THE CTS GAMBIT: STANCHING THE FEDERALIZATION OF CORPORATE LAW

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CTS Corp. v. Dynamics Corp. of America[1] is at once baffling and remarkable. The Supreme Court's surprising 1987 decision upholding the constitutionality of an Indiana antitakeover statute has produced a cavalcade of criticism. It has been argued that the Court misconceived the protectionist motives of state antitakeover statutes in general and the Indiana statute in particular,[2] that it disregarded the efficiency of a robust market in corporate control,[3] and that it rigidly conceptualized the corporation as a creature of the law of its chartering state.[4]

Decided on preemption and dormant commerce clause grounds, *CTS* rejected arguments that Indiana's control share statute unduly favored incumbent managers and that it imposed on bidders unwarranted delays, uncertainty, and costs while shareholders collectively decided a bid's fate.[5] Justice Powell, writing for the majority, resorted to the rhetoric of

1. 481 U.S. 69 (1987).

2. Langevoort, *The Supreme Court and the Politics of Corporate Takeovers: A Comment on* CTS Corp. v. Dynamics Corp. of Am., 101 HARV. L. REV. 96, 116-17 (1987) [hereinafter Langevoort, *A Comment on* CTS] (criticizing Court's lack of candor); Oesterle, *Delaware's Takeover Statute: Of Chills, Pills, Standstills and Who Gets Iced*, 13 DEL. J. CORP. L. 879, 937-39 (1988) [hereinafter Oesterle, *Delaware's Takeover Statute*]; Regan, *Siamese Essays: (I)* CTS Corp. v. Dynamics Corp. of America *and Dormant Commerce Clause Doctrine; (II) Extraterritorial State Legislation*, 85 MICH. L. REV. 1865, 1871 (1987) [hereinafter Regan, *Siamese Essays*]. *See also CTS*, 481 U.S. at 100 (White, J., dissenting).

3. Butler, *Corporation-Specific Anti-Takeover Statutes and the Market for Corporate Charters*, 1988 WIS. L. REV. 365, 380 [hereinafter Butler, *Corporation-Specific Statutes*]; Fischel, *From MITE to CTS: State Anti-takeover Statutes, the Williams Act, the Commerce Clause and Insider Trading*, 1987 Sup. Ct. Rev. 47, 85 (1988) [hereinafter Fischel, *From MITE to CTS*]; Langevoort, *A Comment on* CTS, *supra* note 2, at 109-10; Macey, *State Anti-takeover Legislation and the National Economy*, 1988 WIS. L. REV. 467 [hereinafter Macey, *State Legislation*]. *See also CTS*, 481 U.S. at 98 (White, J., dissenting) (noting that takeover bids often serve a useful function).

4. Butler & Ribstein, *State Anti-Takeover Statutes and the Contract Clause*, 57 U. CIN. L. REV. 611, 653 (1988) [hereinafter Butler & Ribstein, *State Anti-Takeover Statutes*]; Millon, *State Takeover Laws: A Rebirth of Corporation Law*, 45 WASH. & LEE L. REV. 903 (1988).

5. The statute, which applies only to firms incorporated in Indiana with significant Indiana operational and shareholding contacts, IND. CODE ANN. § 23-1-42-4(a) (Burns 1990), requires that disinterested shareholders (excluding the bidder and management) approve voting rights for any bidder that seeks to acquire a controlling interest in the corporation. *Id.* at § 23-1-42-9. A bidder becomes subject to this rite of initiation when its total shareholdings exceed one of three specified thresholds—20%, 33-1/3% or 50%. *Id.* at § 23-1-42-1. The bidder must give notice and the board must set a date for a shareholders' meeting, no later than at the next special or annual shareholders meeting, to decide the bid's fate. *Id.* at §§ 23-1-42-6, 23-1-42-7.

shareholder protection:

> [T]he statute now before the Court protects the independent shareholder against both of the contending parties. . . . It does this by affording shareholders, when a takeover offer is made, an opportunity to decide collectively whether the resulting change in voting control of the corporation, as they perceive it, would be desirable.[6]

Taken at face value, the decision merely addresses whether a chartering state can regulate one aspect of corporate law's many concerns: the voting and transfer rights of shareholders. The case ostensibly concerned little more than the power of a chartering state to protect its corporations' shareholders from coercive bids for their shares.

Although a few commentators have accepted *CTS* on its terms, most have questioned the Court's alertness and motives. The commentary on *CTS* is voluminous and disparate. It has both decried and extolled *CTS*'s effect to protect non-shareholder constituents, to underwrite corporate managers' preference for stasis, and to return corporate governance to the states. Commentators have argued extensively whether these effects are good or bad.

What explains *CTS*? A prevalent answer is that the Court sought to ensure that takeovers would be regulated from some quarter. The Court's fractured 1982 decision in *Edgar v. MITE*[7] invalidated an Illinois antitakeover statute for unconstitutionally interfering with the interstate market for corporate control. *MITE* disempowered the states and left a regulatory gap; *CTS* abandons *MITE*.

Another explanation, only partially developed in the literature, is that the Court awoke to the implications of *MITE*, whose latent potential to federalize shareholder free-trading rights had only vaguely been appreciated. The primacy given in *MITE* to the control market threatened not only the standing of state antitakeover statutes, but also generic corporate codes that authorize firm-specific interference with shareholder transfer and control rights. Invalidation of the Indiana control-share statute would have intruded even further on traditional state prerogatives over corporate chartering and corporate law.

Both views are deficient. *CTS* is remarkable because it and corporate chartering are about much more. Presented as a case of federalism,[8] *CTS* is best understood in that light. The Court faced the choice of ac-

6. *CTS*, 481 U.S. at 82, 91.

7. 457 U.S. 624 (1982).

8. The appellant CTS, invoking "settled principles of Federalism," Brief for Appellant CTS

tively mediating the state and federal roles or passively withdrawing. It chose the posture of a diffident gatekeeper. By disregarding the protectionist effects and motives of antitakeover statutes, the Court drew a straight-forward and undemanding blueprint for a state antitakeover regime. States have accepted the *CTS* invitation, and today more than eighty percent of all U.S. corporate assets are under the umbrella of state antitakeover legislation. Further, *CTS* constitutionalizes the internal affairs doctrine and thus the chartering state's status. By doing this, *CTS* avoids a regulatory patchwork and significantly deflates pressure for federal judicial, administrative, or legislative intervention. Despite many calls for a greater federal role, little indicates the Securities and Exchange Commission (SEC) or Congress will intervene.

Perhaps most remarkable, *CTS*'s corporate federalism, unlike other federal-state allocations of commercial regulatory power, does not abdicate regulatory power to the states. State corporate law is largely facilitative—only weakly regulatory. Managers of publicly-held firms control where the firm is incorporated and have significant political influence at the state level. If dissatisfied with one state's chartering package, they can reincorporate in another. Nonetheless, manager-buyers and state-sellers face a variety of constraints that mold the terms of the chartering product. Each state operates in a national market for corporate charters. Regardless of its merits, the only regulatory risk is federal intervention. *CTS* minimizes the risk by setting clear and simple parameters for an incorporation-based ordering. This Article advances the thesis that *CTS* legitimizes and catalyzes this corporate law process.

The Court, however, reserves a modest gatekeeping role in the law process. Its preemption analysis under the Williams Act suggests that a state antitakeover statute's *effects* still have some bearing on whether it interferes with or undermines the assumptions of federal tender offer regulation. *CTS* leaves the seeds for judicial federalizing of base-level shareholder voting/control rights. Furthermore, the Court's blind rejection of

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Corporation at 10, CTS Corp. v. Dynamics Corp. of America, 481 U.S. 69 (1987) (No. 86-71) [hereinafter CTS Brief], framed the issue as follows:

> [T]he two controlling questions presented by this case involve not economics but Federalism. First, did the Congress, in enacting the Williams Act, make a political decision to bar the States from developing their generic corporation laws . . .? Second, if the Congress made no such decision, should the "dormant" Commerce Clause nonetheless be construed to impose that same result as a matter of constitutional law?

Id. at 12. CTS never defined precisely what were the settled principles, treating them as tenets of constitutional faith. "Patently, . . . State law—not Federal law—governs the scheduling of and voting rights at shareholder meetings of the State's domestic corporations." *Id.* at 18.

the Indiana statute's discriminatory and protectionist motives, for which the Court found no record evidence, does not preclude some supervision of the state political process in the future to assure full representation. In view of current congressional inertia on takeovers, the result of a political stalemate between competing management and shareholder interest groups, these limited gatekeeping possibilities emerge as consistent with the Court's gambit to stanch the federalization of corporate law.

CTS sets into motion a process of state-based private ordering over which the Court has assumed continuing, albeit limited, responsibility. This Article sets out a federalism perspective on *CTS* and explores the wisdom of the Court's federalism gambit, comparing the current incorporation-based antitakeover regime with the likely product of a federal response.

Part I considers the regulatory, market, and political landscape of corporate law and state antitakeover statutes. It explores the facilitative nature of state corporate law and its unique federalism implications, of which the relevant federal and state players have been acutely aware.

Part II summarizes the *CTS* preemption and dormant commerce clause analysis, highlighting the Court's analytical and doctrinal foibles. It criticizes the Court's refusal to inquire meaningfully into the Indiana statute's political genesis or its effects, which the Court downplays in its preemption analysis and virtually disregards under the dormant commerce clause. This part asserts that *CTS* constitutionalizes the internal affairs doctrine—the state choice of law rule that the manager-shareholder relationship is governed by the law of the chartering state—and considers the extent to which the Court reserves a federalism gatekeeping role.

Part III considers and rejects a variety of suggested hypotheses that explain *CTS*'s blindness and its curious doctrinal results. In addition to exploring how the Court sought to preserve incorporation-based private ordering of corporate governance, it discusses the Court's attempts to minimize the possibility of any federal response.

Part IV summarizes the current state of corporate federalism, in particular the response following *CTS* by the relevant players. It reaches some conclusions about the legality of the current and evolving antitakeover regime, conclusions that readily flow from a federalism perspective of *CTS*.

Part V evaluates the forces that constrain antitakeover statutes at the state level and considers the wisdom of *CTS*, comparing the corporate political economy at the federal and state levels. It concludes that far more forces than recognized constrain state antitakeover statutes—for example, the threat of federal intervention (always looming in the wings) and the rhetoric of populism. It then considers the political stalemate that broad-based representation at the federal level has produced and, in the face of congressional paralysis, the Court's role as a catalyst for ensuring a legitimate federalism.

I. CORPORATE FEDERALISM'S LANDSCAPE

State corporate law is a venerated tenet of our federalism. It is a deep-rooted tradition that the ordering of the relationship between managers and shareholders—corporate law[9]—rests primarily with the states.[10] Except for federal disclosure regulation and specific programs regulating financial firms such as broker-dealers, banks, and mutual funds, the responsibilities that managers owe shareholders and the relationships between shareholders find their origins in state statutory and common law. Like property and contract rights, corporate rights are state-based.

The tradition has not been without its rough moments. Flirting with a

9. In the chimeral world of the "corporation," nominalizations and metaphor hold significant power. To avoid the conceptual pitfalls of confusing the actors and their actions, I make a concerted effort to follow certain conventions of style and meaning:

> (1) State statutes that discourage takeovers are "antitakeover" statutes, not bland and deceptive "takeover" laws. Their purpose and effect is anti-takeover.
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> (2) "Corporate regulation" should be used with great caution. State corporate law is more facilitative than regulatory. More descriptive are "rules of corporate governance," which connote corporation law's essentially private character.
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> (3) The "corporation," in this light, merely personifies the union of shareholders (equity investors) and managers. It should be distinguished from the "incorporated firm," the aggregation of all the constituencies that contribute to the business.

Speaking of the corporation, without identifying the corporate actor, is to invite a muddle. Although it might be possible to draw other participants into the fold, the American tradition has been shareholder wealth maximization. *See* Johnson, *The Delaware Judiciary and the Meaning of Corporate Life and Corporate Law*, 68 TEX. L. REV. 865, 873-78 (1990) [hereinafter Johnson, *The Delaware Judiciary*]. The legal relationship of creditors, employees, tax collectors and communities are defined for the most part by other sets of rules: contract law, labor law, tax law, environmental law. Williamson, *Corporate Governance*, 93 YALE L.J. 1197, 1198-99 (1984). The personified "corporation" acts as an intermediary between the shareholder-management union and others with a stake in the firm.

10. The Supreme Court's expression of this tenet is far more frequent than any attempt to explain it. For example, in Cort v. Ash, 422 U.S. 66, 84 (1975), the Court rejected that shareholders have an implied federal cause of action against corporate directors who approve criminal political contributions, stating that a corporation's internal affairs are presumptively governed by state law. It gave a "chicken-and-egg explanation: "[I]nvestors commit their funds to corporate directors on [this] understanding." *Id.* at 84.

federal law of corporations is a common reaction whenever the state marriage turns sour.[11] There are dramatic instances of federal intervention. The failure of state law to deal with the interstate phenomenon of monopolizing trusts justified the Sherman Act,[12] and its failure to control stock market excesses justified the federal New Deal securities laws.[13]

But the tradition of state corporate law has proved resilient. Proposals for encompassing federal regulation of the corporation have fared poorly.[14] For example, during the progressive era that produced the Sherman Act, Congress seriously considered a federal corporate code.[15] Likewise, early proposals to deal with the perceived causes of the Depression contemplated broad federal regulation of the shareholder-manager relationship.[16] But the progressive-era antitrust laws, as now under-

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11. Some have advocated federal incorporation because of state law's failure to regulate corporate managers' imposition of externalities on non-shareholder constituents. *See, e.g.*, R. NADER, M. GREEN & J. SELIGMAN, CONSTITUTIONALIZING THE CORPORATION: THE CASE FOR THE FEDERAL CHARTERING OF GIANT CORPORATIONS 84 (1976) (arguing that "the case for federal chartering [is]. . . compelling [and] our current economic crisis and corporate crime wave underscore the failure of the old corporate law system"); Schwartz, *Towards New Corporate Goals: Co-existence with Society*, 60 GEO. L.J. 57, 104 (1971) (advocating federal incorporation to "harmonize our economic activity with society's idea of general welfare"); Urofsky, *Proposed Federal Incorporation in the Progressive Era,* 26 AM. J. LEG. HIST. 160 (1982) (noting that despite widespread support, federal incorporation laws failed because of disagreements on specifics) [hereinafter Urofsky, *Federal Incorporation*]; Note, *Federal Chartering of Corporations: A Proposal*, 61 GEO. L.J. 89, 95 (1972) (arguing that states "abdicated their responsibility to govern in an attempt to attract 'corporate' business [and] are now overpowered by their creations").

