integrity of the markets, on the one hand, and the useful function of Wall Street professionals, on the other. In the absence of a clear breach of confidence to an employer or client, the SEC should proceed cautiously. Moreover, the SEC should seek tippee liability only when it can clearly establish knowledge by a tippee of a breach of such confidence. An overzealous enforcement policy can impede the free flow of information necessary to creating more efficient markets.[61]

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THE WILLIAMS ACT AND PREEMPTION OF SECOND GENERATION STATE TAKEOVER LEGISLATION

In 1982, in *Edgar v. MITE Corp.*,[1] the United States Supreme Court declared unconstitutional the Illinois Business Takeover Act.[2] A majority of the Court found that the statute impermissibly burdened interstate commerce.[3] Three justices argued further that the Williams Act,[4] the principal federal legislation regulating corporate takeovers, preempted the Illinois act.[5] Two justices disagreed, interpreting the Williams Act to leave some room for state regulation of corporate takeovers.[6]

61. *See* The SEC v. Wall Street, *supra* note 2; *but cf.* Laderman, *supra* note 1.

1. 457 U.S. 624 (1982).
2. ILL. REV. STAT. ch. 121½, § 137.51 *et seq.* (1979). *See infra* notes 19-22 and accompanying text.
3. 457 U.S. at 643-46.
4. Pub. L. No. 90-439, 82 Stat. 454 (1968) (codified as amended at 15 U.S.C. §§ 78m(d)-(f), 78n(d)-(e) (1982)).
5. 457 U.S. at 620-40. Article VI, clause 2 of the United States Constitution provides that "the Laws of the United States . . . shall be the supreme Law of the Land . . ., any Thing in the Constitution or Laws of any state to the contrary notwithstanding." The Supreme Court has held that the supremacy clause invalidates not only state laws that conflict directly with the operation of federal law, but also state laws that conflict with the purposes of the federal law. *See, e.g.*, Rice v. Santa Fe Elevator Corp., 331 U.S. 218, 229-30 (1947).
6. Justice Powell found nothing in the Williams Act to suggest "a congressional intent to prohibit state legislation designed to assure—at least in some circumstances—greater protection to interests that include but often are broader than those of incumbent management." 457 U.S. at 646, 647 (Powell, J., concurring). Justice Stevens discerned no "prohibition against state legislation

Recently, several federal courts have extended the *MITE* plurality's preemption analysis to invalidate state takeover legislation designed to avoid the Court's objections to the Illinois Act.[7] In preempting these so-called "second-generation statutes," however, the courts jumped too eagerly onto the *MITE* plurality's bandwagon. Applying literally the language of the *MITE* plurality, the courts failed to distinguish the effects of these statutes from the effects of the Illinois act involved in *MITE*. In fact, the second-generation statutes involved in these cases arguably *effectuate* the purposes underlying the Williams Act. Perhaps more importantly, extending the reasoning of the *MITE* plurality to these statutes has broad implications for other areas of corporate law that traditionally have been, and should continue to be, left to the states. This Recent Development examines these issues and concludes that these cases represent an inappropriate extension of the rationale of the *MITE* plurality.

I. *EDGAR V. MITE CORP.* AND THE PREEMPTIVE EFFECT OF THE WILLIAMS ACT

A. *The Williams Act*

Congress enacted the Williams Act in 1968 to fill a gap in the protection offered investors under the federal securities laws.[8] Although the federal securities laws regulated other forms of effecting a change of corporate control, such as proxy contests[9] and mergers,[10] neither the federal government nor the states regulated cash tender offers. As in these other areas, Congress elected to regulate takeovers primarily through disclosure.[11] It did, however, extend shareholders some substantive protection against the coercive nature of tender offers. Thus, the Act seeks to give

designed to provide special protection for incumbent management." *Id.* at 647, 655 (Stevens, J., concurring).

7. *See* Dynamics Corp. of America v. CTS Corp., 794 F.2d 250 (7th Cir.), *prob. juris. noted,* 107 S. Ct. 258 (1986); Terry v. Yamashita, 643 F. Supp. 161 (D. Hawaii 1986); Fleet Aerospace Corp. v. Holderman, 637 F. Supp. 742 (S.D. Ohio), *aff'd,* 796 F.2d 135 (6th Cir. 1986); APL Ltd. Partnership v. Van Dusen Air, Inc., 622 F. Supp. 1216 (D. Minn. 1985); Icahn v. Blunt, 612 F. Supp. 1400 (W.D. Mo. 1985).

