* note 27 (describing the methods provided to monitor management).
233. *Id.* at 3189.
234. *Id.* at 3190. Although a concern for local industry and communities is a legitimate state interest, the commerce clause was intended to avoid purposeful economic protectionism by the states. Regan, *supra* note 202. If the legislation requires the business to remain in a state, it would be unconstitutional. In fact, however, the statutes do not require businesses or assets to remain in the state. A statute that is motivated by a belief that takeovers
Although the existence of the problem is unclear, the commerce clause should not upset the use of state corporate law to protect these interests, given the strong presumption in favor of state corporate law. A statute that protects other nonshareholder interests therefore should not automatically be invalid under the commerce clause. Even if investor protection is the significant issue, the opinion in *CTS Corp.* offers little indication of what concept of investor protection the Court would endorse. As discussed previously, the policy of the Williams Act is to facilitate decision-making. Other views of investor protection include complete investor autonomy or maximizing the power of the board or managers and

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235. Arguably the goal of the legislation is outside the typical internal affairs type statute and really deals with state economic development. Corporate governance rules have often been used to deal with a variety of economic concerns beyond protection of shareholders. For example, a concern for creditors can be found in the legal capital rules of state corporate statutes. See B. Manning, *A Concise Textbook on Legal Capital* (2d ed. 1981). Many states used to require a minimum capitalization to incorporate. *Id.* at 17. These statutes were designed to protect the public and creditors. *Id.* But see Langevoort, *The Supreme Court and the Politics of Corporate Takeovers: A Comment on CTS Corp.* v. Dynamics Corp. of America, 101 Harv. L. Rev. 96, 106-07 (1987) (criticizing the Court for failing to see that the legislation was not to protect shareholders but to protect Indiana's economic interests, which might be local protectionism). Even if a court were to conclude that protecting interests outside those of the typical internal affairs statutes—shareholders, officers, and directors—was not entitled to the same presumption as the Court in *CTS Corp.* appears to have given corporate law, the interests protected by the state could then be balanced against the burdens.

236. The Court indicated that the state has an interest in relationships among the parties involved in corporations as well as in shareholders. *CTS Corp.*, 107 S. Ct. at 1651. In discussing the shareholder protection provided by the Indiana statute, the Court suggested that the "possibility of coercion in some takeover bids offers additional justification for Indiana's decision to promote the autonomy of independent shareholders." *Id.* at 1651 (emphasis added). In *Hyde Park v. Partners, L.P.* v. Connolly, the United States Court of Appeals for the First Circuit recognized that under the *CTS Corp.* opinion, interests other than those of the shareholders might be permissible and that it was not clear that the law would "substantially chill tender offers." 839 F.2d 837, 847 (1st Cir. 1988). Even if the law did chill tender offers, the court indicated that "it is hard to judge whether the resultant benefits to state shareholders and to corporate stability would be outweighed by the disadvantages that would be suffered by those same stockholders and the burdens that would be placed on the interstate market." *Id.* Initially the New York statute raised concern for the statute's constitutionality under the commerce clause. See *Pinto, supra* note 69. Upon further reflection, the limitation on the role of states in providing corporate law if courts use the commerce clause to invalidate the takeover statutes became a greater concern. See *Pinto, supra* note 49. The Court in *CTS Corp.* expressed this concern.
allowing considerations of corporate constituencies in addition to the shareholders. Neither the Williams Act nor the commerce clause resolves this debate.\(^{237}\)

Although the Court found that the Indiana statute protected shareholders, it should not follow logically that other models that give power to the board or protect other interests are unconstitutional on commerce clause grounds. These statutes continue to provide equal access to the corporation and its shares by residents and nonresidents of the state. They do not preclude a tender offer, but instead provide a regulatory mechanism that seeks to protect corporate interests. Under the rationale of *CTS Corp.*, when a court is faced with a corporate law statute enacted by the state of incorporation which burdens interstate commerce, the statute should be presumptively valid given the state’s interest in the relationships created.\(^{238}\)

\[\text{b. The Role of a Nonincorporating State}\]

The fact that the state of incorporation has a significant role to play in regulating its corporations and that its law should be presumptively valid does not mean that the commerce clause mandates that law if another state has also regulated in the same area. When faced with burdensome inconsistent regulation involving corporate governance, a court should use the commerce clause to choose a law, but that law should not automatically be the law of the state of incorporation.

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\(^{237}\) According to Justice Scalia, whether Indiana’s statute benefits shareholders or incumbent management is “a highly debatable question, but it is extraordinary to think that the constitutionality of the Act should depend on the answer.” *CTS Corp.*, 107 S. Ct. at 1653 (Scalia, J., concurring). According to Justice Scalia:

Nothing in the Constitution says that the protection of entrenched management is any less important a “putative local benefit” than the protection of entrenched shareholders, and I do not know what qualifies us to make that judgment—or the related judgment as to how effective the present statute is in achieving one or the other objective—or the ultimate (and the most ineffable) judgment as to whether, given importance-level \(x\), and effectiveness-level \(y\), the worth of the statute is “outweighed” by impact-on-commerce \(z\).

*Id.*

\(^{238}\) This presumption could be rebutted by a showing of an excessive burden on interstate commerce or, in the case of inconsistent regulation, a significant interest of another state. See *infra* text accompanying notes 261-300.
The opinion in *CTS Corp.* suggests that the fourth-generation statutes, which provide for regulation that affects tender offers and do not use the state of incorporation as a nexus, may be unconstitutional. These fourth-generation statutes present two issues. The first is the potential problem of inconsistent regulation that may result from these statutes. The second is whether a state can regulate the internal affairs of foreign corporations.\(^{239}\)

If another state regulates the internal affairs of a foreign corporation, a court should not automatically invalidate the regulation under the commerce clause. If the statute burdens interstate commerce, the benefits should be balanced with the burdens. If the incorporating state has regulated in the area, the fourth-generation statute may create inconsistent regulation with the law of the state of incorporation, and this inconsistency may impermissibly burden interstate commerce. In that case, the balancing test takes on a new dimension. The courts should recognize the importance of the internal affairs doctrine as representing an interest of the incorporating state in the corporate relationships it creates. Given the importance of the state of incorporation in creating the corporation and establishing governance rules affecting the relationships created, that law would be presumptively valid in the face of inconsistent regulation of another state.

### i. Inconsistent Regulation

In *CTS Corp.*, the Court indicated that it has applied the commerce clause to invalidate statutes that subject activities to inconsistent regulation.\(^{240}\) Because the fourth-generation statutes were enacted after the *CTS Corp.* decision, the Court in *CTS Corp.* never addressed the problem of multiple state regulations in corpo-

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239. On the internal affairs doctrine, see Demott, *Perspectives on Choice of Law for Corporate Internal Affairs*, 48 LAW & CONTEMP. PROBS., Summer 1985, at 161 (1985). The Maryland Supreme Court provided a widely accepted definition of internal affairs:

> Where the act complained of affects the complainant solely in his capacity as a member of the corporation, whether it be as stockholder, director, president, or other officer, and is the act of the corporation, whether acting in stockholders’ meeting, or through its agents, the board of directors, then such action is the management of the internal affairs of the corporation. . . .

North State Copper & Gold Mining Co. v. Field, 64 Md. 151, 154, 20 A. 1039, 1040 (1885).

240. *CTS Corp.*, 107 S. Ct. at 1649.
rate governance. The concerns raised by these statutes are the problem of inconsistent regulation and its effect on interstate commerce.\textsuperscript{241}

In \textit{CTS Corp.} the Court appeared to treat inconsistent regulation as an independent ground for automatic invalidation under the commerce clause, thereby precluding any balancing test. The Court, however, has not abandoned its traditional approach of balancing the benefits with the burdens when faced with inconsistent regulation as long as the regulation is not direct or discriminatory.\textsuperscript{242} Of the cases cited in the \textit{CTS Corp.} opinion that dealt with inconsistent regulation, those that did not involve balancing involved regulations that raised particular commerce clause problems.\textsuperscript{243} In some cases the Court found direct state regulation,\textsuperscript{244} which per se violates the commerce clause. Other cases involved interstate transportation, an area that requires a uniform system of regulations.\textsuperscript{245}

\begin{quote}
241. Justice Scalia in his concurrence indicated, “As long as a State’s corporation law governs only its own corporations and does not discriminate against out-of-state interests, it should survive this Court's scrutiny under the Commerce Clause. . . .” \textit{Id.} at 1653 (Scalia, J., concurring). This suggests that the state of incorporation is primary but does not preclude other states’ regulation, which could be subject to the traditional balancing approach.