Others, recently including SEC Chairman Breeden, have worried about state law's failure to protect shareholders and capital markets. *Breeden Calls for Unified Market to Meet Overseas Competitive Challenge*, 22 Sec. Reg. & L. Rep. (BNA) 351 (Mar. 9, 1990) (reporting Breeden's comments calling for unitary regulation of the U.S. capital markets at Practicing Law Institute's "SEC Speaks in 1990") [hereinafter *Breeden Calls for United Market*]; Boyer, *Federalism and Corporation Law: Drawing the Line in State Takeover Regulation*, 47 OHIO ST. L.J. 1037, 1041-56 (1986) [hereinafter Boyer, *Drawing the Line*]; Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 YALE L.J. 663 (1974) [hereinafter Cary, *Reflections*] (advocating federal standards of corporate responsibility); Schwartz, *Federalism and Corporate Governance*, 45 OHIO ST. L.J. 545, 552-56 (1984).

12. State laws had prohibited corporate ownership of stock, and thus interstate holding companies, but did not prohibit non-corporate trust ownership. P. AREEDA & D. TURNER, ANTITRUST LAW (1978).

13. L. LOSS, FUNDAMENTALS OF SECURITIES REGULATION, 25-35 (1988).

14. For a brief history of the influence of federal incorporation, see L. LOSS, *supra* note 13, at 29-38; Boyer, *Drawing the Line*, *supra* note 11, at 1041-56 (stating it is "remarkable" that no federal incorporation emerged by the end of the New Deal); Urofsky, *Federal Incorporation*, *supra* note 11.

15. Boyer, *Drawing the Line*, *supra* note 11, at 1048-50 (summarizing progressive-era initiatives to create a federal corporate code); Letwin, *Congress and the Sherman Antitrust Law: 1887-1890*, 23 U. CHI. L. REV. 221 (1956).

16. *See* Thel, *The Original Conception of Section 10(b) of the Securities Exchange Act*, 42 STAN. L. REV. 385 (1990) (arguing that the restrictive understanding of § 10(b) was policy-oriented, not

stood, dealt only with impact on markets, not concentrations of wealth.[17] The federal securities acts, insofar as they regulate nonfinancial firms, have been understood to require only honesty, not fairness, in the shareholder-manager relationship.[18]

Not surprisingly, the takeover phenomenon of the last two decades and the perceived deficiencies of the state response have led many again to flirt with federal corporate law. To appreciate modern corporate federalism in the takeover context—and hence the meaning of *CTS*—compels a look first at the state chartering market, the evolution of the market for corporate control, and the roles assumed by the principal regulators of those markets. It is against this backdrop that *CTS* and the state antitakeover regime it legitimizes must be seen.

A. The Nature of State Corporate Law

1. Increasingly facilitative, not regulatory

State corporate law has become more facilitative than regulatory. Although a century ago corporate law shared many characteristics of traditional governmental regulation—prescribing the kinds of business, ownership activities, capital structures and governance rules available to incorporated firms—today it is largely enabling and facilitative.[19] Cor-

based on any empiricism of congressional purposes or intent; the Court's two limits of "only knowing and intentional conduct" and "conduct involving deception" are not supported by the original congressional understanding).

17. *See, e.g.*, United States v. General Dynamics Corp., 415 U.S. 486, 501 (1974) (market effects, not size); Brown Shoe Co. v. United States, 370 U.S. 294, 320 (1962) (competition, not competitors).

18. Schreiber v. Burlington Northern, Inc., 472 U.S. 1 (1985) (refusing to imply under the broad "manipulative" language of § 14(e) of the Williams Act a private action to challenge unfair management takeover defenses); Santa Fe Indus. v. Green, 430 U.S. 462 (1977) (refusing to imply under § 10(b) a private action to challenge fully-disclosed, but assertedly unfair price in squeeze-out merger). *See* Anderson, *The Meaning of Federalism: Interpreting the Securities Exchange Act of 1934*, 70 VA. L. REV. 813 (1984) (questioning the Court's refusal to imply federal protection of shareholders governance rights under the federal securities laws).

Even the federal securities rules that are not disclosure-based strain to fit a disclosure mold. For example, proxy rules prescribing the form of the proxy and mandating shareholder access to the proxy machinery are rooted in notions of shareholder democracy, not disclosure. *See* L. LOSS, *supra* note 13, at 868. Substantive insider-trading regulation, nominally disclosure-based, is anchored in notions of corporate fiduciary duties. Dirks v. SEC, 463 U.S. 646, 654 (1983) (holding that an insider's disclosure duty "arises rather from the existence of a fiduciary relationship"); Chiarella v. United States, 445 U.S. 222, 230 (1980) (premising insider-trading liability on "a duty to disclose arising from a relationship of trust and confidence between parties to a transaction" and the duty of corporate insiders "to place the shareholder's welfare before their own").

19. *See, e.g.*, Cary, *Reflections*, *supra* note 11, at 664 (describing the removal of size and power

porate statutes, much like contract and property law, enable by recognizing the rights and powers of the corporate participants and the corporation's legal personality. They facilitate by specifying default structures and provisions, which the parties have broad discretion to adopt and modify. Mandatory and prohibitory provisions are the exception.

In this light, modern corporate law appears as a state-provided service that offers those seeking to structure their business relationship a relatively standardized, off-the-rack package consisting of a governance structure, legal personality, delineation of ownership rights, and limited liability for the corporate participants.[20] The package is roughly analogous to a state-written form partnership agreement, with state-provided immunity from participant liability.

Only a small set of rules remains mandatory, and their scope is diminishing: the ultra vires doctrine has become an historical curio;[21] capital structure rules have been and continue to be relaxed;[22] the corporate "equal dignity" rule accepts that even if some paths to a goal are prohibited, other permissible paths can nonetheless be taken;[23] recent statutes permit charter amendments limiting director liability for fiduciary breaches;[24] others dilute judicial fiduciary scrutiny if internal procedures are followed;[25] and recent case law permits managers to sidestep rules prohibiting subsidiaries from owning the parent company's stock through management-controlled employee stock ownership plans.[26]

limits); Millon, *supra* note 4 (describing corporate law's change from a regulatory to facilitative model).

20. *See generally* R. CLARK, CORPORATE LAW 2 (1986).

21. *See, e.g.*, Moran v. Household Int'l Co., 500 A.2d 1346 (Del. 1985) (upholding flip-over poison pill plan that creates obligations in any *acquiring* firm that triggers the plan's purchase provisions).

22. *See* B. MANNING, A CONCISE TEXTBOOK ON LEGAL CAPITAL 84-90 (2d ed. 1985).

23. Branson, *Indeterminacy: The Final Ingredient in an Interest Group Analysis of Corporate Law*, 43 VAND. L. REV. 85, 96-97 (1990) [hereinafter Branson, *Indeterminacy*] (describing Delaware's "equal dignity" rule, which permits a "circuitous statutory path to evade a shareholder protection or requirement of a more direct route").

24. DEL. CODE ANN. tit. 8, § 102(b)(7) (Supp. 1988). *See also* Gelb, *Director Due Care Liability: An Assessment of the New Statutes*, 61 TEMP. L. REV. 13 (1988).

25. REVISED MODEL BUSINESS CORP. ACT Subchapter F, *reprinted in* 44 BUS. LAW. 1307 (1989) [hereinafter RMBCA]. *See also* Branson, *Assault on Another Citadel: Attempts to Curtail the Fiduciary Standard of Loyalty Applicable to Corporate Directors*, 57 FORDHAM L. REV. 375 (1988) [hereinafter Branson, *Another Citadel*] (arguing that allowing corporations to opt out of directors' duty of loyalty would remove the "bedrock" under and "brackets" around corporate private ordering).

26. Shamrock Holdings, Inc. v. Polaroid Corp., 559 A.2d 257, 262 (Del. Ch. 1989) (upholding

Even the few remaining mandatory rules—in particular, fiduciary duties—might not be seen as truly regulatory, but instead as facilitative. Because most of them represent what managers or shareholders, or both, would have demanded had they fully negotiated their relationship, they function to save the parties the expense of negotiating and verifying what they would have included anyway.[27] The proliferation of statutes and cases that allow opting out from previously mandatory rules confirms this.

If one state's rules become too oppressive or unwieldy, managers can reincorporate in a state having a more facilitating and reassuring corporate law environment.[28] Under the well-established internal affairs doc-

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employee stock ownership plan's purchase of target's stock "to introduce a note of stability at this time of increasing corporate takeover activity [sic]"). The strategy reduces the amount of publicly-traded stock available to a bidder, which in Delaware increases the difficulty of surpassing the 85% threshold required to avoid Delaware's antitakeover statute. DEL. CODE ANN. tit. 8 § 203 (1990) (prohibiting business combinations with 15% acquirers for a three-year period after the acquisition, unless (among other things) the acquirer buys 85% of the firm's stock). Interest in such strategies seems to be growing. *See* Bernstein, *How to Keep Raiders at Bay—On the Cheap*, BUS. WEEK, Jan. 29, 1990, at 59 (reporting that management of potential targets have been adding stock to existing pension and savings plans, on the general assumption that employees tend to favor current management).

27. Although a debate has begun on whether any rules should be mandatory, even current mandatory rules—such as the prohibition of subsidiaries owning the voting stock of parent companies—can be seen as rules out of which shareholders in only unusual circumstances would choose to opt. Easterbrook & Fischel, *The Corporate Contract*, 89 COLUM. L. REV. 1416, 1444-45 (1989) (arguing that corporate law "fills in the blanks . . . with the terms that people would have bargained for" if the need had been foreseen). Mandatory corporate rules thus allow shareholders to purchase stock without undertaking the expense either to verify that these base-level rules are in place or to negotiate their installation. *See* Gordon, *The Mandatory Structure of Corporate Law*, 89 COLUM. L. REV. 1549, 1597 (1989) (arguing that shareholders rely on mandatory rules, which protect against "informational defects" in the bargaining process).

28. Much of the literature on the chartering market assumes that managers control this decision. *See, e.g.*, Macey & Miller, *Toward an Interest-Group Theory of Delaware Corporate Law*, 65 TEX. L. REV. 469, 485 (1987) (stating Delaware caters to managers "[b]ecause managers make the decision about where to incorporate"); Winter, *State Law, Shareholder Protection and the Theory of the Corporation*, 6 J. LEGAL STUD. 251, 252 (1977) [hereinafter Winter, *Theory of the Corporation]* (arguing "the decision as to which state to incorporate in is in almost all cases a managerial decision"). In one sense, this is true. Because in most states the firms must initiate and approve mergers and other fundamental organic changes—the tools for reincorporation—managers control initiation of the process. Once the reincorporation process is initiated, however, it is not a foregone conclusion, since nearly all state statutes also require that shareholders approve the change.

Historically, shareholder approval is readily obtainable, both because of shareholder passivity and perhaps perceived interest. *See, e.g.*, Gordon, *supra* note 27, at 27. Powerful evidence exists that reincorporation in Delaware tends to result in supra-normal gains for shareholders. Romano, *Law as a Product: Some Pieces of the Incorporation Puzzle*, 1 J. L. ECON. & ORG. 225, 265-73 (1985) [hereinafter Romano, *Law as a Product*] (finding that on average, reincorporation in Delaware from trine, corporate rules of the incorporating state exclusively govern the shareholder-manager relationship.[29] Without moving assets, people, or political allegiances, it is possible for corporate managers to choose a different regulatory regime for the shareholder-manager relationship, subject only to easily obtained shareholder approval.[30] Although according to traditional (and discredited) doctrine the original state and any other state in which the incorporated firm does business have continuing regulatory power over the foreign corporation, states have shown great restraint in exercising this power.[31] In fact, some suggest that a state

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1960-1983 was accompanied by abnormal positive returns of 4.1% during a period extending 99 days before and after the announcement). The certainty that shareholders, particularly where there is significant institutional ownership, will approve reincorporation in a state offering an aggressively protective antitakeover regime today seems questionable.

29. *See* DeMott, *Perspectives on Choice of Law for Corporate Internal Affairs*, 48 LAW & CONTEMP. PROBS. 161 (1985); Kozyris, *Corporate Wars and Choice of Law*, 1985 DUKE L.J. 1, 17-18 [hereinafter Kozyris, *Corporate Wars*] (finding that over the last 25 years, "in all but a handful of [potential conflicts cases involving corporations] the law of the state of incorporation was applied"); Reese & Kaufman, *The Law Governing Corporate Affairs: Choice of Law and the Impact of Full Faith and Credit*, 58 COLUM. L. REV. 1118, 1124-25 & n.37 (stating general rule and collecting cases). Exceptions to the doctrine are few and invariably involve foreign corporations whose dominant business activities are outside the chartering state. *See, e.g.*, In re Orfa Securities Litigation, 654 F. Supp. 1449 (D.N.J. 1987) (applying the law of the corporation's principal place of business where officers' illegal stock trading occurred, rather than the law of the chartering state); Western Airlines, Inc. v. Sobieski, 191 Cal. App. 399, 12 Cal. Rptr. 719 (1961).

The doctrine establishes a regime for private corporate ordering chosen by management and shareholders. Its uniformity and stability promote certainty in structuring corporate relationships.