8. *See* H.R. REP. NO. 1711, 90th Cong., 2d Sess. 4 (1968), *reprinted in* 1968 U.S. CODE CONG. & AD. NEWS 2811, 2813 [hereinafter cited as HOUSE REPORT]; S. REP. NO. 550, 90th Cong., 1st Sess. 1 (1967) [hereinafter cited as SENATE REPORT].

9. *See* 15 U.S.C. § 78n(a)-(c) (1982).

10. The federal securities laws regulate mergers through (1) the proxy regulations, *see id.*, when shareholder votes are required by state law, and (2) the registration requirements under the Securities Act of 1933, 15 U.S.C. § 77a *et seq.* (1982), when shares are exchanged.

11. *See* HOUSE REPORT, *supra* note 8, at 2812-13; SENATE REPORT, *supra* note 8, at 3.

shareholders sufficient time to decide whether or not to tender their shares pursuant to a tender offer.[12]

To effectuate these purposes, the Williams Act requires a tender offeror to file certain disclosures concerning his bid with the Securities and Exchange Commission.[13] The Act also compels the bidder to keep his offer open for at least twenty business days.[14] Once a shareholder tenders his shares, the Act extends him limited withdrawal rights with respect to those shares.[15] In a partial tender offer, the bidder must purchase the tendered shares on a pro rata basis.[16] Finally, if the offeror increases his offering price, all tendering shareholders are entitled to the higher consideration, even those who deposited their shares before the increase.[17]

B. Edgar v. MITE Corp. *and State Regulation of Takeovers*

Apparently dissatisfied with the protection afforded investors by the Williams Act, and motivated in part by a desire to protect local corporations from takeovers,[18] 37 states enacted legislation regulating tender offers. These statutes emulated, but often went beyond, the provisions of the Williams Act. The Illinois act at issue in *MITE* was typical. It required that the offeror disclose his intentions *prior* to commencing a bid.[19] It also authorized Illinois' Secretary of State to hold a hearing on the offer, either at his discretion or at the request of any person owning at

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12. *See* HOUSE REPORT, *supra* note 8, at 2812.

13. *See* 15 U.S.C. §§ 78m(d)(1), 78n(d)(1) (1982); 17 C.F.R. § 240.13d-1 (1986). The Act also subjects solicitations and recommendations concerning an offer, including those of incumbent management, to similar disclosure requirements. *See* 15 U.S.C. § 78n(d)(4) (1982); 17 C.F.R. § 240.14d-9 (1986). Indeed, target management *must* disclose its position on a proposed tender offer within ten days of announcement of the bid. *See* 17 C.F.R. § 240.14e-2 (1986).

14. *See* 17 C.F.R. § 240.14e-1(a) (1986).

15. *See* 15 U.S.C. § 78n(d)(5) (1982); 17 C.F.R. § 240.14d-7 (1986).

16. 15 U.S.C. § 78n(d)(6) (1982).

17. *Id.* at § 78n(d)(7).

18. In fact, some states enacted legislation designed to thwart specific takeover attempts of corporations within the state. Missouri enacted a tender offer statute to protect Trans World Airlines, Inc. from Carl C. Icahn's takeover attempt. Utah sought to block the rumored Arab takeover of Kennecott Copper Corp. *See* Comment, Edgar v. MITE Corp.*: Is the Preemption of State Takeover Statutes Complete,* 1983 UTAH L. REV. 415, 422-23.

19. ILL. REV. STAT. ch. 121 ½, § 137.54.A. (1979). In enacting the Williams Act, Congress specifically refused to provide for such pre-commencement notification of the target corporation by a bidder. *Compare* 113 CONG. REC. 854, 856-57 (1967) (text of S. 510 reintroduced in the 90th Congress by Senator Williams) *with* 111 CONG. REC. 28256, 28258 (1965) (statement of Senator Williams describing S. 2731, the predecessor of S. 510 introduced in the 89th Congress).

least ten percent of the corporation's outstanding shares.[20] If the secretary found that the offeror failed to provide "full and fair disclosure" or that the offer was inequitable, the offer could not proceed.[21] In any event, the offer could not proceed until the secretary completed the hearing.[22]