242. \textit{Contra} Regan, \textit{supra} note 208. Prior to \textit{CTS Corp.}, Professor Regan argued that in cases involving the movement of goods, the Court should not balance, but should focus on purposeful economic protectionism. Regan, \textit{supra} note 202. In his subsequent article, he views \textit{CTS Corp.} as supporting his argument against balancing. Regan, \textit{supra} note 208.

243. The Court in \textit{CTS Corp.} cited \textit{Kassel v. Consolidated Freightways Corp.}, 450 U.S. 662 (1981), as a case in which a statute was invalidated because of inconsistent regulation. \textit{CTS Corp.}, 107 S. Ct. at 1649. The Court in \textit{Kassel} was faced with an Iowa law that restricted the size of trucks using its highway. \textit{Kassel}, 450 U.S. at 665-66. The law differed from that of other states, and the Court balanced the benefits and the burdens. The Court found the state’s safety interest to be illusory and a significant impairment to the federal interest in an efficient and safe highway system. \textit{Id.} at 671.


245. For example, the Court in \textit{CTS Corp.} cited its 1851 opinion in \textit{Cooley v. Board of Wardens}, in which a Pennsylvania law was held unconstitutional because it required ships entering or leaving the Port of Philadelphia to use a local pilot. \textit{CTS Corp.}, 107 S. Ct. at 1649 (citing \textit{Cooley v. Board of Wardens}, 53 U.S. (12 How.) 299 (1851)). In \textit{Cooley}, the Court indicated that when a power is exercised by the states, which “are in their nature national, or admit only of one uniform system, . . .” the states cannot regulate. 53 U.S. at 319. The Court also cited \textit{Southern Pac. Co. v. Arizona}, 325 U.S. 761 (1945) (cited in \textit{CTS Corp.}, 107 S. Ct. at 1649). In that case, the Court again found a situation that dictated a uniform system. The Court found an Arizona law that limited the size of trains had the
The cases involving inconsistent regulation expressed a concern with both the need for uniformity and the problems of extraterritoriality—one state controlling commerce beyond its borders. The Court traditionally has used the commerce clause to accommodate the competing demands of state interests versus national interest. The usual result when national interests prevail is the invalidation of the particular state law.

The Court, however, traditionally has not used the commerce clause to arbitrate directly between two state laws by mandating one state’s law as the provider of a uniform system. What would be the justification for the Court mandating only the law of the state of incorporation over all other states without applying a balancing test? Is the corporation and the regulation of the actors within it

practical effect of extending the regulation beyond its borders and interfered with the need for a uniform rail system. *Id.* at 775.

246. *See Southern Pac. Co.*, 325 U.S. 761 (practical effect of one state setting minimum standards is to control commerce beyond its boundaries); *Edgar*, 457 U.S. 624 (Illinois takeover statute invalidated for its “sweeping extraterritorial effect”). The Court in *Edgar* stated that “if Illinois may impose such regulations, so may other states; and interstate commerce in securities transactions generated by tender offers would be thoroughly stifled.” *Id.* at 642.

Professor Regan also views the Court’s discussion of inconsistent regulation in *CTS Corp.* as possibly implicating a concern for the extraterritorial effect of the legislation. Regan, *supra* note 208, at 1875-84. Professor Regan has argued that the Court should abandon the balancing test. He would allow the state of incorporation to export its law based on a territorial assumption that the internal affairs are located in that state and thus another state cannot regulate that activity. He views the Court’s opinion in *CTS Corp.* as possibly based on the idea that the share attributes dealt with by Indiana’s statute are located in the state of incorporation. *Id.* at 1877-78. Another state’s attempt to regulate the effects of the behavior through regulation of the activity located in another state is extraterritorial. *Id.* at 1899. This lack of balancing is formalistic, however, and ignores the possibility of a strong state interest in the internal affairs of basically local corporations incorporated elsewhere. Using his basic analysis, one could argue that the state’s creation of the entity and the relationships gives the state a significant interest to protect which must be balanced with the interests of other states. *See infra* text accompanying notes 288-300.


248. *But cf.* *Bibb v. Navajo Freight Lines, Inc.*, 359 U.S. 520 (1959) (invalidating a law that required trucks to use mudguards was out of line with the requirements of other states and thus the law interfered with interstate transportation). The decision in *Bibb* suggests that by invalidating a law that differs from that of other states, the Court may choose one state’s law to provide a uniform system. In *Bibb*, the Court could have invalidated all state laws under the rationale of *Cooley*, but instead it dealt only with the Illinois statute involved in the case before it. The invalidation of one law while others were left intact did not mean that those laws would not still be subject to balancing if the Court were faced with those statutes.
so different from other multistate dealings or so important to our national economy as to require a constitutional mandate of the law of the state of corporation? No one would suggest that because the corporation owes its existence to the state, that state has the right to dictate its law whenever the corporation enters into multistate commercial transactions.\(^2\) Even if the Court concludes that this issue involves an area of national importance, such as transportation, this does not mean an end to balancing or to the automatic application of the law of one state over another.\(^2\) In fact, uniformity of state laws and a federal corporate law may be preferable for multistate corporations. However, given its strong statement of support for state corporate law in \textit{CTS Corp.}, the Court is unlikely to invalidate all state corporate laws that burden interstate commerce to achieve uniform treatment in takeovers.\(^2\) Of course, diversity in regulation is a byproduct of our federal system and does not always result in a constitutional issue.\(^2\) Courts could take several approaches when faced with these fourth-generation statutes.

\(^2\) For example, the burdens of multistate taxation could be solved by allowing the state of incorporation to dictate taxation. No one has suggested that this burden should be remedied by mandating this result under the commerce clause. In fact, the Court in \textit{Moorman Mfg. Co. v. Blair}, 437 U.S. 267 (1978), recognizing the problem of multistate firms, indicated that the commerce clause does not prohibit overlap in the computation of taxable income. The Court held that it was best left to Congress and not to the Court to prescribe a uniform rule. \textit{Id.} at 278-80.

\(^2\) \textit{See Regan, supra} note 202, at 1182-85.

\(^2\) One can argue that Delaware is creating an extraterritorial effect by exporting its law to other states that may in fact have a more significant relationship to the corporation. If a uniform system is needed, then all state corporate law that burdens interstate commerce should be invalidated under the rationale of \textit{Cooley}. \textit{Cf. Fiflis, Of Lollipops and Law—A Proposal for a National Policy Concerning Tender Offer Defenses}, 19 U.C. Davis L. Rev. 303 (1986). According to Professor Fiflis, in discussing the \textit{Unocal Corp.} case, which dealt with takeover defenses, “[o]ne may properly ask whether it is appropriate for Delaware, which conceivably may not be the abode of a single Unocal shareholder, to fix national policy in an international securities market, while Congress and the federal courts, Nero-like, abdicate a policymaking role.” \textit{Id.} at 306. Given the strong support for the state of incorporation in \textit{CTS Corp.}, the Court probably would not take that approach. This support for state corporate law could become less deferential, which appears to be what happened in the Court’s changing attitude toward state regulation of highways.