> Application of the local law of the state of incorporation will usually be supported by those choice-of-law factors favoring the needs of the interstate and international systems, certainty, predictability and uniformity of result, protection of the justified expectations of the parties and ease in the application of the law to be applied.

RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 302 comment e (1969).

30. Professor Romano estimated in 1985 that the cost of reincorporation for a large public corporation is between $3-4 million, based on present costs of $1.1 million and an increase in annual expenditures of between $100,000 and $200,000. Romano, *Law as a Product*, *supra* note 28, at 249.

31. State power over foreign corporations derives from the Supreme Court's mid-nineteenth century interpretation of the privileges and immunities clause of Article IV:

> The corporation being the mere creation of local law, can have no legal existence beyond the limits of the sovereignty where created. . . . The recognition of its existence even by other States, and the enforcement of its contracts made therein, depend purely upon the comity of those States — a comity which is never extended where the existence of the corporation or the exercise of its powers are prejudicial to their interests or repugnant to their policy. . . . [S]uch assent may be granted upon such terms and conditions as those States may think proper to impose.

Paul v. Virginia, 75 U.S. (8 Wall.) 168, 181 (1868). This "creature of law" conception generates enormous opportunities for state governmental abuse of firms conducted in the corporate form. *See* Epstein, *The Supreme Court 1987 Term: Unconstitutional Conditions, State Power, and the Limits of Consent*, 102 HARV. L. REV. 5, 32 (1988). Nonetheless, most state statutes specifically disempower the state and its courts from regulating the internal affairs of foreign corporations. *See* RMBCA should have no constitutional power to interfere with corporate relationships of foreign corporations.[32] Professor Macey's argument that the "proper role of [the corporate] legal system is to facilitate the intra-firm contracting process" is coming of age.[33]

But the analogy of corporate chartering to a state-provided service has its limits. State corporate law still prohibits some shareholder-manager agreements and retains a regulatory flavor—for the protection of shareholders, for the benefit of those who deal with the corporation, and for the appearance that chartering states are marketing something more than special-interest private law.[34] For example, although the rules on shareholder approval of mergers have been significantly relaxed—moving from a requirement of unanimity, to two-thirds, to majority rule—the requirement is still intact; it cannot be sidestepped by amending the articles.[35] Likewise, managers of a public corporation cannot do away with

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§ 15.05(c) ("This Act does not authorize this state to regulate the organization or internal affairs of a foreign corporation authorized to transact business in this state."); MODEL BUSINESS CORP. ACT § 106 [hereinafter MBCA] ("[N]othing in this Act contained shall be construed to authorize this State to regulate the organization or the internal affairs of such [foreign] corporation."). *See also* DeMott, *supra* note 29, at 163 (noting that half the states have provisions based on sec. 106).

Further, the Supreme Court has made clear the *Paul v. Virginia* conditioning power is not limitless. *See* Western & Southern Life Insurance Co. v. Board of Equalization, 451 U.S. 648, 656-68 (1981) (accepting unconstitutional conditions doctrine); Bendix Autolite Corp. v. Midwesco Ent., Inc., 486 U.S. 888 (1988) (holding that Ohio cannot toll its statute of limitations while foreign corporation has not appointed an in-state agent, when the burden on out-of-state corporations exposed to general jurisdiction outweighs the State's interests in applying its tolling rules only to foreign corporations).

32. *See* Epstein, *supra*, note 31, at 31-32; Hale, *Unconstitutional Conditions and Constitutional Rights*, 35 COLUM. L. REV. 321 (1935) (while state can exclude, it cannot burden their entry into state commerce); Kozyris, *Some Observations on State Regulation of Multistate Takeovers—Controlling Choice of Law Through the Commerce Clause*, 14 DEL. J. CORP. L. 499, 524-25 (1989) [hereinafter Kozyris, *Some Observations*]; Reese & Kaufman, *supra* note 29, at 1139.

33. Macey, *supra* note 3.

34. *See* Coffee, *Shareholders Versus Managers: The Strain in the Corporate Web*, 85 MICH. L. REV. 1, 71-72 (1986) [hereinafter Coffee, *Strain in the Web*] (pointing out that corporate limited liability casts states in the role of an insurer, forcing the corporation's voluntary and involuntary creditors to bear the risk of corporate failures); Johnson, *The Delaware Judiciary*, *supra* note 9 (arguing that Delaware takeover fiduciary cases take into account non-shareholder constituents); Johnson & Millon, *Missing the Point About State Takeover Statutes*, 87 MICH. L. REV. 846, 855 (1989) [hereinafter Johnson & Millon, *Missing the Point*] (arguing that a significant rethinking is underway of the question for whom corporate law operates). A regulatory philosophy is stronger in some states than others. *See* Demott, *supra* note 29, at 179 (describing such states as New York and California as having a more regulatory approach, a "counterculture" of corporate law).

35. *See, e.g*, RMBCA § 11.02, Official Comment. Some have argued against the contract model with respect to publicly-held firms with dispersed shareholders. *See, e.g*, Brudney, *Corporate Governance, Agency Costs, and the Rhetoric of Contract*, 85 COLUM. L. REV. 1403 (1985).

the board of directors, whose modern legitimacy hinges in part on the appearance that outside directors represent non-shareholder interests.[36] Recent antitakeover statutes, passed amid the rhetoric of saving local jobs and communities, make clear the corporation is still a regulated form.[37]

Even if its regulatory qualities have declined, corporate chartering in the United States has been uniquely governmental: private incorporation is not available.[38] Not only is this deeply rooted in history, it is readily explained by corporate limited liability. Privately provided liability limits would be exorbitant. Although corporate managers could conceivably negotiate limited liability with voluntary creditors, only states through their regulatory power can force contract and tort creditors to assume the risks of business failure—a subsidy for management and shareholder participation in the firm. To foist this subsidy on private parties solely in the name of private ordering would seem, at the least, politically unpalatable.

2. *Market for corporate charters*

Corporate chartering does not exist in a competitive vacuum. Each state participates to varying degrees in a national market for corporate charters. For many states, the principal customers are managers of local businesses; for others, it is a mix of local and national businesses;[39] for

36. *See* PRINCIPLES OF CORPORATE GOVERNANCE AND STRUCTURE: RESTATEMENT AND RECOMMENDATIONS § 2.01 (Tent. Draft No. 1, 1982). Recent Delaware takeover cases have expanded fiduciary duties to encompass non-shareholder interests. Johnson, *The Delaware Judiciary*, *supra* note 9, at 923 (pointing out that courts take into account non-shareholder constituencies by framing directors' fiduciary duties "by reference to the vague and unknowable long run"; arguing the legal community "screen[s] and translate[s] widely held social norms into legal doctrine").

37. *See, e.g.*, Romano, *The Political Economy of Takeover Statutes*, 73 VA. L. REV. 111 (1987) [hereinafter Romano, *Political Economy*] (describing the enactment in Connecticut of a second-generation statute). In fact, SEC Chairman Breeden recently suggested that this state-based regulation creates a fragmentation that "may need to be re-evaluated" if U.S. financial markets are to compete with Japan and a unified Europe. Because foreign issuers often exclude U.S. investors from their offerings, Breeden called for unitary U.S. regulation of capital markets to overcome the "internal [state] barriers that reduce liquidity and increase costs without compelling justification." *Breeden Calls for Unified Market*, *supra* note 11 (reporting Breeden's comments at Practicing Law Institute's "SEC Speaks in 1990").

38. The precursor of the modern corporation, deeds of settlement, was privately-drafted. The form, however, did not offer limited liability, a nineteenth century innovation. *See* L. SOLOMON, D. SCHWARTZ & J. BAUMAN, CORPORATIONS, LAW AND POLICY 4 (2d ed. 1988).

39. Some of these states provide two kinds of chartering packages: close corporation statutes and generic corporate codes. *See, e.g.*, CAL. CORP. CODE §§ 158, 300-303; (Deering Supp. 1990); DEL. CODE ANN. tit. 8, §§ 341-356 (1983) (special provisions for electing closely-held corporations).

Delaware, the principal customers are managers of national businesses. In each case, the reasons for state participation in the chartering market vary: to provide a favorable climate for local enterprise and capital formation; to attract direct revenues in the form of franchise and incorporation fees; and to promote the local corporate community, which offers accessory legal and paper-handling services.

The notion of a chartering market is not new. In 1934 Justice Brandeis summarized Delaware's turn-of-the-century ascendancy as a "race of laxity" for corporate charters.[40] Professor Cary in 1974 confirmed that little had changed as the modern corporation evolved from one of corporate managerialism to finance corporatism.[41] Cary's empirical argument that Delaware had won a chartering race for large public corporations—a race he pejoratively characterized "for the bottom"—is not seriously debated. Few doubt the existence of a chartering market or the identity of its dominant supplier, Delaware.

Instead, the debate has evolved into one on the desirability of virtually unregulated state competition for chartering business, compared to an unarticulated, ideal chartering regime. Most commentators have focused on tiny, visible Delaware—the most successful facilitator. A majority of the Fortune 500 companies and nearly forty-five percent of those listed on the New York Stock Exchange are incorporated in the state.[42] More than eighty percent of recent incorporations and reincorporations by public firms have been in Delaware.[43] Managers choose Delaware because of its reassuring corporate law environment: a facilitative statute, a sophisticated and experienced corporate bar, a competent and non-partisan corporate judiciary, a responsive (but sober) state legislature, and a large body of caselaw.[44] Three current theories explaining the chartering

40. Louis K. Liggett Co. v. Lee, 288 U.S. 517, 559-61 (1933) (Brandeis, J., dissenting) (describing corporate law's transition from regulation to facilitation and the turn-of-the century competition between New York, New Jersey, Delaware, and Maryland for corporate charters).

41. Cary, *Reflections*, *supra* note 11, at 668-70. During the last 50 years the modern public corporation has evolved from one of professional managerialism to finance corporatism. *See* Lipton, *Corporate Governance in the Age of Finance Corporatism*, 136 U. PA. L. REV. 1, 4-6 (1987).

42. *See* Geylein & Koenig, *Pension Funds Plot Against Takeover Law*, Wall St. J., Apr. 5, 1989, at C1, cols. 5-6 (reporting that 56% of Fortune 500 companies are incorporated in Delaware); Kaletsky, *Delaware Makes Its Mark on Corporate America*, FINANCIAL TIMES, Feb. 8, 1988, at 24.

43. Dodd & Leftwich, *The Market for Corporate Charters: "Unhealthy Competition" Versus Federal Regulation*, 53 J. BUS. 259, 263 (1980) (finding that 90% of sample firms reincorporating between 1927 and 1977 do so in Delaware); Romano, *Law as a Product*, *supra* note 28, at 244 (finding 81% between 1961 and 1983).

44. Macey & Miller, *supra* note 28, at 484; Romano, *Law as Product*, *supra* note 28, at 280.

market address why Delaware law is as it is, and whether this is good or bad.

a. *Reformists*

The pro-regulatory view, championed first and foremost by Cary, posits that Delaware's chartering product aims only to maximize Delaware revenues, from chartering and franchise fees[45] and Delaware-based corporate services, advice and litigation. Because the principal, if not exclusive, customers for chartering services are business managers, the reformists argue that Delaware's statute panders only to them.[46] The final legislative product does not reflect the interests of shareholders and other non-manager constituents, neither of whom are meaningfully represented in Delaware's political process.

The reformists also argue that Delaware's judiciary acts as an accomplice in this revenue-enhancing charade. Whether witting or not, Delaware judges are said to fill in the gaps of the statute to accomplish Delaware's sordid revenue-enhancing purposes. The judiciary has strong ties to the Delaware corporate bar, and the revolving door between the bench and bar motivates judges to rule in such a way as to maximize the bar's advice and litigation revenues. The reformists point to Delaware's statutory changes and court decisions that seem to provide significant advantages to managers, to the detriment of shareholders. The reformists propose federal intervention, in a variety of forms.

b. *Free-marketers*

Over the last decade, a free-market explanation for the chartering market and Delaware's dominant position challenged the reformists' views.[47]

45. DEL. CODE ANN. tit. 8, § 391 (Supp. 1988) (setting incorporation and other filing fees); *Id.* at tit. 8, § 502 (imposing annual franchise tax). Delaware's rates are higher than in other states. Romano, *Law as Product*, *supra* note 28, at 242.

46. My use of the "reformist" label is not an innovation. *See* Macey & Miller, *supra* note 28 (adopting the labels "reformist," "corporate federalist," and "public choice theorist" for the three groups who have sought to explain the corporate chartering market).

47. The free-marketers, most of whom are associated with the law and economics movement, argue that managers will have strong market-based incentives to make incorporation choices that optimize shareholder wealth. *See* Fischel, *The "Race to the Bottom" Revisited: Reflections on Recent Developments in Delaware's Corporation Law*, 76 NW. U.L. REV. 913 (1982) [hereinafter Fischel, *The Race Revisited*]; Winter, *Theory of the Corporation*, *supra* note 28. *See also* R. POSNER, ECONOMIC ANALYSIS OF LAW, 389-92 (3d ed. 1986); R. WINTER, GOVERNMENT AND THE CORPORATION, 7-11, 28-42 (1978); Baysinger & Butler, *Race for the Bottom v. Climb to the Top: The ALI Project and Uniformity in Corporate Law*, 10 J. CORP. L. 431, 456 (1985) [hereinafter Baysinger &

The free-marketers agree with many of the empirical observations of the reformists, but see only a market functioning optimally.[48] They wonder only why every manager has not already chosen Delaware and why other states have not been successful in challenging Delaware. The free-marketers, most prominently Judge Winter and Professor Fischel, argue that opportunistic managers are not unconstrained in their choice of where to incorporate. If they incorporate in a state whose rules allow them too much opportunity for shirking or outright diversion, the firm's equity securities will become unattractive;[49] if the firm cannot efficiently raise capital, its performance in its product and service markets will suffer; ultimately, the firm will go bankrupt or (perhaps sooner) become a takeover target. This pressure keeps managers from incorporating opportunistically. As proof, stock prices of Delaware corporations seem to perform as well as prices of firms incorporated elsewhere, if not better.[50]

Other states can try to outperform Delaware, and there have been a variety of attempts—Nevada and Pennsylvania to name a couple. In fact, states other than Delaware collectively continue to hold an edge in retaining firms in the chartering market. Most large national firms are

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Butler, *The ALI Project*]; Baysinger & Butler, *The Role of Corporate Law in the Theory of the Firm*, 28 J.L. & ECON. 179 (1985) [hereinafter Baysinger & Butler, *Role of Corporate Law*]; Dodd & Leftwich, *The Market for Corporate Charters: "Unhealthy Competition" Versus Federal Regulation*, 53 J. BUS. 259, 282 (1980); Fischel, *From MITE to CTS*, *supra* note 3, at 47. Some free-marketers are simply pro-management, preferring state chartering because of a trust in state, as opposed to federal, politics. Lipton, *supra* note 41, at 46-47.