Relying on the legislative history of the Williams Act, the plurality in *MITE* argued that the Illinois statute frustrated the Williams Act's policies of neutrality[23] and investor autonomy.[24] The provisions for precommencement notification and administrative hearings introduced extended delay into the tender offer process, giving incumbent management additional time to combat the offer, and thereby unduly favored target management in a takeover contest.[25] Allowing a state official to block a tender offer substituted "investor protection" for "investor autonomy," contrary to Congress' desire that investors decide whether or not to tender their shares pursuant to a tender offer.[26]

II. SECOND GENERATION STATE TAKEOVER STATUTES AND THE EXTENSION OF *EDGAR V. MITE CORP.*

In the wake of *MITE*, several states enacted various types of statutes regulating corporate takeovers.[27] Generally, these second-generation state statutes seek to regulate tender offers in a manner consistent with the state's existing regulation of corporations.[28] State corporation law traditionally has provided the substantive regulation of mergers, in part by requiring the affirmative vote of the shareholders before a proposed

20. ILL. REV. STAT. ch. 121 ½, at § 137.54.A.

21. *Id.* at § 137.54.F.

22. *Id.* at § 137.54.B.

23. The *MITE* plurality viewed the Williams Act as establishing a balance between incumbent management and tender offerors. 457 U.S. at 634. This notion derives from several statements in the legislative history of the Act to the effect that Congress took "extreme care to avoid tipping the scales either in favor of management or in favor of the persons making the takeover bids." 113 CONG. REC. 24664 (1967) (statement of Senator Williams); *see also* HOUSE REPORT, *supra* note 8, at 2813; SENATE REPORT, *supra* note 8, at 3.

24. The *MITE* plurality explained the Williams Act's concept of investor autonomy as follows: once target management had been given opportunity to express its position on a tender offer, "Congress anticipated that the investor if he so chose, and the takeover bidder should be free to move forward within the time-frame provided by Congress." 457 U.S. at 634.

25. 457 U.S. at 634-39.

26. *Id.* at 639-40.

27. *See generally* Thompson, *Defining the Federal and State Realms of Tender Offer Regulation*, 64 WASH. U.L.Q. 1057 (1986).

28. *Id.*

merger can go through.[29] One type of second-generation statute, the so-called "control share acquisition statute," simply seeks to subject tender offers to a similar vote.[30]

Inevitably, these statutes delay the tender offer process. After the offeror notifies the target corporation of its offer, target management must call a meeting of the shareholders to vote on the proposed acquisition and solicit proxies on the matter. Although most control share acquisition statutes require that the meeting be held within fifty days after the offeror notifies the target corporation,[31] the logistical problems associated with calling a shareholder meeting (as well as target management's self-interest) ensure that the meeting will not occur significantly before the end of the fifty day period. During this time, the bidder cannot close his offer.

In light of the *MITE* plurality's focus on delay under the Illinois statute, this delay figured prominently in Supremacy Clause challenges to control share acquisition statutes. The potential fifty day delay, the courts maintained, thwarted the purposes of the Williams Act by extending its twenty business day (approximately 28 day) timetable. In the words of Judge Posner in *Dynamics Corp. of America v. CTS Corp.*,[32] "if the Williams Act is to be taken as a congressional determination that a month (roughly) is enough time to force a tender offer to be kept open, fifty days is too much."

But, drawing from the notions of investor autonomy contained in the

29. *See, e.g.*, DEL. CODE ANN., tit. 8, § 251 (1983); REV. MODEL BUS. CORP. ACT § 11.01(a) (1984). State merger provisions generally require that the directors approve the merger plan before submitting it to shareholders for approval. Tender offers, on the other hand, bypass target management. The bidder makes an offer to purchase shares directly from shareholders. A significant, if not predominent feature, of second generation state statutes is an attempt to create a stronger role for target management in a tender offer. Control share acquisition statutes accomplish this by exempting statutory mergers from the terms of the statute. *See, e.g.*, MINN. STAT. ANN. § 302A.011 subd. 38 (West 1985); MO. ANN. STAT. § 351.407(10) (Vernon Supp. 1987); OHIO REV. CODE ANN. § 1701.01(Z)(2) (Page 1985). Statutory mergers require only a majority vote of the shareholders, including the bidder. Thus, if the supermajority shareholder voting provisions of control share acquisition statutes sufficiently increase the cost of a hostile takeover to a bidder as some suggest, *see infra* notes 31-35 and accompanying text, the bidder will prefer to negotiate a friendly, less costly deal with target management.