\(^2\) \textit{Regan, supra} note 208, at 1885. Professor Regan has argued that the opinion in \textit{CTS Corp.} discussing inconsistent regulation appears to be concerned with extraterritoriality. Professor Regan believes that the extraterritoriality issue should not be an issue under the dormant commerce clause but recognizes that it was important to the decision in \textit{CTS Corp.} \textit{Id.} at 1873-79.
The courts could avoid the risk of inconsistent regulation by adopting the notion of "lex incorporatonis,"\textsuperscript{253} by rejecting any balancing of interests,\textsuperscript{254} or by claiming the nonincorporating state has no legitimate interest. The courts could also determine that a uniform system is necessary, as the Supreme Court has done in some cases involving transportation, and that the states cannot regulate effectively in that area.\textsuperscript{255} The courts should analyze each statute to determine if in fact inconsistent regulation existed, and if so it could balance the burdens with the benefits.\textsuperscript{256} The fourth-generation statutes may not create inconsistent regulation.\textsuperscript{257}

The fact that an incorporating state has chosen a different regulatory model than another state attempting to apply its law to the same jurisdiction may not create inconsistent regulation.\textsuperscript{258} The courts could avoid the risk of inconsistent regulation by adopting the notion of "lex incorporatonis,"\textsuperscript{253} by rejecting any balancing of interests,\textsuperscript{254} or by claiming the nonincorporating state has no legitimate interest. The courts could also determine that a uniform system is necessary, as the Supreme Court has done in some cases involving transportation, and that the states cannot regulate effectively in that area.\textsuperscript{255} The courts should analyze each statute to determine if in fact inconsistent regulation existed, and if so it could balance the burdens with the benefits.\textsuperscript{256} The fourth-generation statutes may not create inconsistent regulation.\textsuperscript{257} The fact that an incorporating state has chosen a different regulatory model than another state attempting to apply its law to the same jurisdiction may not create inconsistent regulation.\textsuperscript{258}

\textsuperscript{253} See Kozyris, Corporate Wars and Choice of Law, 1985 DUKE L.J. 1; see also Reese & Kaufman, The Law Governing Corporate Affairs: Choice of Law and the Impact of Full Faith and Credit, 58 COLUM. L. REV. 1118 (1958) (arguing that the law of the state of incorporation should apply in most cases with very limited exceptions).

\textsuperscript{254} Professor Regan has argued against balancing in the dormant commerce clause, and he sees CTS Corp. as confirming his view. Regan, supra note 208, at 1866-68.

\textsuperscript{255} Regan, supra note 202, at 1182-85.

\textsuperscript{256} According to Gunther:

\textquote{The modern Court is not likely to invalidate a state law merely because it creates a risk of multiple inconsistent burdens, because other states might enact conflicting laws in the same area. Rather, as in Bibb, the Court is likely to insist on a showing that actual inconsistent burdens exist.}

G. GUNThER, supra note 22, at 254-55. Contra TLX Acquisition Corp. v. Telex Corp., No. 87-3056-R (W.D. Okla. Nov. 3, 1987). In TLX Acquisition Corp., the district court preliminarily enjoined the enforcement of Oklahoma's voting rights statute, which applied to Telex, a Delaware corporation with a presence in Oklahoma. The court found the statute facially unconstitutional because it created an impermissible risk of inconsistent state regulation of voting rights and also because the statute's burdens outweighed the legitimate interests of Oklahoma. Id., slip op. at 28. Although it was argued that in fact there was no inconsistent regulation because at the time Delaware had no conflicting law and no evidence of a state having a greater interest than Oklahoma was presented, the court concluded that when a state regulated voting rights of foreign corporations there was "an impermissible risk of inconsistent regulations." Id., slip op. at 20. The court acknowledged that the Supreme Court usually invalidated inconsistent regulation when faced with actual inconsistent statutes. The district court, however, found no actual conflict, and instead relied on the language in CTS Corp., in which the Supreme Court discussed inconsistent regulation and indicated that the Indiana statute "does not create an impermissible risk of inconsistent regulation by different States." Id., slip op. at 22 (quoting CTS Corp., 107 S. Ct. at 1649).

\textsuperscript{257} Cf. R. Crampton, D. Currie & H. Kay, Conflict of Laws ch. 2 (1981) (discussing the issue of false conflicts in interest analysis under choice of law principles). See generally Kaplan, Foreign Corporations and Local Corporate Policy, 6 VAND. L. REV. 433, 476-77 (1973) (imposing the law of several states may create not conflict but compatible cumulation).
corporation does not necessarily create inconsistent regulation for the corporation.\textsuperscript{258} The statutory models, if viewed as protective of shareholders or even of other interests, would not necessarily create a conflict if the policies that underlie them were similar or not viewed as inconsistent.\textsuperscript{259}

If in fact the enactment of the fourth-generation statutes creates burdensome inconsistent regulation, the remedy may be invalidation under the commerce clause. For example, if states enact laws or have a policy encouraging hostile takeovers and other states have laws that restrict them, contradictory regulation exists. In addition, if the net result of these statutes is to impose multiple and costly regulation, they may create a cumulative burden.\textsuperscript{260} The courts probably will continue to analyze these fourth-generation statutes, which are not discriminatory or direct regulation of interstate activities, by first determining if they impermissibly burden interstate commerce. If they do not, then the issue is whether these

\textsuperscript{258} Cf. Norlin Corp. v. Rooney Pace, Inc., 744 F.2d 255, 263-64 (2d Cir. 1984). In Norlin Corp., the United States Court of Appeals for the Second Circuit did not apply the law of Panama, the country of incorporation, but applied New York law since the conflict was illusory because it was unclear whether Panama would apply its law to the transaction. See infra note 281.

\textsuperscript{259} Two statutes may be viewed as complementary in protecting the same interests. For example, Oklahoma adopted a voting rights statute that required the corporation to have either its principal place of business, its principal office, or substantial assets in Oklahoma as well as either more than 10\% of the shareholders residing in Oklahoma, more than 10\% of its shares owned by residents, or 10,000 shareholder residents. 1987 Okla. Sess. Law Serv. ch. 146, § 18 (West). Delaware's takeover statute is a modified business combination model that places power in the hands of the board and allows for a two-thirds vote by the disinterested shareholders to avoid the limitations on future business combinations. Del. Code Ann. tit. 8, § 203 (1988). These different statutes have similar purposes—protection of shareholders—and may be viewed as consistent. Even if the statutes are protecting different interests they still may be consistent. For example, the Oklahoma statute is also protecting state interests in a corporation with significant number of assets and employees in the state. This protection of other interests does not necessarily create a conflict if the application of the statutes does not undermine the particular interests of the states involved. If there is inconsistency then the court should balance the benefits and burdens.

\textsuperscript{260} Professor Tribe notes that a "potent localizing bias" develops when individual state regulations operate in the aggregate against interstate commerce. See L. Tribe, supra note 23, at 434. By making the conduct of commercial activity that is confined to a single state easier and more profitable than multistate commercial activity, this bias discourages the development of national enterprise. Id. It is not clear that given the nexus requirements of the statutes, no more than two states will be involved. Professor Tribe has indicated that in cases of actual conflict, the Supreme Court "has been extremely severe in its scrutiny of state action." Id. at 435.
statutes in fact create inconsistent regulation. If an inconsistency exists, the courts should subject the regulation to the balancing test.

ii. Internal Affairs Doctrine

The decision in CTS Corp. implicitly raised questions concerning the role of choice of law principles—and particularly the internal affairs doctrine, which applies the law of the state of incorporation to corporate governance issues—in commerce clause analysis.261 The Court in CTS Corp. implicitly adopted the view

261. In Edgar v. MITE Corp., 457 U.S. 624 (1982), the Court seemed to give some weight to the use of the internal affairs doctrine in commerce clause analysis. The Court indicated that the Illinois statute was not an internal affairs statute because it applied to foreign corporations and that the law regulated the transfer of shares, which traditionally is outside the internal affairs doctrine. Id. at 640. Interestingly, in CTS Corp. the Court’s only reference to the Second Restatement of Conflicts and the internal affairs doctrine is in its short discussion of inconsistent regulation and not in its discussion of balancing. CTS Corp., 107 S. Ct. at 1649. In CTS Corp., the Court emphasized the role of the state in regulating its corporations and protecting investors. The Court’s failure to discuss the internal affairs doctrine may not be important, however, because Indiana’s voting rights model dealt with an issue normally covered by the doctrine.