48. *See, e.g.*, Winter, *The "Race for the Top" Revisited: A Comment on Eisenberg*, 89 COLUM. L REV. 1526 (1989).

49. The Efficient Capital Market Hypothesis posits that a firm's stock trading price will reflect information about its prospects. *See* Coffee, *Market Failure and the Economic Case for a Mandatory Disclosure System*, 70 VA. L. REV. 717 (1984) [hereinafter Coffee, *Market Failure*] (describing the Hypothesis, the way public information is transformed by securities analysts into stock prices, and the reasons for a mandatory, as opposed to voluntary, disclosure system). A suboptimally-incorporated firm's debt securities and access to debt markets also may suffer. Creditors free-ride, to a certain extent, on the profit-maximization incentives forced on managers by equity-based constraints, such as fiduciary duties and disciplining from markets for corporate control.

50. *See* Romano, *Law as a Product*, *supra* note 28, at 265-73 (finding that reincorporation in Delaware coincided with supra-normal returns of 4.1% during a period extending 99 days before and 99 days after the reincorporation announcement; attributing much of the favorable effect to perceived lower costs to firms undertaking operational or organization changes, such as an initial public offering or acquisition activity); Dodd & Leftwich, *supra* note 43, at 275 (finding that shareholders of firms reincorporating in Delaware earn positive abnormal returns of 30.25% over the 25-month period before and including the month of reincorporation). *Cf.* Weiss & White, *Of Econometrics and Indeterminacy: A Study of Investors' Reactions to "Changes" in Corporate Law*, 75 CALIF. L. REV. 551, 602 (1988) (concluding that shareholders' reaction to corporate law changes may reflect little more than indeterminacy about the changes' meaning).

incorporated outside Delaware, as are most of the hundreds of thousands of middle- and small-sized firms, most of which are incorporated locally.

The free-marketers' emphasis is on horizontal federalism—the relationship among the states. In the scheme, they largely ignore the vertical federal-state relationship, except as an object of fear. Free-marketers cringe at the thought of federal intervention, the only source of corporate regulation in a true sense. They assume any regulated regime would create and allocate chartering products less efficiently than a decentralized open market.

c. *Public-choice theorists*

Proceeding from the assumption that law is a product of special-interest politics, public-choice theorists take a little from each of the reformists and the free-marketers, expanding on both their points. Led by Professors Romano and Macey, they argue that a state's chartering product predictably will reflect the interests of those who wield political power—that is, cohesive, legitimate, and well-funded special interest groups.[51] In most states, including Delaware, this means that corporate statutes and caselaw can be expected to reflect the interests of the corporate bar—the most cohesive, influential, informed, and ostensibly legitimate of the state's corporate special interest groups. Not surprisingly, members of the state corporate bar in Delaware and elsewhere tend to draft corporate legislation and influence, if not decide, corporate law cases.

Although shareholders are not well represented at the state level,[52] this does not necessarily mean that state corporate law will be pro-management. Instead, the bar will predictably want to keep a fine balance between incorporation-enhancing and litigation-enhancing rules. Although incorporation produces general state revenues, which members of the bar

51. Branson, *Indeterminacy*, *supra* note 23; Coffee, *The Future of Corporate Federalism: State Competition and the New Trend Toward De Facto Federal Minimum Standards*, 8 CARDOZO L. REV. 759 (1987) [hereinafter Coffee, *Corporate Federalism*]; Macey & Miller, *supra* note 28; Romano, *The Future of Hostile Takeovers: Legislation and Public Opinion*, 57 U. CIN. L. REV. 457 (1988) [hereinafter Romano, *Future of Hostile Takeovers*].

52. *See, e.g.*, Davis, *Epilogue: The Role of the Hostile Takeover and the Role of the States*, 1988 WIS. L. REV. 491, 502 (noting that not even the Wisconsin Investment Board, the state agency responsible for investing state pension moneys, participated in the adoption of Wisconsin's antitakeover statute); Romano, *Political Economy*, *supra* note 37, at 120-41 (noting that only business lobbied in Connecticut, while business and labor lobby in many other states).

share proportionally with the rest of the state, incorporation is of special importance to the bar because it produces prospective clients.

Once incorporation occurs, the bar has an interest in maximizing its revenues. To do this, managers who have chosen Delaware, for example, must be made to believe that they are getting better corporate governance rules than they would had they incorporated elsewhere. Litigation, which produces caselaw and the appearance of predictable constraints on manager opportunism, is consistent with manager expectations. A state political process that fails to balance effectively the incorporation-enhancing and litigation-enhancing mix will lose to other states that do it better; Delaware currently seems to do it best.[53]

To make their point, the public-choice theorists ask what would happen if Delaware adopted, as Professor Cary charged it had, a rule that "shareholders never win." Shareholder plaintiffs and their lawyers would be terribly discouraged and would vanish; defense lawyers, part of the same sustenance chain, would become extinct; the rich body of cases for which Delaware is famous would petrify; giving legal advice, though extraordinarily easy, would no longer be lucrative; the decision to charter in Delaware would become problematic as a practical matter, as skeptical investors might well choose not to invest in Delaware-incorporated firms and worried shareholders might not approve reincorporation in Delaware.

Public-choice theory only purports to explain legislation, not to justify it. According to the theory, the likelihood of federal intervention in the chartering market depends not on an analysis of how well the state political structure had mixed its franchise- and litigation-enhancing rules according to some measure of economic efficiency or distributive justice, but instead on the dynamics of federal politics.

3. *Justifications for regulating the chartering market*

A principal theoretical justification for government regulation is the failure of markets to allocate products efficiently or fairly, producing either externalities or suboptimal production because of free-riding consumption of public goods.[54] In the context of the chartering market, federal intervention might be justified if we concluded that managers

53. Macey & Miller, *supra* note 28; Macey, *State Legislation*, *supra* note 3, at 487.

54. Epstein, *supra* note 31, at 14 (arguing that the legal system should "enforce bargains when and only when" they create joint gains for the contracting parties and respect non-party interests); Easterbrook, *Insider Trading, Secret Agents, Evidentiary Privileges, and the Production of Informa-*

unilaterally set the terms of the manager-shareholder bargain (state corporate law) and that collective action problems prevented shareholders from organizing to negotiate a better deal. Likewise, federal regulation might be justified if state chartering were viewed as a public good (like a dammed lake) in which (1) one firm's use of a state's chartering service does not reduce the amount available to other firms and (2) exclusion is difficult or impossible.[55] If managers who consume the service (power boaters on the dammed lake) are left to run amuck by the chartering state (the dam provider), without paying fully for their special access rights and at the expense of shareholders (placid canoeists), regulation of the chartering market provides the only way to assure optimal availability and use of the public good. Likewise, federal intervention would be justified if managers' consumption of the chartering product imposes externalities on other corporate constituents (water-starved farmers downstream).

The underlying tenet of the corporate reformists is that the chartering market panders to managers—the consumers of its products—and as a result imposes externalities on non-customer shareholders and other constituents. As to these non-manager constituents, corporate law rules that might protect their interests are public goods in suboptimal supply. Proof of the failure of the chartering market to internalize these external costs, according to the reformists, is found in state rules and cases detrimental to shareholder and constituent interests. Further proof is found in the market's oligopolistic character. State chartering lacks significant product differentiation; generic state corporate codes follow relatively

tion, 1981 SUP. CT. REV. 309, 349 (arguing that government regulation is appropriate to "control cases of externalities and monopoly").

55. Professor Romano made this observation about corporate chartering, which like a classic public good, is "characterized by nonrivalry and nonexcludability [where] one individual's consumption of such a good does not reduce the amount of the good available to others, and it is impossible or extremely expensive to exclude any individual from consuming or using the good." Romano, *Future of Hostile Takeovers*, *supra* note 51, at 465. One firm's and its shareholders' consumption of a state's corporate law does not deplete the amount available to others, and excluding firms from using a state's chartering service may be impossible or impractical.

Romano also argues that "[c]orporate codes governing the relation between shareholders and managers share many of the characteristics of local public goods . . . whose externalities fall completely within [the chartering state's] borders . . . ." *Id.* at 466. For publicly-traded firms, this seems wrong. Later she concludes, properly, that antitakeover statutes produce benefits that "are concentrated on local citizens—managers and, arguably, locally-employed workers of targets, and local businesses and charities with relations to targets—but the costs are dispersed among shareholder and bidding firms who typically do not reside in the legislating state." *Id.* at 467.

consistent patterns.[56] One is hard-pressed to identify rules of different states that have made or might make an outcome-determinative difference under a modified internal affairs doctrine—that is, inconsistent rules that could not be complied with at the same time.[57] Delaware, the market's dominant participant, sets the tone for the market.[58]

The free-marketers respond to the assertion of shareholder externalities by arguing that the interaction of other interrelated markets reduces the ability of Delaware and other chartering states to offer a suboptimal product.[59] The free-market thesis, however, makes significant and tenuous assumptions about the functioning of these other markets. There are numerous weak links in the free-marketers' causal chain. For example, if capital markets fail to recognize a suboptimal incorporation decision, it will not affect the firm's efforts to raise capital—reincorporation will never be compelled.[60] If the firm is mature and has few needs for equity

56. Adoption of the MBCA was widespread; 34 states had adopted it as of 1984. As of 1989, 23 states have adopted or are in the process of adopting the 1984 RMBCA. 44 BUS. LAW. 559 (1989). Some significant states, in terms of incorporation, have not followed the model corporate codes, among them Delaware, Pennsylvania, New York, and California. Others have copied the Delaware statute, even seeking to clone Delaware's caselaw by calling on their courts to follow it. In addition, the recent RMBCA adopts many aspects of the Delaware statute, including the indemnification and merger procedures.

57. Buxbaum, *The Threatened Constitutionalization of the Internal Affairs Doctrine in Corporation Law*, 75 CALIF. L. REV. 29, 37-38 (1987) (identifying only cumulative versus ordinary voting as creating a regulatory dilemma); Kozyris, *Some Observations*, *supra* note 32 (same). Moreover, although there are a variety of schemes, for example, on amending articles and approving mergers, it would be possible to comply with any two simply by following the more exacting standard.

58. Romano, *Law as Product*, *supra* note 28, at 233-40 (finding that Delaware led the way in changes (1) elaborating director and officer indemnification, (2) relaxing voting requirements for mergers, and (3) eliminating appraisal rights for publicly-traded shares). To illustrate, despite the great significance given the supposed crisis in director liability, most states followed Delaware's lead and adopted statutory provisions authorizing corporate charter amendments to excuse directors from liability for breaching their duty of care. Hanks, *Recent State Legislation on Director and Officer Liability Limitation and Indemnification*, 43 BUS. LAW. 1207 (1988) (reporting that 40 limited-liability statutes have been enacted); Weiss, *The Effect of Director Liability Statutes on Corporate Law and Policy*, 14 J. CORP. L. 637, 646-47 (1989) (reporting that most states have enacted enabling liability-limitation statutes, though a handful has enacted self-executing versions).

59. The free-marketers pursue this argument on the assumption that shareholder wealth maximization supplies the appropriate referent; they do not address externalities on other constituents, assuming they can protect themselves contractually or find protection outside corporate law.

60. *See* Romano, *State Competition Debate in Corporate Law*, 8 CARDOZO L. REV. 709, 712 (1987) [hereinafter Romano, *State Competition Debate*]. In fact, the failure of capital markets to appreciate good management has been the principal argument for antitakeover statutes and defenses. *See* Paramount Communications, Inc. v. Time, Inc. 571 A.2d 1140 (Del. 1990). *Cf.* Kraakman, *Taking Discounts Seriously: The Implications of "Discounted" Share Prices as an Acquisition Motive*, 88 COLUM. L. REV. 891, 936-38 (1988) (stating that takeovers occur because of "trading dynamics

capital, suboptimal incorporation may not hurt its competitiveness.[61] If the firm is a monopolist, such as a regulated utility, or one that operates in an oligopolistic market, difficulty in raising capital may not affect the firm's performance in its product and service markets. Even if a firm's stock price falls because of suboptimal incorporation, a poorly-functioning control market may undermine management disciplining. Failures in the control market may be due to market factors, such as the unavailability of junk bond financing, or to intrusive legal rules, such as corporate law rules that empower managers to pursue opportunistic antitakeover strategies. Short of the specter of bankruptcy or discipline from a weak market in managerial talent, many managers may never feel the repercussions of the firm's suboptimal incorporation. That managers of firms with dispersed shareholders tend to incorporate in less regulatory states suggests that shareholders most in need of regulatory chartering are least likely to obtain it.[62] Shareholders may tolerate more than they might desire.