30. *See, e.g.*, MINN. STAT. ANN. § 302A.671 (West 1985 & Supp. 1987); MO. ANN. STAT. § 351.407 (Vernon Supp. 1987); OHIO REV. CODE ANN. § 1701.831 (Page 1985). Each of these statutes requires a "supermajority" vote of the shareholders. Ohio and Minnesota require a majority vote of the shares held by "disinterested" shareholders; Missouri requires a two-thirds vote of the "disinterested" shareholders.

31. *See* statutes cited *supra* note 30.

32. 794 F.2d at 263.

plurality opinion in *MITE*,[33] the courts also found the requirement of shareholder approval inconsistent with the purposes of the Williams Act. According to Judge Posner, subjecting a tender offer to a vote of the shareholders put the acquirer at the "tender mercies" of the disinterested shareholders.[34] Another court maintained that shareholder approval took the decision to tender "out of the hands of the shareholder and placed it in the hands of management and other shareholders."[35] In a similar vein, one court criticized the shareholder approval requirement as depriving the investor of the ability to make an independent decision, exclusive of the other shareholders in the company.[36]

III. ANALYSIS

In invalidating the control share acquisition statutes at issue in these cases, the courts seized on the language of the *MITE* plurality too eagerly and applied it with questionable validity. In light of the Illinois provisions before the Court in *MITE*, the focus on the additional delay created by the control share acquisition statutes seems overstated, if not misplaced. If delay helps incumbent management, the longer delay afforded by these statutes arguably helps it more. But the *MITE* plurality's disapproval of a measure that might delay a takeover *indefinitely* should not necessarily result in the invalidation of statutes that would delay a takeover seven weeks rather than the four weeks prescribed by the Williams Act. Measured by the possible deterrent effect additional delay would have on potential tender offerors—the overriding concern of Congress in refusing to introduce further delay into the tender offer process[37]—control share acquisition statutes are almost certainly distinguishable from the Illinois statute involved in *MITE*.

It is also important to remember that federal regulation was *intended* to delay the tender offer process and provides for a *minimum* twenty business day delay.[38] This delay affords shareholders additional time in which to decide whether or not to tender their shares and affords target management time to respond to an offer. Without ascribing too much importance to these aspects of the federal regulation, nevertheless the

33. *See supra* notes 24 & 26 and accompanying text.
34. 794 F.2d at 262.
35. *Icahn*, 612 F. Supp. at 1420.
36. *Fleet Aerospace*, 637 F. Supp. at 758.
37. *See* HOUSE REPORT, *supra* note 8, at 2813; SENATE REPORT, *supra* note 8, at 3.
38. *See supra* notes 12 & 14 and accompanying text.

additional three week delay might actually be consistent with the Williams Act.

It requires a similar leap in logic to conclude that requiring shareholder approval of a tender offer is as destructive of investor autonomy as allowing a state official to block a takeover if he finds it inequitable. Majority shareholder approval admittedly diminishes an individual investor's autonomy to some extent.[39] But it leaves the decision in the hands of the shareholders as a group, the locus of other major decisions about the direction of corporate policy.[40] And certainly majority shareholder approval is far closer to the sphere of investor decisionmaking than a requirement that a state official give the tender offer his imprimatur. Moreover, shareholder approval of a proposed tender offer at a meeting called for that purpose eliminates the coercive nature of tender offers which Congress sought to remedy.[41]

On a more fundamental level, extending the reasoning of the *MITE* plurality to control share acquisition statutes implicates a much broader range of state regulation of corporations. In fact, the control share acquisition statutes themselves, even though they directly regulate tender offers,[42] parallel traditional aspects of state regulation of corporations.[43] In focusing on delay, the *MITE* plurality emphasized that delay permits incumbent management to take additional steps to defeat a bid, thereby

39. The individual investor is no longer free to sell his shares to a tender offeror without the consent of the holders of a (super)majority of the corporation's outstanding shares. Moreover, because the market price of the shares would reflect the uncertainty surrounding the shareholder vote, selling into the market would not be an adequate alternative.

40. The *Revised Model Business Corporation Act*, for example, requires a shareholder vote to elect the corporation's directors (REV. MODEL BUS. CORP. ACT. § 7.28 (1984)), to amend the articles of incorporation (*id.* at § 10.03), and to approve fundamental corporate changes such as mergers (*id.* at § 11.01), share exchanges (*id.* at § 11.02), and a sale of substantially all of the corporation's assets, except in the regular course of business (*id.* at §§ 12.01 & 12.02).