Professor Buxbaum argues that CTS Corp. should not be viewed as constitutionalizing the “state of incorporation” version of the internal affairs doctrine under the commerce clause, which would be the “Delawarization” of state corporate law. Buxbaum, The Threatened Constitutionalization of the Internal Affairs Doctrine in Corporation Law, 75 CALIF. L. REV. 29, 34-35 (1987). Generally the internal affairs doctrine is not implicated in transactions involving shares. The use of the internal affairs doctrine in commerce clause analysis may cause problems for the shareholder approval model, however. This model involves shareholders in the tender offer process by allowing them to act collectively in approving a tender offer and also uses the state of incorporation as a nexus. It prohibits the purchase of shares unless approved in advance by the shareholders. Although arguments can be made that this model is similar to Indiana’s statute in protecting shareholders, it is not a typical internal affairs statute, even though it involves voting rights, because it denies an offering shareholder the right to buy and individual shareholders the right to sell without collective shareholder approval. According to the Second Restatement of Conflicts:

It should be added that certain issues which are peculiar to corporations or to other organizations do not affect matters of organic structure or internal administration and need not, as a practical matter, be governed by a single law. An example is the transfer of individual shares of a share issue. There is no practical reason, for example, why a corporation incorporated in state X should not comply with the requirements of state Y when it seeks to sell its shares in the latter state.

RESTATEMENT (SECOND) OF THE CONFLICT OF LAWS § 302 comment e (1971). This was one of the reasons the Court in Edgar found that Illinois had no interest in the internal affairs because its statute applied to transactions in shares. In APL Ltd. Partnership v. Van Dusen
that the internal affairs doctrine should be a significant factor in determining whether state corporate law impermissibly interferes with interstate commerce because states have an interest in the internal affairs of corporations. In most cases, the use of the doctrine will support the goals of the commerce clause by providing a single rule of law, which facilitates multistate commercial transactions. However, this reasoning should not apply automatically to

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Air, Inc., 622 F. Supp. 1216 (1985), the court indicated, in finding Minnesota's shareholder approval model unconstitutional, that "[t]here is little doubt that a state has some constitutionally sanctioned right to govern the internal affairs of its corporations." Id. at 1223. The court found the doctrine inapplicable, however, because the shareholder approval model involves the "[r]egulation of shareholders—and those who would become shareholders—which is not the same as regulating the corporation itself." Id. (emphasis in original).

The Court in CTS Corp. neither rejected nor adopted the implications of Edgar that only an internal affairs type statute would create an important state interest because the Indiana law was a typical internal affairs type statute that involved voting rights. According to the Court, "No principle of corporation law and practice is more firmly established than a State's authority to regulate domestic corporations, including the authority to define the voting rights of shareholders." CTS Corp., 107 S. Ct. at 1649. See Restatement (Second) of the Conflict of Laws § 304. The question remains whether the Court's emphasis on the state of incorporation, which created the corporation, as having a significant interest in regulating corporate governance meant that the internal affairs doctrine would not be the only significant factor.

Professor Shipman has argued for a broader view of internal affairs to cover statutes that affect tender offers because these offers have a significant impact on the corporation and shareholders. Shipman, Some Thoughts About the Role of State Takeover Legislation: The Ohio Takeover Act, 21 Case W. Res. L. Rev. 722, 740-61 (1970). Thus the ability of the shareholder approval model to withstand attack may depend on whether the Court in CTS Corp. meant that all state corporate law of the state of incorporation would be valid or that only matters covered by the traditional view of the internal affairs doctrine would be upheld. Even under the internal affairs doctrine, the law of state of incorporation "has usually been applied in the absence of an explicitly local statute." Restatement (Second) of the Conflict of Laws § 302 comment e.

262. See Pinto, supra note 49, for the argument that the Court should be wary of using the commerce clause to upset state corporate law and the internal affairs doctrine because it normally provides for a single law, because it encourages the market for corporate charters, which in some commentators' view enhances shareholder wealth, and because it is consistent with the view that corporate law is more contractual than regulatory. Id. at 489-96. The fourth-generation statutes will interfere with the single-law principle only when the courts do not choose between several laws and there is more than one law to contend with. The market for corporate charters depends on both the state's ability to export its law and the investors' ability to choose that law. In those cases in which the fourth-generation statutes apply over the state of incorporation, this principle may be viewed as limiting that market and affecting the contracting by the investors.

all cases. The courts should consider the incorporating state's interest when balancing the interests of the nonincorporating state's regulation.

Arguably, the Court in *Edgar* and *CTS Corp.* has mandated the use of the law of the state of incorporation. In *Edgar*, the statute was held unconstitutional because Illinois attempted to regulate foreign corporations. The Court indicated broadly that a "State has no legitimate interest in protecting nonresident shareholders. Insofar as the Illinois law burdens out-of-state transactions, there is nothing to be weighed in the balance to sustain the law." In *CTS Corp.* the Court accepted that statement but limited its effect to states that attempt to protect "nonresident shareholders of nonresident corporations." On its face, this statement appears to give the state of incorporation the only role in protecting shareholders. This severely restricts the ability of states to regulate foreign corporations.

The strong support for state corporate law in *CTS Corp.* should not be interpreted broadly to preclude state regulation of foreign corporations by fourth-generation statutes. The Court in *CTS Corp.* contrasted the Indiana statute with the Illinois law in *Edgar* in order to limit the broad language of *Edgar*. The Illinois statute was potentially applicable if no shareholders resided in Illinois. Such an application is significantly different from that of the fourth-generation statutes. Although a state may have no interest in protecting nonresident shareholders of nonresident corporations, it should be able to protect resident shareholders of nonresident corporations when a significant number of shareholders reside in the state. Thus, in analyzing the state's interests in the fourth-

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264. Edgar v. MITE Corp., 457 U.S. 624, 645 (1982). The Court in *Edgar* stated that "Illinois has no interest in regulating the internal affairs of foreign corporations." *Id.* at 645-46. Interestingly, the corporation was incorporated in Illinois with 27% of the shareholders being Illinois residents. *Id.* at 642.

265. *Id.* at 644.

266. *CTS Corp.*, 107 S. Ct. at 1651 (emphasis in original).

267. In *Edgar*, the Court stated that "Illinois has no interest in regulating the internal affairs of foreign corporations." 457 U.S. at 645-46. The Court previously had pointed out that the Illinois statute applied with only 10% resident shareholders and corporations not incorporated in the state and having no principal place of business in the state. *Id.*

268. In Western Air Lines, Inc. v. Sobieski, 191 Cal. App. 2d 399, 12 Cal. Rptr. 719 (1961), the California court was faced with a Delaware corporation that had its executive office in
generation statutes, if the intent of the statute is investor protection then the presence of shareholders should be significant.\textsuperscript{269}

In enacting statutes that apply to foreign corporations, the state may also be using an internal affairs type regulation to protect interests other than those of resident shareholders. States enact these fourth-generation statutes because of fears of the detrimental effects often associated with hostile takeovers. These interests are entitled to some weight in balancing the benefits with the burdens on interstate commerce. These interests carry less weight, however, if they represent local protectionism that unduly restricts the interstate transfer of property.\textsuperscript{270}

Although the Court historically has deferred to the law of the state of incorporation on issues involving internal affairs,\textsuperscript{271} that does not mean that the Court has established a constitutional requirement under the commerce clause mandating that the law of

California, conducted a predominant amount of its business in California (60% of its wages and salaries were paid to California employees), and had 30% of its stock owned by California residents. The Commissioner of Corporations had ruled that the elimination of cumulative voting, which was permissible in Delaware but not allowed in California, was unfair and that the corporation was subject to California regulation. \textit{Id.} at 403-04, 12 Cal. Rptr. at 722. The District Court of Appeal reversed the lower court's determination that Delaware law applied and stressed the local nature of the contacts involved. \textit{Id.} at 413-15, 12 Cal. Rptr. at 728-29. \textit{See} Reese \& Kaufman, \textit{supra} note 253 (criticizing the result in \textit{Sobieski}).

269. On issues of fiduciary duty the application of the law of the state of incorporation is less compelling and the state with a significant number of shareholders may have a stronger interest. \textit{Kozyris, supra} note 253, at 64.

270. In a case decided before \textit{CTS Corp.}, the United States District Court for the Western District of Missouri invalidated Missouri's shareholder approval statute, which applied to corporations that were not incorporated in Missouri but had significant contacts with the state, on constitutional grounds. \textit{Id.} at 403-04, 12 Cal. Rptr. at 722. The District Court of Appeal reversed the lower court's determination that Delaware law applied and stressed the local nature of the contacts involved. \textit{Id.} at 413-15, 12 Cal. Rptr. at 728-29. \textit{See} Reese \& Kaufman, \textit{supra} note 253 (criticizing the result in \textit{Sobieski}).