Even if managers are faithful surrogates for shareholder interests, federal intervention might be justified if the public-good chartering service offered by states is suboptimal from the perspective of managers. Professor Romano has suggested the possibility.[63] Any one firm's use of the service does not reduce the amount available to others, and a state may find it difficult to prevent free-riding by excluding such use. Hence, Romano suggests that the chartering market may not produce optimal chartering products. States will have no incentive to produce an optimal chartering service because free-riding firms will not fully compensate them for the effort. Even if some exclusion were possible, optimal chartering would still be doubtful since each additional incorporation has a marginal cost near zero, making any market pricing system inefficient.

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in the securities market" without regard to management or finances or assets of the target). Further, there may be a significant lag between the time of a poor incorporation decision and the market's awakening, such as when a perceptive observer notices that state courts have been applying a "shareholders-almost-always-lose" rule.

61. *See, e.g.*, Gilson, *Evaluating Dual Class Common Stock: The Relevance of Substitutes*, 73 VA. L. REV. 807, 824 (1987) (arguing that mature companies, compared to growing companies with high-risk capital needs, have higher agency costs).

62. Baysinger & Butler, *Role of Corporate Law*, *supra* note 47 (suggesting that firms with diffuse shareholders tend to incorporate in Delaware, while firms with concentrated shareholder patterns incorporate in more regulatory states). This is consistent with the prediction that managers of firms with widely-dispersed shareholders will behave more opportunistically than when shareholders are more concentrated.

63. Romano, *Future of Hostile Takeovers*, *supra* note 51, at 465.

Romano's argument, at least insofar as it is directed at suboptimality from the perspective of managers, fails. Not only does the hue and cry on behalf of managers ring hollow, but the public-good analogy may not be apt when applied to managers. Free-riding by incorporated firms does not seem to be a significant problem: states can and do charge incorporation and annual franchise fees for the chartering service.[64] Free-riding occurs only in the unusual case when a specific firm initiates and lobbies for corporate reform, as happens when an antitakeover statute is enacted. While this may suggest that the state may want to pass these costs on to free-riding firms, for example, by charging a fee for opting into an antitakeover regime, this hardly justifies federal intervention. Further, that providing the chartering service (including the preparation, interpretation, and revision of corporate statutes) is not costless is not a problem: most, if not all, of the cost is borne directly through chartering and franchise fees and indirectly when the corporate bar passes its costs through to firms using the state's chartering regime. Finally, that the marginal cost of the chartering service is zero is not a problem: the multistate chartering market serves much the same function as would fifty-one telephone companies offering marginal-costless telephone service. Because mobility costs (the cost of reincorporation) are relatively low and the internal affairs doctrine pervasive, no state has a natural chartering monopoly. The state chartering market would seem to count adequately the costs and benefits to managers of the chartering product. There is no reason for federal intervention on their behalf.[65]

But whether the public-good chartering product takes into account the externalities it may impose on shareholders (and non-shareholder constituents) better than would a federalized product, returns us to the question of whether manager opportunism is limited by the market forces that constrain incorporation decisions and the political forces that produce corporate law. The question sets the stage for *CTS* and my less ambitious inquiry into whether the current chartering market—with

64. Romano argues that the free-rider problem, though it can be avoided by exclusion at the time of chartering, cannot be amended later when there are code reforms or judicial interpretations. Romano, *Future of Hostile Takeovers*, *supra* note 51, at 466-67 n.23. This argument fails to take into account exclusion through annual franchise taxes, which Delaware and 30 other states impose. *See* Romano, *Law as Product*, *supra* note 28, at 255.

65. As Professor Romano correctly points out, where the chartering service creates in-state or out-of-state externalities on constituencies beyond the shareholder-manager relationship, they can be dealt with more effectively by other regulatory regimes, such as environmental protection and antitrust statutes. *See* Romano, *Future of Hostile Takeovers*, *supra* note 51, at 467.

polyglot Delaware the dominant supplier—produces a better antitakeover regime than would the federal government.

B. The 1980s Market for Corporate Control

CTS was argued on March 2 and decided on April 21, 1987.[66] By then it had become clear that corporate takeovers had created one of the highest stakes games in American economic history. At stake were potentially hundreds of billions of dollars in wealth creation.[67]

The fabric of modern economic life was, as is still true, being subjected to great forces of change. The takeover phenomenon seemed to be in an early developmental stage; an early, largely impressionistic debate on the merits of takeovers had taken form.[68] The old corporate guard—

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66. I purposefully cite to the literature referred to in the briefs submitted to the Court—the data from which the Court drew its antitakeover blueprint—noting where it may have been incomplete.

67. In 1985 alone, control transactions exceeding $500,000 resulted in an aggregate purchase price of $179.6 billion. Brief for Appellee Dynamics Corp. of America, at 16 n.15, CTS Corp. v. Dynamics Corp. of America, 481 U.S. 69 (Nos. 86-71 & 86-97) (1987) [hereinafter Dynamics Brief] (citing 3 *Corporate Control Alert* 1, 8 (Apr. 1986)). Estimates of shareholder premiums for takeovers during the 1980s are equally impressive. *See* Jensen, *Takeovers: Their Causes and Consequences*, 2 J. ECON. PERSP. 21 (1988) (estimating that premiums paid in takeovers and restructurings during 1977-86 total $346 billion); Black & Grundfest, *Shareholder Gains from Takeovers and Restructurings Between 1981 and 1986: $162 Billion is a Lot of Money*, 1 J. APPLIED CORP. FIN. 5, 15 (1988) (estimating the gains from takeovers between 1981 and 1986 were $162 billion). These premiums do not necessarily represent wealth creation. Much debate has arisen over whether they were coming from taxpayers, bondholders or other creditors, customers or suppliers, employees, or the shareholders of acquiring firms. *See* Black, *Bidder Overpayment in Takeovers*, 41 STAN. L. REV. 597 (1989) (summarizing the various hypotheses on takeover premiums); Stout, *Are Takeover Premiums Really Premiums? Market Price, Fair Value, and Corporate Law*, 99 YALE L.J. 1235, 1274 (1990) (arguing that takeover premiums do not tell us whether takeovers are good or bad for society, or target shareholders in particular).

68. The Indiana Chamber of Commerce argued in *CTS* that " '[t]he debate has not gone on long enough for definitive solutions to a problem we are only beginning to understand. The empiric data is inadequate, and most important, there is no consensus on the goals we are trying to reach.' " *See* Joint Brief of the Indiana Chamber of Commerce and Indiana Legal Foundation, Inc. as Amici Curiae in Support of Appellants CTS Corporation and the State of Indiana at 19, CTS Corp. v. Dynamics Corp. of America, 481 U.S. 69 (Nos. 86-71, 86-97) (1987) [hereinafter Ind. Chamber of Commerce Brief] (quoting Subak, *Takeovers: Where Are We? Where Do We Go?*, 41 BUS. LAW. 1255, 1256 (1986)). The debate was presented to the Court as follows:

> *Compare* Easterbrook & Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161 (1981) (no resistance to tender offers by incumbent management can be justified), *with* Lowenstein, *Pruning Deadwood in Hostile Takeovers: A Proposal for Legislation*, 83 COLUM. L. REV. 249 (1983) (the advantages possessed by tender offerors under the current regulatory environment justify at least some obstructive tactics on the part of the incumbent board), *and* Bebchuk, *Toward Undistorted Choice and Equal Treatment in Corporate Takeovers*, 98 HARV. L. REV. 1693 (1985) (neither

America's great aristocracy—was challenged by a brash, well-funded new breed.[69] Whether government, federal or state, should have a role and what it should be were relatively nascent, though contentious, questions.

1. *Market correction*

In the mid-1980s the relatively young market for corporate control was in its heyday. There were more tender offers, friendly and contested, than there had been during any other period.[70] The targets of corporate acquisitions and of reorganizations spurred by the threat of acquisition generally fell into one of two broad categories: (1) firms whose managers during the 1960s and 1970s had pursued inefficient policies of conglomeration;[71] and (2) firms whose managers had reacted too slowly to the deregulation of the late 1970s and 1980s.[72] The market for corporate control was correcting itself.

According to the romanticized portraiture of the control market, a firm was targeted for a takeover or reorganization when its asset value exceeded the sum of its stock trading price plus the costs (including a control premium and transaction expenses) required to amass quickly a

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unrestrained tender offers nor defensive tactics by management serve the best interests of corporate shareholders). *Compare* Ginsburg & Robinson, *The Case Against Federal Intervention in the Market for Corporate Control*, BROOKINGS REVIEW (Winter Spring 1986) at 9 (the theory that the threat of tender offers forces management into a short-sighted strategy of maximizing current profits is incorrect), *with* Scherer, *Takeovers: Present and Future Dangers*, BROOKINGS REVIEW (Winter Spring 1986) at 15 (takeovers have not resulted in improved post-takeover performance by acquired corporations).

Ind. Chamber of Commerce Brief, *supra*, at 19 n.10. *See also* CTS Brief, *supra* note 8, at 9 (citing Easterbrook & Fischel and Bebchuk).

69. Gilson, *Just Say No to Whom?*, 25 WAKE FOREST L. REV. 121 (1990) (commenting that if the corporation is perceived as the nation's " 'collective soul' . . . the question of who runs such an important social institution transcends shareholder interest in the price of their stock") (quoting, A. BERLE, THE TWENTIETH CENTURY CAPITALIST REVOLUTION 148 (1954)).

70. Romano, *Future of Hostile Takeovers*, *supra* note 51, at 460 (table 1).

71. *See* Coffee, *Strain in the Web*, *supra* note 34, at 8 (explaining the recent internal restructuring in American corporations as the correction of long-standing managerial bias for corporate growth and inefficient size-maximization); Jensen, *Agency Costs of Free Cash Flow, Corporate Finance, and Takeovers*, 76 AMER. ECON. REV. 323, 324 (1986) (explaining takeovers and recapitalizations as redirecting excess cash flow from unprofitable investments and projects to shareholders); Porter, *From Competitive Advantage to Corporate Strategy*, 87 HARV. BUS. REV. 43 (May-June 1987) (in a sample of 33 large U.S. companies, finding that 75% of pre-1975 acquisitions in unrelated lines of business were subsequently divested, sometimes after hostile takeovers).

72. Jensen, *supra* note 67, at 24-25 (reporting that from 1981 to 1984, 46% of all mergers and acquisitions occurred in recently deregulated industries, such as airlines, transportation, oil and gas, financial services, broadcasting); Coffee, *Strain in the Web*, *supra* note 34, at 31-35 (similar).

control block.[73] A weak stock price reflected equity investors' collective view that managers were not diversifying better than investors could themselves or were not maximally exploiting the firm's assets, or both. Busting-up the assets into many new hands or placing them into more aggressive hands was the solution.[74]

2. *Huge premiums*

No one disputed that shareholders of target firms were garnering extraordinary premiums, on average thirty percent above pre-announcement prices.[75] It was (and still is) unclear whether the premiums were coming from the prospects of increased value created by displacing inefficient management, from customers or suppliers forced to bear noncompetitive prices, from bondholders and workers who seemed inevitably to lose after takeovers, from taxpayers forced to bear a proportionally greater tax burden as corporate equity was converted into debt, or from acquiring firms and their shareholders.[76]

3. *Takeover techniques*

Rapid and dramatic innovation also characterized the takeover market. In the early 1980s, hostile takeovers were generally half-brothers of mergers. The acquiring firm was generally larger, with enough cash to provide an equity base or with sufficient financial capacity to absorb new

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73. The efficiency of the control market was a principal assumption of Justice White's plurality opinion in *MITE*. 457 U.S. at 643.

74. Upon more careful examination, this portraiture contains numerous flaws, the most significant of which is that acquiring firms seemed to perform more poorly as a result of the acquisition. *See* Black, *supra* note 67 (describing and evaluating a bidder overpayment hypothesis). The takeover market of the 1980s had not put an end to managers' "empire building," but merely redirected it.

75. Bradley, Desai & Kim, *Synergistic Gains from Corporate Acquisitions and the Diversion Between the Stockholders of Target and Acquiring Firms*, 21 J. FIN. ECON. 3, 31 (1988) (estimating the premiums paid in takeovers between 1963 and 1984 at 31.8%); Jarrell & Poulsen, *The Returns to Acquiring Firms in Tender Offers: Evidence from Three Decades*, 18 FIN. MGMT. 12 (1989) (estimating premiums paid to target shareholders between 1963 and 1986 at 29.0%, though finding that the size of premiums increased during the 1970s and again in the 1980s).

76. Black, *supra* note 67; Netter, *The Empirical Evidence on Takeovers, Restrictions an Takeovers, and Restrictions on Deductibility of Interest*, 15 J. CORP. L. 219 (1990) (providing an excellent review of the empirical data on the various explanations for the source of takeover premiums); Stout, *supra* note 67, at 1260-61 (summarizing theories for takeover premiums). Professor Stout argues persuasively that the premiums may simply reflect that different shareholders value the same stock differently, forcing any buyer to pay increasingly higher prices to obtain enough shares for control. See Stout, *supra* note 67.

debt. As it became clear, particularly in a bust-up merger, that the key was control rather than long-term ownership, bidders made partial or front-end loaded bids.[77]

Such bids were structurally coercive. For a rational shareholder faced with a partial or two-tier bid, her decision to tender was compelled. To be assured a portion of the front-end premium and to minimize the loss of being stuck with minority shares for which there would be no control premium, the rational choice was to tender.[78] The coercion of such bids justified strong defensive reactions by target managers, ostensibly on behalf of dispersed shareholders who individually were compelled to do what collectively they would not.

But by 1987, the control market—whose major events during this period were measured in weeks and months rather than years—had moved to any-and-all cash bids, making structurally coercive bids largely a thing of the past. Junk bond financing, which proved its viability in 1985, avoided the need for partial or two-tier bidding. A bidder could raise cash to fund an offer for all the target's shares by borrowing against the target's assets and future cash flow.