41. *Cf. supra* note 12 and accompanying text. Tender offers are illustrative of the "prisoners' dilemma." An individual shareholder, even though he believes the tender offer price is inadequate, will tender his shares pursuant to the offer fearing that because the other prisoners, the other shareholders, may not share his views and thus may tender their shares, he will be left as a minority shareholder in a close corporation. All shareholders face the same dilemma and therefore tender their shares, ensuring the success of the bid. Control share acquisition statutes eliminate this problem by permitting the shareholders to get together—to come to a consensus about the offer—before tendering their shares.

42. The fact that control share acquisition statutes directly regulate the tender offer transaction could provide a means by which the Court could distinguish other forms of second-generation state regulation. The other types of second-generation statutes generally regulate second-step merger transactions and thus have a less direct effect on the tender offer transaction.

43. *See supra* text accompanying notes 28-29.

increasing the expected cost of a takeover to a potential bidder, and thus discouraging takeover bids.[44] It viewed the Williams Act as expressly forbidding this result. This notion of the Act could be applied with equal force to other forms of state regulation which similarly increase the bidder's takeover costs.[45] Moreover, much of state corporate law can be construed as taking tender offer decisions out of the hands of individual shareholders, contrary to the concept of investor autonomy.[46] Thus, extending the reasoning of the *MITE* plurality would likely federalize much of state corporate law.

Such a result would seem to conflict with another line of Supreme Court authority expressed most clearly in *Santa Fe Industries, Inc. v. Green*.[47] In *Santa Fe* the Court declined to expand the reach of rule 10b-5 to allegations of corporate mismanagement,[48] holding that a rule 10b-5 cause of action must allege an element of deception.[49] But the Court stated further:

> [T]his extension of the federal securities laws would overlap and quite possibly interfere with state law .... Absent a clear indication of congressional intent, we are reluctant to federalize the substantial portion of the law of corporations that deals with transactions in securities, particularly where established state policies of corporate regulation would be overridden.[50]

The Court found no such intention in section 10(b) of the Exchange Act.

Similarly, no such intention appears in the Williams Act. Indeed, such a result would appear to be foreclosed by the Supreme Court's decision in *Schreiber v. Burlington Northern, Inc.*,[51] which draws from and parallels *Santa Fe*. In *Schreiber*, the plaintiff alleged facts that suggested that target management benefitted in a takeover bid at the expense of sharehold-

44. *See MITE*, 457 U.S. at 635; *cf. id.* at 643-44.

45. *See* Thompson, *supra* note 27.

46. *See id.*

47. 430 U.S. 462 (1977).

48. The plaintiffs in *Santa Fe* challenged a short-form merger effected in conformity with state law. They alleged that management intentionally undervalued the company's stock for its own benefit. These actions allegedly violated rule 10b-5 which proscribes "any device, scheme, or artifice to defraud," 17 C.F.R. § 240.10b-5 (1986). 430 U.S. at 466-68. The Court of Appeals for the Second Circuit agreed and held that rule 10b-5 encompassed a shareholder's claim "that the majority has committed a breach of its fiduciary duty to deal fairly with minority shareholders by effecting the merger without any justifiable business purpose." Green v. Santa Fe Indus., Inc., 533 F.2d 1283, 1291 (2d Cir. 1976), *rev'd,* 430 U.S. 462 (1977).

49. 430 U.S. at 473-74.

50. *Id.* at 479.

51. 105 S. Ct. 2458 (1985).

ers.[52] The Court read section 14(e) of the Exchange Act to require an element of deception.[53] Thus, as in *Santa Fe*, the Court refused to find a cause of action for conduct seemingly governed by state law.

IV. CONCLUSION

The reasoning employed in recent cases invalidating state regulation of takeovers compels the conclusion that the Williams Act preempts any state regulation that increases the cost of a takeover bid or that takes the tender offer decision out of the hands of individual investors. This conclusion, however, does not follow necessarily from the Supreme Court's decision in *Edgar v. MITE Corp.* Moreover, it seems to conflict with another well-established line of Supreme Court authority. There may be sound practical reasons for limiting all state regulation of corporate takeovers.[54] But Congress did not contemplate such a result when it enacted the Williams Act.

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52. *Id.* at 2460-61.
53. *Id.* at 2461-65.
54. *See generally* Winter, *State Law, Shareholder Protection, and the Theory of the Corporation*, 6 J. LEGAL STUDIES 251 (1977).