271. In \textit{Cort v. Ash}, 422 U.S. 66 (1975), the Court emphasized that corporations are creatures of state law and that "except where federal law expressly requires certain responsibilities of directors with respect to stockholders, state law will govern the internal affairs of the corporation." \textit{Id.} at 84.
the state of incorporation be applied on all corporate governance issues. Courts generally have assumed that the law of the state of incorporation governed, especially if internal affairs issues were raised, but that should not mandate its use under the commerce clause. This assumption developed because states historically have limited their regulation of corporate governance to corporations that are incorporated in the state.272

The constitutional underpinnings to the choice of the state of incorporation’s law traditionally have been the full faith and credit clause273 and to a lesser extent the due process clause.274 In Order of United Commercial Travellers v. Wolfe,275 the Supreme Court used the full faith and credit clause to mandate a choice of law rule for a fraternal corporation that selected the law of the state of incorporation. Although some have argued that this decision is lim-


273. U.S. Const. art. IV, § 1 provides that “Full Faith and Credit shall be given in each State to the public Acts, Records, and judicial Proceedings of every other State.” See Buxbaum, supra note 261, at 1133, arguing that the jurisprudence of the full faith and credit clause requires application in commerce clause analysis. See also Reese & Kaufman, supra note 253, arguing that full faith and credit clause is best suited to require the use of the law of the state of incorporation if the interests of another state are not seriously affected and the circumstances concern a legal area requiring regulation by a single law. The authors recognize the difficult problem when a single law is needed and states other than the state of incorporation have significant interests to protect. They suggest that when the laws are similar in policy and are intended to protect shareholders and creditors, then another state’s law will not be invalid. If not, the only time the law of another state should apply is when that state has an “extremely close connection with the corporation and unusually important policy of its own to protect.” Id. at 1144. The authors suggested that the commerce clause could possibly serve as a constitutional mandate for use of the state of incorporation, but they indicated that “the commerce clause has not been used as a basis for laying down constitutional rules of choice of law and would seem a less likely candidate for such a role.” Id. at 1129 n.42.

274. U.S. Const. amend. XIV, § 1 prohibits the states from depriving persons of “life, liberty, or property, without due process of law.” See generally L. Brilmayer, An Introduction to Jurisdiction in the American Federal System ch. 9 (1986).

asured to fraternal organizations and no longer reflects the Court's current thinking on full faith and credit, its holding arguably is revived under the commerce clause by the decisions in Edgar and CTS Corp. The Court's use of the commerce clause to constitutionalize a choice of law rule that requires only the use of the state of incorporation, without any reference to another state's interest, appears to run contrary to its recent treatment of choice of law under the full faith and credit and due process clauses. In the choice of law area, the Court has moved away from the traditional vested rights, which focused on territorial factors, to a broader range of factors and has shown a reluctance to use due process and full faith and credit to invalidate the forum's law when that state has significant contacts.

In McDermott, Inc. v. Lewis, the Supreme Court of Delaware recently reviewed the arguments concerning the use of the internal

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277. See Kozyris, supra note 253, at 35.

278. In Allstate Ins. Co. v. Hague, 449 U.S. 302, 308 n.10 (1981), the Court indicated that "[i]n deciding constitutional choice-of-law questions, whether under the Due Process Clause or the Full Faith and Credit Clause, this Court has traditionally examined the contacts of the State, whose law was applied, with the parties and with the occurrence or transaction giving rise to the litigation."

279. See generally L. BRILMAYER, supra note 274, ch. 7 (discussing evolution of choice of law principles).

280. Id. at 287-88. In Allstate Insurance Co., the Court appeared to allow a state to apply its law as long as a significant contact or aggregation of contacts created a state interest "such that choice of its law is neither arbitrary nor fundamentally unfair." 449 U.S. at 312-13. Subsequently, in Phillips Petroleum Co. v. Shutts, 472 U.S. 797 (1985), the Court looked at the fairness of applying a state's law to a nationwide class action in which a majority of the plaintiffs were out-of-state residents with no idea of which law would apply. "When considering fairness in this context, an important element is the expectation of the parties." Id. at 822. See generally Buxbaum, supra note 261 (discussing these cases in light of CTS Corp.). See also Kogan, Toward A Jurisprudence of Choice of Law: The Priority of Fairness Over Comity, 62 N.Y.U.L. REV. 651 (1987) (arguing that the primary constitutional limitation on choice of law is fairness to the litigants). In terms of fairness one can argue that there are expectations that the state of incorporation's law will apply, but the use of a significant nexus by the fourth-generation statutes and the ability to opt out may counter the fairness of applying the law of the state of incorporation.

281. 531 A.2d 206 (Del. 1987). The issue in the case was which law should determine whether a Delaware subsidiary of a Panamanian parent corporation could vote the shares of the parent. Under Delaware law, corporations incorporated in Delaware cannot have their
affairs doctrine and the power of states to regulate foreign corporations. The court found not only that conflict of law principles dictate the use of the law of the state of incorporation but also that the Constitution required this under the due process, full faith and credit, and commerce clauses.\textsuperscript{282} The court interpreted \textit{CTS Corp.} and \textit{Edgar} as mandating the internal affairs doctrine except in rare cases.\textsuperscript{283} In addition, the court indicated that full faith and credit, except in rare circumstances,\textsuperscript{284} required the use of the internal affairs doctrine. Because the facts of the case indicated that Delaware had no relationship with the corporation, the result makes sense. Given Delaware's role as the incorporating state of many

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shares voted by a majority-owned subsidiary. DEL. CODE ANN. tit. 8 § 160(c) (1988). The court used the internal affairs doctrine to apply Panamanian law. But cf. Norlin Corp. v. Rooney, Pace Inc., 744 F.2d 255 (2d Cir. 1984). This case involved a similar issue of the ability to vote the shares of a subsidiary where neither corporation was incorporated in New York. The court, applying New York law, found that Panama probably would not apply its law and went on to reject the automatic application of the internal affairs doctrine. According to the court:

Norlin's contacts with the State of New York are far from insubstantial. The company's principal place of business is located within the state, and its board of directors meets here. The resolution approving the contested stock issuances were adopted in this state, and the company stock has been traded on the NYSE. Whether these contacts are sufficient for a New York court to apply New York law is, in our view, a question that does not lend itself to a simple answer. We need not, however, grapple with it to resolve the present inquiry. The principles compelling a forum state to apply foreign law come into play only when a legitimate and substantial interest of another state would thereby be served. Conversely, when the interests of only one state are truly involved, the purported conflict is purely illusory. Thus there is no reason why the law of the forum state should not control.

\textit{Id.} at 263-64.

\textsuperscript{282} Id. at 217. The court cited the statements in \textit{CTS Corp.} that corporations "except in the rarest situations [are] organized under, and governed by, the law of a single jurisdiction, traditionally the corporate law of the state of its incorporation." \textit{Id.} (quoting \textit{CTS Corp.}, 107 U.S. at 1649). Tradition, not the Constitution, mandates this result.

\textsuperscript{283} Id. at 218. The national policy appears to relate to predictability, practicality, and equality, which require a single law. \textit{Id.} at 218 n.15 (citing Kozyris, supra note 253, at 34). The emphasis is on giving full faith and credit to the choice made by the parties. The problem with this approach is that it fails to recognize that the Court currently views full faith and credit as focusing on whether the state has a significant state interest such that its choice of law is neither arbitrary or unfair. \textit{Allstate Ins. Co.}, 449 U.S. at 312-13.
\end{quote}
publicly held corporations, the court’s declaration of the primacy of the internal affairs doctrine is not surprising. The decision in *McDermott, Inc.* uses the commerce clause to establish the use of a “lex incorporatonis” without any real balancing of interests. This rationale would automatically invalidate not only the fourth-generation statutes but also the statutes of states that apply corporate governance rules to foreign corporations.  