4. *Wrenching side-effects*

Perhaps the most politically charged aspect of the takeover phenomenon has been the stories of uprooted employees, plant closings, precipitous drops in targets' bond prices after a takeover, forced concessions from suppliers, and pension plan terminations and withdrawals.[79] Although these events may have resulted equally from changing economic conditions in the country,[80] takeovers (particularly hostile ones)

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77. In a partial bid, the bidder offers a takeover premium only for the shares purchased; he makes no promise as to unpurchased shares. In a two-tier bid, the bidder typically offers cash for 51% of the target's stock, promising to buy out the remaining shares in a squeeze-out merger for debt or other consideration at a discount compared to the front-end cash. *See, e.g.*, Booth, *The Promise of State Takeover Statutes*, 86 MICH. L. REV. 1635 (1988) [hereinafter Booth, *Promise of Takeover Statutes*].

78. A rich body of literature developed in the mid-1980s on the coercion of such bids. Justice Powell cited to some of it in *CTS*. 481 U.S. at 83. *See, e.g.*, *Two-Tier Tender Offer Pricing and Non-Tender Offer Purchase Programs*, Exchange Act Release No. 21079, [1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,637, at 86,916 (June 21, 1984); Lowenstein, *supra* note 68, at 307-09.

79. *See* Johnson & Millon, *Missing the Point*, *supra* note 34, at 848 (1989) (arguing that "state legislators perceive that hostile takeovers cause lost jobs, destruction of established supplier and customer relationships, and loss of tax revenues and charitable contributions"). Some have argued that wage concessions from employees and price concessions from suppliers serve as a significant source for financing takeovers.

80. For example, empirical studies suggest that takeovers may not be the primary cause of

became the object of public animosity.

C. *The Corporate Federalism Players*

CTS was not decided in isolation. The market for corporate control is subject to a dizzying patchwork of federal and state statutory, administrative, and judicial law. Yet by 1987, there were clear patterns in the ways the principal takeover regulators were playing their hands.

1. *A paralyzed Congress*

As of 1987, Congress was for the most part sitting out the game of regulating takeovers. Although takeover bills and hearings during the 1980s were common fare, demonstrably little had emerged. In fact, of the sixty-two bills introduced between 1982 and 1987 relating generally to tender offers, only one was reported out of committee.[81]

In 1968, in response to management pressure to regulate so-called "Saturday night special" cash tender offers, Congress enacted the Williams Act to mandate early warning signals of prospective takeovers, to require disclosure so shareholders and the markets could evaluate tender offers, and to regulate the structure of such offers so shareholders would not be stampeded into tendering.[82] By rule, the SEC required that tender offers remain open for at least twenty business days.[83] The Williams Act had been a hard-fought compromise, which in the end took a relatively

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recent labor dislocations. One study indicates that of 286 plant closings (from 1980 to 1984) only 40 were by firms that had been taken over, and of these only 22 were hostile takeovers. Blackwell, Marr & Spivey, *Plant Closings: Shareholders' Wealth, Advance Notice and Takeover Activity*, *cited in* Netter, *supra* note 76, at 35 n.100.

81. *See* Romano, *Future of Hostile Takeovers*, *supra* note 51, at 471 (describing the post-*MITE* activity in Congress). The only bill reported out of committee came soon after *MITE*, but the bill was never taken up by the whole House. H.R. 5693, 98th Cong., 2d Sess. (1984) (The Equity in Foreign and Domestic Credit Act of 1984); H. REP. No. 1028, 98th Cong., 2d Sess. (1984).

82. Securities Exchange Act of 1934 §§ 13(d), 14(d), 14(e), 15 U.S.C. § 78m(d), n(d)-(e) (1990). The Act plugged a regulatory gap. Federal proxy rules required disclosure of negotiated takeovers requiring shareholder approval, and the 1933 Act's prospectus disclosure rules applied if any securities were exchanged in a tender offer. But no federal securities law regulated the buying of a control block for cash, whether through open-market purchases or a tender offer. *See* Johnson & Millon, *Misreading the Williams Act*, 87 MICH. L. REV. 1862, 1894 (1989).

83. Rule 14e-1, 17 C.F.R. § 240.14e-1 (1990). In implementing an explicit waiting period under its rule-making authority, the SEC rejected extending the waiting requirement to 30 days as upsetting the Act's policy of neutrality. *Tender Offers*, Exchange Act Release No. 16,384, [1979-1980 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 82,373, at 82,595-96 (Nov. 29, 1979) [hereinafter Rule 14e-1 Adopting Release] (finding persuasive the view that a minimum period of 30 business days is "unnecessarily long"; "tender offers which do not stay open for a reasonable length of time increase the likelihood of hasty, ill-considered decision-making").

non-committal stance toward the merits of takeovers and the control market.[84] Early bills, ultimately rejected, would have significantly strengthened the hand of managers.[85] As the Supreme Court would make clear in *CTS* and other cases, the Williams Act was not comprehensive takeover legislation.[86]

Aside from correcting amendments to the Williams Act in 1970, Congress had remained largely passive in the takeover area. In 1976, it passed the Hart-Scott-Rodino antitrust amendments to ensure greater opportunities for antitrust review by federal agencies of business acquisitions.[87] In 1984, Congress denied corporate tax deductibility for golden parachute payments following a change of control if they exceed three times the executive's average annual compensation over the preceding five years.[88] Not really designed to generate federal tax revenues, the golden parachute legislation operates in tandem with state corporate fiduciary law to create a bright-line (and perhaps generous) ceiling that corporate boards will be reluctant to exceed for fear of liability under a theory of corporate waste.[89]

More telling, as of 1987, was what Congress had not done. The 1980s flurry of takeover hearings—twenty-one during the period from 1982 to 1987—showcased the takeover actors, revealing the absence of anything close to a political consensus on what, if anything, should be done.[90] The

84. *See, e.g*, Johnson & Millon, *Misreading the Williams Act*, *supra* note 82, at 1913.

85. The Supreme Court found the original bill to be "avowedly pro-management." Piper v. Chris-Craft Indus., Inc., 430 U.S. 1, 30 (1977); Schreiber v. Burlington Northern, Inc., 472 U.S. 1, 9 n.8 (1985). Congress rejected this approach, adopting instead a disclosure scheme. The charge remains, however, that managers essentially won the fight. The early-warning system of the Act and its disclosure requirements provide managers potent weapons for delay, litigation, and the mounting of defensive reactions. *See, e.g.*, Dynamics Corp. of America v. CTS Corp., 794 F.2d 250, 262 (7th Cir. 1986) (Posner, J.) (stating the Williams Act's "effect" is that of an antitakeover statute).

86. Johnson & Millon, *Misreading the Williams Act*, *supra* note 82.

87. Hart-Scott-Rodino Antitrust Improvement Act of 1976, 15 U.S.C. §§ 1311-14 (1988). *See* H. REP. NO. 1373, 94th Cong., 2d Sess. 5 (1976), *reprinted in* U.S. CODE CONG. & ADMIN. NEWS 2637.

88. 26 U.S.C. § 280G (1988). In addition, any executive who receives excess parachute payments is subject to a 20% excise tax. 26 U.S.C. § 4999 (1988).

89. *See* Coffee, *Strain in the Web*, *supra* note 34, at 78.

90. *See, e.g.*, *Oversight Hearings on Mergers and Acquisitions Before the Subcomm. on Economic Stabilization of the House Comm. on Banking, Finance and Urban Affairs*, 100th Cong., 1st Sess. 1 (1987) (statement of Rep. Markey, chairman of the committee) (stating "[w]e are faced with a classic question of how to strike the balance between sufficient market freedom . . . and sufficient regulation to curb abuses which threaten to hold our entire economic future hostage"); H.R. REP. NO. 1028, 98th Cong., 2d Sess 5 (1984) (stating "[c]orporate takeovers may serve to bring innovation and new capital to existing businesses, to help companies achieve economies of size and, in some instances,

sixty-two bills offered a variety of solutions: restricting defensive tactics; validating state antitakeover legislation; preempting it; and tightening reporting and waiting-period requirements under the Williams Act.[91] The bills went nowhere, in part because of an ambivalence about takeover regulation in federal hands.[92]

2. *A cautious SEC*

The SEC, cautious of far-reaching federal intrusion into corporate governance, had been playing a weak hand favoring market solutions. The SEC had largely acquiesced in the Supreme Court's view that the Williams Act was intended to regulate only disclosure in the takeover context.[93]

During the 1980s, the SEC tinkered with the Williams Act rules to streamline the tender offer process.[94] But the changes, giving shareholders broader withdrawal rights and assuring them equal treatment in a

provide a mechanism to remove ineffective management [but] may also result in the loss of jobs, cause management to focus upon short term stock performance instead of long-term prospects, and reduce the amount of credit available for product purposes"). Congress was politically unable to find the balance.

91. Romano, *Future of Hostile Takeovers*, *supra* note 51, at 471 (describing the post-*MITE* activity in Congress). *See, e.g.*, H.R. 5693, 98th Cong., 2d Sess. (1984) (requiring foreign acquirors to comply with U.S. margin requirements; requiring disclosure of 5% holdings within 24 hours; requiring acquirers to file community impact statements with local government; mandating that tender offers stay open for 40 business days; and prohibiting golden parachutes, defensive stock issuances and buy-backs).

92. *See, e.g*, *Impact of Corporate Takeovers: Hearings Before the Subcomm. on Securities of the Senate Comm. on Banking Housing and Urban Affairs*, 99th Cong., 1st Sess. 893 (1985) (statement of Alexander B. Trowbridge, president of the National Association of Manufacturers) (stating that "[i]t would be wrong to replace longstanding State laws and court decisions with a new Federal corporation law as a result of the activities of corporate raiders whose effect on the economy is at best suspect"). In fact, the principal concern of the business community seemed to be federal disclosure and insider trading law, governance matters which had fallen into federal hands. *See, e.g.*, *Hostile Takeovers: Hearings Before the Senate Comm. on Banking, Housing and Urban Affairs*, 100th Cong., 1st Sess. 128 (1987) (statements of 16 Fortune 200 executives, each decrying insider trading and the power of Wall Street).

93. *See* Schreiber v. Burlington Northern, Inc., 472 U.S. 1 (1985) (holding that § 14(e) did not authorize a private action challenging unfair management takeover defenses).

94. Besides requiring disclosure by the bidder, the SEC tender offer rules seek to ensure an opportunity for shareholders to reflect on the bid. Many of the SEC rules expand the minima specified in the Williams Act:

(1) *Open for minimum 20-day period*. The tender offer must be left open a minimum of 20 business days. Securities and Exchange Act of 1934, Rule 14e-1, 17 C.F.R. § 240.14e-1 (1990). And if there is any change in the offered price or the percentage of shares being sought, the offer must be left open for an additional 10 days after the change.

(2) *Shareholder withdrawal at any time*. Shareholders can withdraw their shares (revoke their

tender offer, stuck close to the "stop, look and listen" disclosure philosophy of the Williams Act.[95]

Proposals for direct intrusion into corporate governance fared poorly. Controversial proposed going-private rules, which would have required that a firm's restructuring to eliminate public ownership be fair, were withdrawn.[96] Concept releases proposing to regulate such matters as

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tenders) at any time while the tender offer is open. *Id.* at Rule 14d-7, 17 C.F.R. § 240.14d-7 (1990).

(3) *All-holders rule.* The tender offer must be open to all shareholders of the same class, and not exclude any shareholders from tendering. *Id.* at Rule 14d-10(a)(1), 17 C.F.R. § 240.14d-10(a)(1) (1990).

(4) *Best-price rule.* Each shareholder must be paid the best price paid to any other shareholder. *Id.* at Rule 14d-10(a)(2), 17 C.F.R. § 240.14d-10(a)(2) (1990). If different consideration alternatives are provided (cash or debentures, for example), each shareholder can choose. *Id.* at Rule 14a-10(c), 17 C.F.R. § 240.14.10(c) (1990).

(5) *Pro rata purchase if tender offer oversubscribed.* When the bidder seeks only a portion of all the shares (a partial tender offer) and more shares are tendered than are sought, the bidder must purchase on a pro rata basis. *Id.* at § 14(d)(6), 15 U.S.C. § 78n(d)(6) (1988). For example, if the offer is for 50% of a target's stock and 75% of the shares are tendered, the bidder must purchase two-thirds (50/75) of each tendering shareholder's shares (disregarding fractions) and return the unpurchased shares. *Id.* at Rule 14d-8, 17 C.F.R. § 240.14d-8 (1990).

(6) *No outside purchases.* The bidder cannot make purchases outside the tender offer while it is pending. *Id.* at Rule 10b-13, 17 C.F.R. § 240.10b-13 (1990). *See also* Kozyris, *Some Observations*, *supra* note 32.

95. It has been argued that the equal-treatment and best-price rules go beyond disclosure, intruding into the governance of shareholder transfer rights. Oesterle, *The Rise and Fall of Street Sweep Takeovers*, 1989 DUKE L.J. 202. Both rules prohibit bidders from offering increasingly lower prices, a practice that coerces early tenders. In this context, they easily fall into a disclosure-protection mold. Shareholders should make their sell decision on the basis of price, not structural coercion. The rules also prohibit denying to early tenderers ultimately higher prices, and the equal-treatment rule prohibits categorizing shareholders. Although this would seem simply to ensure fairness to shareholders—traditionally a state law prerogative—a disclosure purpose can also be discerned. The rules ensure risk arbitrage in the tender offer process, and thus a market price that efficiently reflects information about the tender offer. If arbs could not be sure that they would be paid the ultimately highest price—either because they were excluded from participating or they were denied last-minute price spikes—they would be unwilling to buy based on their assessment of that price. Without these rules, the market price will not reflect the arb-driven market's perception of what the bidder will ultimately bid. Shareholders could be deceived into tendering or not tendering.

96. In 1975, the SEC proposed to regulate going-private transactions to assure fairness to shareholders under the authority of § 13(e)(1) of the 1934 Act, which prohibits issuer repurchases unless they comply with SEC rules. *See* Notice of Public Fact-Finding Investigation and Rulemaking Proceeding in the Matter of "Going Private" Transactions by Public Companies and Their Affiliates, Exchange Act Release No. 5567, [1974-1976, Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 80,104 (Feb. 12, 1975). The going-private rules, when adopted in 1979, did not contain a fairness requirement. Going Private Transactions by Public Companies or Their Affiliates, Exchange Act Release No. 6100, [1979 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 82,166 (Aug. 15, 1979). The agency later withdrew the rule and explained "issuer repurchase programs are seldom undertaken with improper intent [and] may frequently be of substantial benefit to investors," and the proposed rule would have been "overly intrusive." Purchases of Certain Equity Securities by the Issuer, Exchange

poison pills, greenmail, and golden parachutes died from indifference.[97] The SEC ultimately capitulated in its attempt to have market sweeps regulated and thus prohibited as tender offers, persuaded by arguments that open-market purchase programs can be an efficient mechanism in a market for corporate control.[98] In fact, the SEC saw its own role as antiregulatory, at one point floating the idea that shareholders should be allowed to opt out of certain Williams Act provisions.[99]

While the SEC hesitated to take a regulatory role in corporate governance, it was an outspoken advocate in Congress and in state legislatures for an unregulated market for corporate control.[100] In both *CTS* and *MITE*, the SEC filed amicus briefs arguing against the constitutionality of antitakeover statutes, although in *CTS* on rather narrow grounds.[101]

Act Release No. 19,244, [1982 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,276 (1982). *See generally* 1 HAZEN, SECURITIES REGULATION § 11.17 (2d. ed. 1990).

97. *Concept Release on Takeovers and Contests for Corporate Control: Advance Notice of Possible Commission Actions*, [1986-1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,018, at 88,203-06 (July 30, 1986).

98. For nearly 20 years the takeover bar and the courts had urged the SEC to define "tender offer," which the Williams Act does not define. In 1979 the SEC proposed a definition, but never adopted it. *See* Proposed Amendments to Tender Offer Rules, Exchange Act Release No. 16385, [1979-1980 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 82,374 (Dec. 19, 1979); *Excerpts from Final Report of SEC Advisory Committee on Tender Offers*, 15 Sec. Reg. & L. Rep. (BNA) No. 28 at 1375 (July 15, 1983). In litigation, the agency took the position that market sweeps should be regulated as tender offers, effectively killing them, but the court resolved the issue against the SEC. *See* Hanson Trust PLC v. SCM Corp., 774 F.2d 47 (2d Cir. 1985) (holding that five privately-negotiated purchases and one open-market purchase totaling 25% of target's stock did not constitute a tender offer, even though the purchases came on the heels of a withdrawn tender offer). The agency seemed afraid to be conclusive. *See* Oesterle, *The Rise and Fall*, *supra* note 95, at 220 n.81 (suggesting that the SEC is afraid that its rules will be followed). Shareholders gain by selling to arbs, who provide an outlet where the buyer is unwilling to pay the premium induced by the tender offer rules, but stock has been accumulated. *See* Leebron, *Games Corporations Play: A Theory of Tender Offers*, 61 N.Y.U. L. REV. 153, 175-77 (1986).

99. *Concept Release on Takeovers and Contests: Advance Notice of Possible Commission Actions for Corporate Control*, [1986-1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,018 (July 30, 1986).

100. *See, e.g*, *Tender Offer Tactics and Corporate Director Responsibilities: Hearings on S. 2448 and S. 2797 Before the Senate Comm. on Banking, Housing and Urban Affairs*, 98th Cong., 2d Sess. 72 (1984) (statement of SEC Chairman Shad) (questioning whether shareholders ought to be deprived of two-tier tender offers, on the theory that some offers may be better than none); Oesterle, *Delaware's Takeover Statute*, *supra* note 2, at 904 n.99, 905 n.103 (summarizing letters by SEC Commissioners to Delaware's corporate drafting group urging that firms be allowed to fend for themselves against two-tier bids).

101. In *CTS*, the SEC only challenged the Indiana statute on the narrow ground that on balance it imposed more costs on the national control market than it produced benefits for shareholders; it agreed the Williams Act did not preempt the statute. In its balancing argument, the SEC sought to distinguish the Indiana statute from other state corporate rules on the ground that the statute regu-

In state court, the SEC took amicus positions against poison pills.[102]

3. *A wilting federal judiciary*

During the takeover binge of the 1980s, lower federal courts and the Supreme Court for the most part cut their losses. Federal courts had adopted an attitude of disentanglement that mirrored that of Congress. Both in their interpretation of federal securities laws and state fiduciary law, federal courts, with only the short-lived *MITE* exception, mostly avoided becoming enmeshed in corporate governance issues.

In a series of decisions stretching from 1975 to 1985, the Supreme Court pared back the reach of rule 10b-5 and the comparable section 14(e) of the Williams Act. The Court stated emphatically that federal securities law focused on disclosure and foreswore any desire to "federalize . . . the law of corporations."[103] But where state regulation was spotty, such as in the case of insider trading, federal courts and the Supreme Court showed few misgivings about federalizing and even criminalizing this significant aspect of corporate governance.[104]

Nothing compelled the Court's operating assumption that the federal securities laws were meant only to regulate corporate disclosure. The legislative history of section 10(b) indicates a much broader congressional concern than about securities fraud in its traditional forms.[105]

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lated only shareholders and third parties, not such things as mergers or acquisitions that go to the "the very structure of the corporation." Brief for the Securities and Exchange Commission and the United States as Amici Curiae at 25-26 & n.28, CTS Corp. v. Dynamics Corp. of America, 481 U.S. 69 (1987) (Nos. 86-71 and 86-97) [hereinafter SEC Brief]. The SEC's arguments in *MITE*, where the corporate federalism stakes were perceived as far less weighty, were more strident than in *CTS*.

102. *See* Moran v. Household Int'l Co., 500 A.2d 1346 (Del. 1985).

103. Santa Fe Indus. v. Green, 430 U.S. 462, 479 (1977) (refusing minority shareholder's challenge to a fully-disclosed, but assertedly unfair price in a squeeze-out merger):

> 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.

104. Carpenter v. United States, 484 U.S. 19 (1987) (holding Wall Street Journal writer criminally liable under mail and wire fraud statutes for tipping information on upcoming stories); Chiarella v. United States, 445 U.S. 222 (1980) (holding composer at financial printer not liable since he had no fiduciary duty to the firms in whose stock he traded). *See also* SEC v. Texas Gulf Sulphur Co., 401 F.2d 833 (2d Cir. 1968), *cert. denied*, 394 U.S. 976 (1969) (holding various insiders liable for trading on and tipping non-public confidential information). Courts have also interpreted rule 10b-5 to require corporate disclosure of material information, even when neither managers nor the corporation trade on inside information. Basic Inc. v. Levinson, 485 U.S. 228 (1988). The disclosure duty arises when a federal court determines that wealth-maximizing shareholders would prefer disclosure to secrecy.

105. *See* Thel, *supra* note 16, at 385.

Further, the Williams Act's broad-brushed section 14(e) offered strong textual and policy support for greater federal activism in regulating management behavior in the tender offer context.[106] But the Court did not bite.

The Court also circumscribed enforcement of the Williams Act's disclosure rules to avoid federal encroachment into corporate governance. Unsuccessful bidders were denied damages arising from deceptive or unfair defensive tactics undertaken by managers, leaving them to their state remedies.[107] It made little difference to the Court that such remedies traditionally had been illusory.[108]

Edgar v. MITE proved the only real exception to this passivity.[109] A bare majority, with Justice Powell joining the opinion on the narrow issue of balancing under the dormant commerce clause, held that Illinois's first-generation antitakeover statute unconstitutionally interfered with the interstate market for publicly-traded shares. This intervention had enormous (though not immediately apparent) potential to realign corporate federalism, based as it was on the federalization of shareholders' transfer/control rights.

4. *Torrid state legislatures*

State legislatures showed none of the paralysis of Congress. Despite the *MITE* setback, they played their hands with vigor. Although before *CTS* state antitakeover statutes fared poorly in court,[110] their aim was

106. *See* Booth, *The Problem with Federal Tender Offer Law*, 77 CALIF. L. REV. 707, 750 (1989) [hereinafter Booth, *Tender Offer Law*] (arguing that "since garden-variety market manipulation was already prohibited under Section 9 of the Exchange Act, Congress presumably intended to reach different conduct when it passed the Williams Act"); Steinberg, *Tender Offer Regulation: The Need for Reform*, 23 WAKE FOREST L. REV. 1, 19-22 (1988) (arguing that the legislative history of § 14(e) suggests more than a disclosure purpose).

107. Piper v. Chris-Craft Indus., Inc., 430 U.S. 1, 41-42 (1977) (holding that an unsuccessful bidder cannot recover damages under § 14(e) of the Williams Act for deception by the target's management and suggesting that unsuccessful bidder should look to state law to seek damages for having been wrongfully denied a 'fair opportunity' to compete for control of another corporation").

108. *See, e.g.*, Unocal v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985) (upholding target's use of self-tender to increase its debt, while excluding hostile bidder from tendering its shares).

109. White leaped into the takeover fray in *MITE* with seeming relish, stating in connection with the preemption analysis: "Congress . . . left the determination whether the Illinois statute conflicts with the Williams Act to the courts." 457 U.S. at 631.

110. Lower courts uniformly invalidated second-generation statutes as unconstitutional. *See* Kozyris, *Some Observations*, *supra* note 32, at 501 n.6 (collecting cases invalidating first-generation statutes on preemption and commerce clause grounds).

straightforward: to insulate local managers from the control market and as a by-product to protect the state's business status quo.

Before *MITE*, during the decade following the unsatisfying compromise of the Williams Act, most state legislatures passed antitakeover statutes that significantly regulated takeover bids. These statutes, ostensibly extensions of state blue sky regulation, required pre-offer waiting periods, disclosure, and opportunities for open-ended administrative hearings into the fairness of a tender offer.[111] Like state blue sky regulation, they based jurisdiction on the target's contacts with the state and applied if the target had local shareholders or in-state business operations (particularly corporate headquarters), regardless of where the larger was incorporated.

The first-generation statutes focused only on hostile takeovers. Broad opt-out provisions allowed management to choose whether the relevant antitakeover scheme applied to the corporation and, if chosen, which bidders would be regulated. The statutes thus allowed management to increase prohibitively the costs to unwanted bidders, while exempting management-approved transactions.

After *MITE*, state legislatures enacted a second generation of antitakeover statutes. The new statutes sought to overcome the Illinois statute's deficiencies identified in Justice White's plurality opinion. The second-generation statutes' provisions were made consistent with the Williams Act's disclosure and timing requirements; jurisdiction was generally limited to corporations chartered in the state, sometimes with the additional requirement of specified local operational and shareholding contacts; and their provisions were grafted onto existing shareholder voting or appraisal rights.[112] By adding delays, increasing the price to the bidder, or limiting a successful bidder's flexibility to manage the business and thus finance the bid, the statutes discouraged takeovers.

At the time of *CTS*, twenty-four states had adopted some version (or combination) of a control-share, fair-price, moratorium, forced redemption or non-shareholder constituency statute.[113] Like the first generation and in line with the facilitative character of corporate law, the statutes

111. *See* Note, *A Failed Experiment: State Takeover Regulation After* Edgar v. MITE Corp., 1983 U. ILL. L. REV. 457; Note, *The Constitutionality of Second Generation Takeover Statutes*, 73 VA. L. REV. 203, 207 (1987) [hereinafter Note, *Second Generation*].

112. *See* Note, *Second Generation*, *supra* note 111, at 208.

113. Brief Amicus Curiae of United Shareholders Ass'n at 6 n.11, CTS Corp. v. Dynamics Corp. of America, 481 U.S. 69 (1987) (Nos. 86-71 & 86-97) [hereinafter United Shareholders Ass'n Brief]

generally had broad opt-in and -out provisions and exemptions, many of them in the hands of management.[114] In *CTS* both parties were clear about the optional, private nature of the Indiana statute.[115]

(counting eight states with control share statutes and sixteen with a combination of fair-price or moratorium statutes). The varieties can be summarized:

Control share statutes. An example is the Indiana statute upheld in *CTS*. Control share statutes allow the body of shareholders (but excluding the bidder and management) to decide on the bidder's fate. Under some statutes, the bidder can acquire "control shares" only if other shareholders approve. *See* OHIO REV. CODE ANN. §§ 1701.01, 1701.831 (Baldwin 1985). Under others, the bidder can acquire voting rights for these shares only if the other shareholders approve. A bidder becomes subject to this rite of initiation when its total shareholdings exceed one of three specified thresholds (usually 20%, 33% and 50%). Under the statutes, the bidder must give notice and the board must set a date for a shareholders meeting (usually no more than 50 days after the notice) to decide on whether the control shares will be enfranchised. Control share statutes are ostensibly meant to protect against coercive tender offers by authorizing collective shareholder action.

Business combination (or moratorium) statutes. Under these statutes, a bidder who acquires a triggering position (often 15%) is prohibited for a moratorium period (such as 3 or 5 years) from entering into a back-end transaction with the corporation. *See* N.Y. BUS. CORP. LAW §§ 1600-1613 (McKinney 1986). The statutes provide a variety of means to lift or avoid the moratorium: (1) the board and a supermajority (such as two-thirds) of the other shareholders approve the transaction, (2) the transaction is for a fair-price, according to a statutory formula, (3) the bidder acquired control in a tender offer for a significant majority of the stock (such as 85%), or (4) the original board of directors approved the bidder's buying control. The statutes prevent squeeze-out mergers, and thus financing based on the target's assets, unless they comply with the statutory exemptions. The statutes give the board enhanced negotiating leverage and shareholders greater opportunity to share in the control premium.

Fair price statutes. These statutes, predecessors of the business combination statutes, prohibit back-end transactions with a bidder who triggers the statute, unless the bidder pays a fair price or the transaction is approved by one of the methods described above. MD. CORP. & ASSOC. CODE ANN. § 3-202 (1985). Price fairness is usually defined by a formula that assures shareholders a price at least equal to that paid in the front-end acquisition of control. Fair price statutes are meant to prevent front-end loaded bids.