The Delaware court went too far in rejecting the use of a balancing test. Although the internal affairs doctrine usually suggests the state of incorporation as the proper choice of law, another state may have a dominant interest. The *Second Restatement of Conflicts* does not require the use of the law of the state of incorporation in all circumstances because that law is inapplicable in the unusual case in which another state “has a more significant relationship to the occurrence and the parties.” The Delaware court’s suggestion that the Constitution mandates the use of the law of the state of incorporation is contrary to the Supreme Court’s use of interest analysis. The Delaware court’s analysis appears to require the law of the state of incorporation in all cases, even when the application of another state’s law creates no conflict. Even those commentators who have argued for greater use of the commerce clause in corporate choice of law have not suggested

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285. See Kozyris, supra note 253, at 57-76.

286. The *Second Restatement of Conflicts* provides:

The local law of the state of incorporation will be applied to determine such issues, except in the unusual case where, with respect to the particular issue, some other state has a more significant relationship to the occurrence and the parties, in which event the local law of the other state will be applied.

*Restatement (Second) of the Conflict of Laws* § 302(2) (1971). The comment indicates that in the absence of an explicitly applicable law, the law of the state of incorporation should apply. Even if an explicit law exists, its application would be rare. Commentators have classified corporations according to the extent of their contacts with a state, and they differ on which state should be able to regulate. The pseudo-foreign corporation does all or nearly all its business in the state. See Latty, *Pseudo-Foreign Corporations*, 65 *Yale L.J.* 137 (1955). Other categories include the “technically foreign” corporation, which does approximately 80% of its business within the state, and the “arguably foreign” corporation, with 50% to 80% of its business in the state. Oldham, *Regulating the Regulators: Limitations Upon a State’s Ability to Regulate Corporations with Multi-State Contacts*, 57 *Den. L.J.* 345, 353 (1980). See also Kaplan, supra note 276; Reese & Kaufman, supra note 253.
that the law of the state of incorporation is the only law that should apply in all cases.287

Allowing a state with substantial interests to apply its own law appears to do little if any harm to interstate commerce. If anything, a rule automatically applying the law of incorporation to situations in which substantially all the assets and shareholders and the principal place of business are in one state that is not the state of incorporation, without any other nexus, would promote form over substance and abandon any real balancing of interests.288

Under a commerce clause analysis, the Court should not choose the law of a state with no resident shareholders over that of a state with substantial resident shareholders, especially if the law created no real conflict or burdens. This result would be particularly ironic in light of the strong support of state regulation articulated in CTS Corp.

The commerce clause thus should not mandate the use of the internal affairs doctrine. If courts are faced with inconsistent or

287. Kozyris, supra note 253, at 55 (arguing for a narrow exception for the pseudo-foreign corporation with a significant presence in one state). See Horowitz, supra note 263, at 819. Horowitz writes, “[A]pplication of the commerce clause to require all states to choose the same single law would not mean that the place of incorporation rule would then become the constitutionally required choice-of-law doctrine in all cases.” Id. He argues for determining which state has the significant interest based on location of the business. Id.

288. For example, Washington's statute is a business combination model that is intended to protect Boeing, the largest employer in the state. The legislation requires that the corporation employ more than 20,000 residents, have its primary offices in the state, have a majority of its assets and employees in the state, have more property in the state than elsewhere, and have either 10% of its shareholders as residents or 10% of its shares owned by residents or more than 5000 shareholders as residents. Washington Takeover Law, supra note 71. Boeing is incorporated in Delaware, where one would expect it has few assets or shareholders. Assuming that Washington's law conflicts with that of Delaware, should Washington's strong interest in its largest private employer carry some weight in balancing interests with burdens? In a footnote in his concurrence in Edgar, Justice Powell, who wrote the majority opinion in CTS Corp., wrote:

The corporate headquarters of the great national and multinational corporations tend to be located in the large cities of a few States. When corporate headquarters are transferred out of a city and State into one of these metropolitan centers, the State and locality from which the transfer is made inevitably suffer significantly. Management personnel—many of whom have provided community leadership—may move to the new corporate headquarters. Contributions to cultural, charitable, and educational life—both in terms of leadership and financial support—also tend to diminish when there is a move of corporate headquarters.

burdensome regulation involving corporate governance rules, they should recognize the importance of the doctrine in balancing interests under the commerce clause. The incorporating state’s regulation of corporate internal affairs is a significant interest of the state of incorporation. As the Court in CTS Corp. indicated, the lower court “failed to appreciate the significance for Commerce Clause analysis of the fact that state regulation of corporate governance is regulation of entities whose very existence and attributes are a product of state law.” Because the Court viewed the incorporating state’s interest as important to interstate commerce because of the state’s role in the creation of corporations, another state’s regulation must involve significant interests and benefits to overcome the burden to interstate commerce of not choosing the law of the state of incorporation. Thus, the law of the incorporating state should be applied presumptively, with the requirement of a strong showing by another state that it has a greater interest in order to rebut the presumption.

In CTS Corp., the Court found that a state “has an interest in promoting stable relationships among parties involved in the corporations it charters . . . .” The Court found that the Indiana statute furthered that interest. Other states also may have an interest in protecting “parties involved in the corporation” located in the state, such as substantial shareholders, major assets, a significant number of employees, or a principal place of business. The

289. In Edgar, the Court discussed the role of the internal affairs doctrine as a conflict of law principle that avoided a corporation being “faced with conflicting demands.” 457 U.S. at 645.
290. CTS Corp., 107 S. Ct. at 1649.
291. Id. at 1651. In Greenspun v. Lindley, 369 N.Y.S.2d 123, 330 N.E.2d 79 (1975), the New York Court of Appeals held that the law of Massachusetts applied prima facie to the question of demand in a derivative suit involving a real estate investment trust incorporated in that state. Id. at 125, 330 N.E.2d at 80. The court indicated, however:

[We reject any automatic application of the so-called ‘internal affairs’ choice-of-law rule, under which the relationship between shareholders and trustees of a business trust by strict analogy to the relationship between shareholders and directors of a business corporation would be governed by the law of the State in which the business entity was formed.

Id. at 126, 330 N.E.2d at 81. The record did not indicate a “significant association or cluster of significant contacts . . . to support a finding of such ‘presence’ ” in New York. Id. at 125, 330 N.E.2d at 80.
292. CTS Corp., 107 S. Ct. at 1651. The Court goes on to indicate that a state has an interest “as well in ensuring that investors in such corporations have an effective voice in
state of incorporation has its strong presumption because its law created the corporation. The greater the number or significance of the corporate interests located in a nonincorporating state, the greater the weight those interests are to be given in the balancing test. If the law creates conflict or inconsistency, a greater burden

corporate affairs.” Id. Thus, the stability of relations is an interest independent from investor protection.

293. For example, in TLX Acquisition Corp. the court found the Oklahoma fourth-generation statute unconstitutional because of the risk of inconsistent regulation and also because the statute’s burdens on interstate commerce outweighed the state interests in regulation. TLX Acquisition Corp. v. Telex Corp., No. 87-2056, slip op. at 8 (W.D. Mo. Nov. 3, 1987). The court recognized that Oklahoma has an interest in its shareholders and arguably in corporations with a major economic presence in the state. Id., slip op. at 23-24. The statute applied to a public corporation with 100 or more shareholders that had either its principal place of business, its principal office, or substantial assets in Oklahoma, and more than 10% of its shareholders residing in Oklahoma, more than 10% of its shares owned by residents, or 10,000 resident shareholders. Id., slip op. at 3 (citing 1987 Okla. Sess. Laws ch. 146, § 18).

According to the court, however, the state had no legitimate interest in nonresident shareholders, the internal affairs of foreign corporations, or out-of-state sales of stock. Id., slip op. at 24. The court found that the statute’s denial of voting rights to foreign corporations in nationwide tender offers or delay of the tender offer was a substantial burden on interstate commerce compared to the legitimate interests of protecting resident shareholders. Id., slip op. at 24-25.

Of course, the statutes have to reflect the concerns expressed by the legislature, and in many cases these fourth-generation statutes may fail to do so. For example, the court in Van Dusen Air, Inc. recognized that Minnesota had an interest in fostering a habitable business climate but found that its statute did not clearly meet that interest. APL Ltd. Partnership v. Van Dusen Air, Inc., 622 F. Supp. 1216, 1223 (D. Minn. 1985), vacated as moot, No. 85-5346 (8th Cir. Nov. 25, 1985). According to the court, Minnesota’s statute “appears to be based upon the questionable assumption that a person who acquires 20% of the voting stock of a corporation . . . is likely to engage in activity that is deleterious to Minnesota’s business climate, such as moving the corporate headquarters or base of operations outside of Minnesota.” Id.

In writing about the constitutionality of the New York “business combination model” this author expressed concern that although the promotion of long-term growth of New York corporations is a legitimate state interest, it is not clear that its statute will in fact promote that interest and thus be a benefit that is weighed against the burden on interstate commerce. First, it is not clear that highly leveraged takeovers or hostile takeovers will have an adverse economic benefit to the corporation, its shareholders, or New York state. In Edgar, the Court implicitly rejected this idea when it extolled the benefits of takeovers to shareholders and society. Second, all business combinations or share acquisitions by 20% owners are subject to the statute and the need for board approval, not just highly leveraged transactions or economically harmful transactions. Thus the impact of the statute is overbroad. Although subsequent acquiror activity is subject to board approval, which is subject to the business judgment rule, the statute does not appear to limit the board’s decisionmaking process to transactions that are harmful to New York. This appears to permit rejections for reasons unrelated to the announced purpose of the statute. Third, it is not clear that the
is required to rebut the presumption of the law of incorporation. Thus, the more localized the interests, the better the chance that a state can rebut the presumption.294 This approach may fall somewhere between the Court's current approach to choice of law, which looks to factors such as state interests, fairness to the defendant, and the relationship of the forum to the action,295 and the position of the Second Restatement of Conflicts, which normally applies the law of the state of incorporation, except in narrow circumstances.296

Although courts traditionally do not use the commerce clause to choose a state law, the practical effect of determining whether a fourth-generation statute that creates inconsistent regulation impermissibly burdens interstate commerce will be the selection of that law or the law of state of incorporation.297 The selection of a law in that case by a balancing of interests under the commerce clause makes sense in the corporate law context. Although the courts traditionally have looked to state law, and particularly the law of the state of incorporation, for the rules associated with cor-

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294. In Pike, the Court indicated that in determining when a legitimate local purpose is found, "the question becomes one of degree. And the extent of the burden that will be tolerated will of course depend on the nature of the local interest involved, and on whether it could be promoted as well with a lesser impact on interstate activities." Pike v. Bruce Church, Inc., 397 U.S. 137, 142 (1970).

295. L. Brilmayer, supra note 274, at 287.

296. Id. at 243.

297. In light of the fourth-generation statutes requirement of a significant presence in the state, a situation involving more than two states—the state of incorporation and the state that enacted the fourth-generation statute—will be rare.
porate governance, this tradition was based to a large degree on both the failure of other states to act and an earlier view of the requirements of the full faith and credit clause. Corporations are important to the nation’s economy, and many corporations have a national presence in terms of both their business activities and those who invest in the corporation. The need for large economic actors requires corporations to have access to capital on a national, if not an international, level. Although the federal government has taken a role under federal securities regulation in protecting the interests of those who invest their capital, the state of incorporation traditionally has regulated in the area of corporate governance with minimal interference from either the federal government or other states in which the corporation may have a significantly greater presence.

As the publicly held corporations become larger, they often have very limited ties to the state of incorporation. This incorporation, however, creates both the entity and the law that usually applies to the relationships created. States other than the incorporating state are now taking a more active role and have enacted the fourth-generation takeover statutes because they perceive that hostile takeovers may be harmful to interests in the state.

Because these fourth-generation statutes may create inconsistent and burdensome regulation and have an extraterritorial reach, the need to keep interstate commerce free of unreasonable burdens may be growing. Given the practical problems of a corporation that tries to meet burdensome inconsistent regulations, the commerce clause seems an appropriate means of resolving these burdens by in effect selecting a single law. The fact that many of these

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298. In CTS Corp., the Court indicates that “the markets that facilitate this national and international participation in ownership of corporations are essential for providing capital not only for new enterprises but also established companies that need to expand their businesses.” 107 S. Ct. at 1650. See also R. Jennings & H. Marsh, Securities Regulation 2 (6th ed. 1987) (citing Report of Special Study of Securities Markets, H.R. Doc. No. 95, 88th Cong., 1st Sess. (1963)), which states that “the trading market unquestionably has an important bearing on the flow of new capital into private enterprise, and thus on the country’s rate of economic growth. The securities markets’ vast resources for marshalling the capital of individual investors all over the world give corporate enterprise access to large sources of funds that would not otherwise be available.”

299. According to Professor Brilmayer, the factors relevant in choice of law include:

(a) The needs of interstate and international systems
fourth-generation statutes permit the corporation to opt out of the legal regimen may also be significant in a commerce clause analysis. Because a corporation can choose not to be covered, it can ease the potential regulatory burden of compliance with multiple regulation. Thus, a corporation may choose uniformity by rejecting the statutory protection. Consequently, the states have limited the exportation of their law. In practice, however, opting out may not be easy because the statutes usually require a shareholder vote.  

**c. Delaware’s Potential Problem**

When the Court in *CTS Corp.* discussed a state’s ability to regulate foreign corporations, it also questioned the extent to which a state could regulate the internal affairs of a corporation that was incorporated in that state but had no other significant nexus to that state, which could be a problem for Delaware’s statute. In *CTS Corp.*, the Court indicated that Indiana had an interest in protecting nonresident shareholders because the corporation was incorporated in the state and because Indiana had an interest in preventing the corporate form from being used in unfair dealing. The Indiana statute differed from the Illinois statute in *Edgar* because Indiana’s law applied to corporations with a substantial number of shareholders residing in the state. According to the

(b) The relevant policies of the forum
(c) The relevant policies of other interested states and the relative interests of those states in the determination of a particular issue
(d) The protection of justified expectations
(e) The basic policies underlying the particular field of law
(f) Certainty, predictability, and uniformity of result.

L. Brilmayer, supra note 274, at 243. Although these factors may also be relevant to the commerce clause, the federal interests protected by that clause may involve different policies. Thus in some situations, conflict of law principles may dictate a different result than the commerce clause would.

300. In TLX Acquisition Corp. v. Telex Corp., No. 87-2056-R (W.D. Okla. Nov. 3, 1987), the court found that the opt-out provision was itself an internal affairs type statute and that it created the risk of inconsistent regulation. Slip op. at 23. According to the court, another state could have enacted a similar but inconsistent law and the corporation might not have had the time to respond to an acquisition covered by the statute by opting out. *Id.* But cf. Phillips Petroleum Co. v. Shutts, 472 U.S. 797 (1985) (the Court refused to apply the law of the forum because of the unfairness to plaintiff and gave little credence to the ability of a plaintiff to opt out of the class action).

301. *CTS Corp.*, 107 S. Ct. at 1651-52.

Court, “every application of the Indiana Act will affect a substantial number of Indiana residents, whom Indiana indisputably has an interest in protecting.” This discussion in CTS Corp. may indicate that Delaware will not be able to impose a takeover statute when the number of resident shareholders is insignificant. The Court’s discussion, however, was dictum. It was intended to further emphasize the difference between the Indiana statute and the Illinois statute that was unconstitutional in Edgar. Consequently, given the Court’s emphasis on the importance of state corporate law and the corporation as a creature of the state, the lack of a shareholder nexus in the Delaware statute should not be significant unless another state can overcome the strong presumption that the state of incorporation law applies.

2. Private Contracting

The Court left open the question whether the commerce clause is implicated if the corporation’s decision to incorporate in a particular state is really a private decision to choose a state’s law. The Court indicated that it would not consider CTS’s contention that the Indiana statute did not violate the commerce clause regardless of its burdens “because a corporation’s decision to be covered by the Act is purely ‘private’ activity beyond the reach of the Commerce Clause.” This notion of private activity has two implications. In a broad sense it could mean that for commerce clause purposes, all state corporate law is contractual in nature, but in a narrower sense it could suggest that the mere act of incorporat-

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304. Id. at 1652 n.14. The fact that the corporations may opt out of the models may also suggest that the statutes are contractual in nature and not subject to the commerce clause.
305. In discussing corporate statutory provisions that affect both resident and nonresident shareholders, the Court in CTS Corp. also referred to partnership provisions that accomplish similar results. CTS Corp., 107 S. Ct. at 1650 n.12. The Court pointed out that the Indiana statute bore a “striking resemblance” to provisions of the Uniform Partnership Act and Uniform Limited Partnership Act which limit the right of someone to gain control of the partnership. Id. The partnership model has been described as “suppletory” in the sense that the law permits contractual modification but attempts in the absence of contract to supply terms that meet the expectations of the parties. M. Eisenberg, The Structure of the Corporation 9 (1976). The large public corporation usually has been viewed differently because of the amount of economic power it wields. Id. at 18. In any case, the Court’s analogy to partnership may indicate its recognition that corporate law is becoming more contractual. See also Data Probe Acquisition Corp. v. Datatab, Inc., 722 F.2d 1 (2d Cir. 1983)
ing is no different than a contractual choice of law provision. In either case private contracting usually is not subject to regulation under the commerce clause.

Some commentators have argued that the corporation is merely a "nexus of contracts," with the entity serving to facilitate contracting among its constituencies. Under this view, state corporate law provides the standard legal arrangement that reduces transaction costs of private bargaining and benefits shareholders. State corporate law has in fact developed from a regulatory focus to a more enabling legal regimen that allows contractual modifications of some of its rules. Often the mechanism provided to alter these rules is shareholder amendment to the certificate of incorporation or bylaws. This does not mean, however, that corporate law should be viewed as purely an issue of contract. This contractual model has been criticized as inappropriate in public corporations in which the shareholders are widely dispersed and are incapable of real bargaining over the terms of the contract.

When a firm incorporates, the parties arguably are choosing that state's laws to govern the internal affairs of the corporation. This is similar to contractual choice of law provisions. This choice,
however, does not necessarily mean that a state’s corporate law does not involve governmental interests.\textsuperscript{313} Otherwise, much of state corporate law would be immune from scrutiny under the commerce clause.\textsuperscript{314} Given the strong statement of the role of the state and its interest in its corporations in the Court’s opinion in \textit{CTS Corp.}, courts should continue to scrutinize these statutes and other corporate law on commerce clause grounds. They should use the internal affairs doctrine in balancing under the commerce clause as opposed to complete acceptance of the notion of private contracting.

Even if a court views the act of incorporating as similar to a private contractual choice, the law of the state of incorporation will not automatically apply to all its corporations. A contractual choice of law is subject to another state’s law when the chosen law

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In incorporating in a particular State, shareholders, for their own particular reasons, determine the body of law that will govern the internal affairs of the corporation and the conduct of their directors. Delaware is obviously a state in which, for various reasons, many businesses choose to incorporate. The corporation and its shareholders rightfully expect that the laws under which they have chosen to do business will be applied. For choice of law purposes, the decision of shareholders to incorporate under the law of one jurisdiction is no different from designating the law governing a business trust, which prima facie determines the applicable law.

\textit{Id.} at 184-85, 517 N.Y.S. 2d at 493 (citation omitted). \textit{See also} Rogers v. Guaranty Trust Co., 288 U.S. 123 (1933). The Court indicated, “When, by acquisition of his stock, plaintiff became a member of the corporation, he, like every other shareholder, impliedly agreed that in respect of its internal affairs the company was to be governed by the laws of the State in which it was organized.” \textit{Id.} at 130.

\textsuperscript{313} Justice Brennan suggested in his dissent in \textit{Shaffer v. Heitner} that because a corporation is the creature of the state, actions that impact on the management of the corporation, whose powers and duties are defined by state law, implicate the state’s public policy.

\textit{433} U.S. 186, 224 (1977) (Brennan, J., dissenting). \textit{But cf.} Moran v. Household Int’l Inc., 500 A.2d 1346 (Del. 1985). In \textit{Moran}, the Supreme Court of Delaware stated, “The fact that directors of a corporation act pursuant to a state statute provides an insufficient nexus to the state for them to be state action which may violate the Commerce Clause or Supremacy Clause.” \textit{Id.} at 1353.

\textsuperscript{314} For example, if a state enacted a statute under its corporate law that required corporations incorporated in that state to remain incorporated in that state, would that law be constitutional because the corporation contractually chose that state? In \textit{Great W. United Corp. v. Kidwell}, the United States Court of Appeals for the Fifth Circuit indicated that “statutes \textit{requiring} business operations to be performed in the home state that could more efficiently be performed elsewhere impose a burden on commerce that is \textit{per se} illegal.” 877 F.2d 1256, 1282 (5th Cir. 1978) (emphasis in original), \textit{rev’d sub nom.} Leroy v. Great W. United Corp., 443 U.S. 173, on \textit{remand}, 602 F.2d 1246 (5th Cir. 1979).
\end{quote}
runs contrary to a fundamental policy of the state concerning the applicable law. Thus the fourth-generation statutes are not necessarily inapplicable under choice of law principles. If a state has significant interests dictating that its law should apply, then, notwithstanding the private choice and consistent with conflict of law principles, its law will apply. Thus, in most cases of conflict, the law of incorporation presumptively will prevail unless stronger governmental interests of another state can rebut the presumption.

V. Conclusion

The Court in CTS Corp. was correct in finding the Indiana statute constitutional. The courts should be wary of invalidating any of the other state takeover statutes. The use of the Williams Act to invalidate state corporate law without a stronger showing of congressional intent or a direct interference from its provisions seems inappropriate. Although Congress could federalize corporate law, it has been reluctant to do so. The states traditionally have regulated corporate law, and Congress has chosen to preempt that law only in limited and explicit circumstances.

Of course, states are not free to preclude access to the corporation or its shares. Under the rationale of CTS Corp., resident and nonresident shareholders must have equal access within the time frames of the Williams Act. Corporate law need not provide the offeror with an unregulated access, however. The policy underlying the Williams Act is investor protection. If state regulation focuses directly on the shareholders and facilitates their decisionmaking, then it furthers the Williams Act’s goals. Even if a statute places power in the board of directors, that regulation is not inconsistent with those goals given the traditional role of the states in establishing the rules of corporate governance. A strong showing that state

315. Restatement (Second) of the Conflict of Laws § 187 comment g (1971). In Greenspun v. Lindley, the court left open the question whether the explicit choice of Massachusetts law in the trust agreement in that case would not allow another state’s law to apply. 36 N.Y.2d 473, 478, 330 N.E.2d 79, 81, 369 N.Y.S.2d 123, 126 (1975). The fourth-generation statutes are not necessarily more difficult to avoid than the other corporate statutes that use the state of incorporation. A corporation can decide to reincorporate or opt out of the statute if it wants to avoid the law of the incorporating state. A corporation can also avoid the law of most of the fourth-generation statutes because of the right to opt out of the statutes.
regulation interferes with investor protection will be required before that regulation will be preempted.

The use of the commerce clause to invalidate state corporate law has also been restricted by the opinion in *CTS Corp.* State corporate law appears to have a strong presumption in its favor because of the state's role in the creation of corporations and the relationships within the corporation. This is a significant interest that should be presumptively valid when balanced against the burdens to interstate commerce. The commerce clause should not be used to resolve the debate over what constitutes investor protection.

The state of incorporation, however, may not have the only interest in its corporations when a particular corporation has a significant relationship with another state. The courts should not use the commerce clause to mandate the internal affairs doctrine, which applies the law of the state of incorporation. Instead, when regulations are inconsistent the courts should consider another state's interest by balancing the benefits with the burdens on interstate commerce. Given the strong interest of the state of incorporation in corporate internal affairs, the nonincorporating state must overcome the burden on interstate commerce of not applying the internal affairs doctrine. Thus, the law of the state of incorporation usually will apply. In certain circumstances, however, a significant local presence may be sufficient to allow another state to regulate.

The Supreme Court has accepted a role for the states in the market for corporate control and has limited the use of the Constitution to protect that market. Although the market for corporate control provides some benefits, so does state corporate law. The debate over the roles of this market and of the states in the protection of investors, the concerns for other interests within the corporate community, and the overall societal impact of hostile takeovers remain controversial. The resolution of this debate belongs in Congress, in the state legislatures, and in the capital markets.

316. Following the decision in *CTS Corp.*, Congress has entertained conflicting proposals both to preempt state law on takeovers and to explicitly permit it. Robb, SEC Faces Doubt On Takeover Plan, N.Y. Times, Sept. 19, 1987, at 41.