Redemption (or appraisal) statutes. Appraisal statutes go one step beyond the fair-price statutes. They give shareholders a right to force any bidder that acquires a triggering block to redeem their shares for cash at a formula price specified in the statute, usually equal to the highest acquisition price the bidder paid. The redemption right exists whether or not the bidder plans a takeover. The statutes in essence force a bidder to acquire control only by any any-and-all tender offer.

Non-shareholder constituency statutes. These statutes, which were not widespread in the second generation, allow and even mandate directors to consider the effect of a takeover bid on non-shareholder stakeholders, such as "employees, suppliers, creditors and customers, the economy of the state, region and nation, community and societal considerations."

For an exhaustive review of the operation of these second-generation statutes, see Hank, *Maryland-Type Takeover Statutes: Are They "Fair Price" or Foul Ball?*, 8 Nat'l L.J., Sept. 8, 1986, at 32.

114. For example, in the takeover battle between CTS and Dynamics, CTS had to opt into the Indiana control share statute. 794 F.2d at 251.

115. Appellee Dynamics argued that the Indiana control share statute

> (1) [v]ests management with discretion to invoke the Chapter; . . . (3) [s]ubjects the shareholder's decision to sell securities to an effective veto by management and at least two groups of shareholder guardians; (4) [p]ermits management to redeem tendered shares pur-

The manner in which the second-generation statutes were enacted sparked as much interest as their substance. Professor Romano, in her seminal work on the political economy of the second generation, described an oft-repeated pattern: local managers fearful of a specific takeover threat approached the state legislature; the company's lawyers drafted a statute; the statute sped through the statehouse without notice or debate; and the governor signed the new law, sometimes at corporate headquarters and usually with grand pronouncements about protecting "our local companies."[116] Most remarkable was the speed of the process, varying from a couple of weeks to a few days.[117] Neither shareholders, their representative groups, nor non-shareholder constituents—such as employees, suppliers, communities—participated.

Nonetheless, local non-shareholder constituents' silent presence constituted part of the legislative enthusiasm for protecting local employ-

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> suant to its own procedures; . . . (6) [g]ives management complete control over the Chapter's enforcement mechanism.

Dynamics Brief, *supra* note 67, at 37. Appellant CTS analogized the statute to an optional state-drafted charter provision on voting rights and argued "the Indiana statute simply permits Indiana corporations to adopt or reject charter provisions governing the voting rights of shares." Reply Brief of Appellant CTS Corp. at 30-32, 32, CTS Corp. v. Dynamics Corp. of America, 481 U.S. 69 (1987) (No. 86-71) [hereinafter CTS Reply Brief].

116. Romano, *Political Economy*, *supra* note 37, at 122-41. Empirical analysis and legislative behavior in other states have borne out Professor Romano's anecdotal account of the history and politics of Connecticut's second-generation statute. *See, e.g.*, Davis, *supra* note 52, at 495-97 (describing process by which Wisconsin's statute was enacted, including governor's statement in Wisconsin decrying the takeover of Wisconsin firms by out-of-state firms); Garfield, *State Competence to Regulate Corporate Takeovers: Lessons from State Takeover Statutes*, 17 HOFSTRA L. REV. 535, 560-62 (1989) ("our companies"). The list of antitakeover statutes, the beleaguered firms for which they were enacted, and the out-of-state bidders provides graphic proof of the politics of antitakeover statutes: Arizona for Greyhound; Connecticut for Aetna; Florida for Harcourt, Brace, Jovanovich (hostile bid by Revlon Group); Indiana for Arvin Industries (anticipated bid by Belzberg brothers); Kentucky for Ashland Oil (bid by Belzberg brothers); Massachusetts for Gillette (bid by Revlon Group); Minnesota for Dayton Hudson (bid by Dart Group); Missouri for TWA (bid by Carl Icahn); New York for CBS (bid by Turner Communications); North Carolina for Burlington Industries (bid by Asher Edelman and Dominion Textile); Ohio for first Goodyear (bid by Sir James Goldsmith) and then for Federated Department Stores (bid by Campeau); Pennsylvania for Scott Paper (bid by Brascan Ltd.); Washington for Boeing (possible bid by T. Boone Pickens); Wisconsin for G. Heileman Brewing (bid by Bond Holdings). *See* Butler, *Corporation-Specific Statutes*, *supra* note 3, at 374-76; Oesterle, *Delaware's Takeover Statute*, *supra* note 2, at 930 n.198; Romano, *Future of Hostile Takeovers*, *supra* note 51, at 461 & n.11.

117. Charming stories exist of how corporate counsel in their rush to get a bill to the legislature inadvertently failed to cover the client target or extended the statute to non-hostile takeovers. Just as quickly the legislature corrected the mistakes. *See, e.g.*, Hank, *supra* note 113, at 38 (describing Maryland legislature's revision of bill vetoed by the governor that would have extended fair-price rules to significant shareholders who had acquired their holdings in non-hostile transactions).

ment, the local tax base, and corporate political and social philanthropy.[118] In the rush to enactment during the second generation, there seemed little concern that too much state reaction would invite a federal response. Many assumed that the second-generation statutes were invalid under *MITE*, and their enactment did little more than to buy management a lawsuit, some time, and some costly uncertainty. Nonetheless, where a state consensus on the benefits of takeovers was less clear, as in those states with significant shareholder or securities industry interests, the state antitakeover legislation assumed a different character. Delaware, for example, never enacted a second-generation statute; a New York fair-price bill, vetoed for being "inordinately protectionist," gave way to a much milder version.[119]

Whatever constraints from the chartering markets and special interest politics limit the states in enacting and interpreting their generic corporate codes, the sense of panic that the antitakeover statutes addressed overwhelmed them. Drafted by the targets' corporate counsel, the statutes became an exception to the rule that the state's corporate bar drafts generic corporate law.[120] They also became an exception to the rule of general uniformity of corporate law, with five basic forms and substantial variance among them.[121]

For managers, the second-generation statutes, if valid, accomplished a number of things. First, like firm-specific defenses, they were largely optional methods to impose added costs on hostile bidders.[122] Second, they

118. *See* Coffee, *The Uncertain Case for Takeover Reform: An Essay on Stockholders, Stakeholders and Bust-Ups*, 1988 WIS. L. REV. 435, 436-37 [hereinafter Coffee, *Uncertain Case*]; Davis, *supra* note 52, at 496; Macey, *State Legislation*, *supra* note 3, at 475 (concluding "state legislators would prefer to see a firm languish or die at home rather than thrive in some other state").

119. In New York the securities industry opposed antitakeover legislation, though labor favored it. *See* Coffee, *Corporate Federalism*, *supra* note 51, 770. Governor Cuomo vetoed the first bill, a fair-price statute, on the ground it was of "dubious constitutionality" and appeared "inordinately protectionistic." N.Y. Times, Aug. 14, 1985, at D1, col. 3. What emerged was a relatively diluted business combination statute that places a five-year moratorium on a bidder's entering into a back-end transaction unless the board approved the transaction before the bidder acquired 20% or unless a majority of disinterested shares opt out of the statute. N.Y. BUS. CORP. LAW § 912 (McKinney 1986). *See* Oesterle, *Delaware's Takeover Statute*, *supra* note 2, at 886-87.

120. Romano, *Future of Hostile Takeovers*, *supra* note 51, at 462.

121. *See, e.g.*, Hank, *supra* note 113, at 38 (describing the variations among Maryland's fair-price statute and similar fair-price provisions in those of Connecticut, Indiana, Kentucky, Louisiana, Michigan, New York, Pennsylvania, Virginia and Wisconsin).

122. Jarrell & Bradley, *The Economic Effects of Federal and State Regulations of Cash Tender Offers*, 23 J. L. & ECON. 371 (1980); Note, *Second Generation*, *supra* note 111, at 224, 226. A prevalent assumption continues that antitakeover statutes make tender offers more risky and expensive, even if the bid is conditioned on the statute not applying. By opting into the statute, manage-

were less costly and more certain than firm-specific defenses. Under many statutes, a firm need not opt into the antitakeover regime, and unlike many firm-specific defenses, no shareholder approval is required. Third, they were legally more certain than firm-specific defenses, whose validity had become increasingly suspect. Courts had invalidated a number of firm-specific defenses for exceeding the board's powers[123] or breaching fiduciary duties,[124] and raised doubts about others. Fourth, enforcement of the statutes was a matter of management choice. Finally, the statutes took political heat off Congress to act, thus insulating the state chartering market from regulation.

Perhaps most important, the second-generation statutes upped the federalism stakes. Rather than focusing on investor contacts to the state, many were incorporation-based, reducing territorial spillover. Further, the statutes replaced the first generation's scheme of administrative notice and review with one based on shareholder disclosure and voting rights, creating a facial resemblance to traditional state regulation of the shareholder-manager relationship.[125] The statutes' formal regulation only of shareholder rights, not the bidding process, forced the federalism issue. They called the *MITE* bluff; their invalidation would have moved

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ment pressures existing bidders to withdraw and chills other bids. *See* Netter, *Shareholder Wealth Effects of the Ohio Antitakeover Law*, 4 J. L. ECO. & ORGANIZ. 373, 377-78 (1988) (describing Sir James Goldsmith's withdrawal from a control contest for Goodyear after Ohio passed a poison-pill validation statute and the decline in stock prices for other potential Ohio takeover targets); Langevoort, *supra* note 2, at 104.

123. To ensure their dilutive effect, many poison pills deny the hostile acquirer the right to buy stock at a discount after a back-end transaction. Courts have invalidated poison pills for violating the statutory requirement that all shares of a class have equal rights. Bank of New York Co. v. Irving Bank Corp., 528 N.Y.S.2d 482 (Sup.), *aff'd*, 533 N.Y.S.2d 411 (App. Div. 1988); Asarco, Inc. v. Court, 611 F. Supp. 468 (D.N.J. 1985) (New Jersey law); Minstar Acquiring Corp. v. AMF, Inc., 621 F. Supp. 1252 (S.D.N.Y. 1985) (same).

124. *See* Oesterle, *The Negotiation Model of Tender Offer Defenses and the Delaware Supreme Court*, 72 CORNELL L. REV. 117, 133-35 (1986); *see also* Gilson & Kraakman, *What Triggers* Revlon?, 25 WAKE FOREST L. REV. 37 (1990) (discussing complex questions of when and whether board can fend off unwanted bid or must act as auctioneer). In particular, the question of when poison pill must be withdrawn has become a thorny, unpredictable, issue. *See* City Capital Associates Limited Partnership v. Interco, Inc., 551 A.2d 787 (Del. Ch.), *appeal dismissed as moot*, 556 A.2d 1070 (Del. 1988) (requiring that board withdraw poison pill in response to all-cash hostile bid); TW Services, Inc. v. SWT Acquisition Corp., [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,334 (Del. Ch. 1989) (allowing target to leave in place poison pill in response to all-cash bid conditioned on the board withdrawing the pill and consenting to a merger agreement). Many statutes specifically absolve directors of any liability for opting into or out of the statutory antitakeover scheme. *See, e.g.*, N.C. GEN. STAT. § 55-9A-09 (1989).

125. In its brief, CTS described the Indiana act as "a comprehensive revision of the State's generic corporation code." CTS Brief, *supra* note 8, at 3.

perilously close to realigning sacrosanct corporate federalism.[126]

5. *Shrewd state courts*

While state legislatures seemed clearly in the pocket of local managers, state courts, particularly in Delaware, seemed to take an independent, longer view. Thrust into a political hot seat, their role underwent a significant metamorphosis. In a triumvirate of 1985 decisions, the Delaware Supreme Court reshaped the corporate fiduciary landscape. The court dramatically made clear that directors could be personally liable for not diligently representing shareholder interests;[127] it began to scrutinize takeover defenses under an avowedly nondeferential proportionality test;[128] and it forbade directors from preferring management-led bids without offering to sell the company in an open, fair auction.[129]

To fill the vacuum left by Congress and the federal judiciary and to correct the deficiencies of the state legislative process, state courts assumed the prominent role of balancing the competing interests of stability and change forced in a takeover.[130] Although some retrenchment occurred after 1987,[131] at the time of *CTS*, state courts emerged as the principal regulators of the control market.[132]

II. THE *CTS* GAMBIT AND ITS DEFICIENCIES

In *CTS* the Supreme Court played its federalism hand with subtlety. Couching its gambit in the rhetoric of shareholder protection and states'

126. CTS made this the cornerstone of its argument to the Supreme Court. CTS Brief, *supra* note 8, at 9 (arguing that "the heart of this case is whether Federal law bars the States from developing generic corporation laws"); CTS Reply Brief, *supra* note 115, at 42 (arguing that "Indiana has, in enacting the Chapter, exercised its power to define and regulate corporate voting rights in a way that differs from the pattern followed by most States . . . .").

127. Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985).

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

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

130. In *CTS*, appellee Dynamics cited to *Unocal* to make its point that management and shareholder have divergent interests in the control context, *see* Dynamics Brief, *supra* note 67, at 22 n.20, unwittingly fueling the argument that federal intervention is unnecessary.

131. *See* Ivanhoe Partners v. Newmont Mining Corp., 535 A.2d 1334 (Del. 1987); Paramount Communications, Inc. v. Time, Inc., 571 A.2d 1140, 1147 (Del. 1989).

132. Associate Justice Moore of the Delaware Supreme Court explained:

> Congress has not done much—really has done nothing—in this area and perhaps with the exception of the all holders rule, the SEC has not done much to relieve us of any pressure. So Delaware is really the focus these days of the hard-fought battle, or battles, for corporate control.

State Competition: Panel Response, 8 CARDOZO L. REV. 779, 779 (1987).

traditional chartering power, the Court in a majority opinion by Justice Powell upheld Indiana's unnoteworthy second-generation control share statute. The Court articulated a tenuous justification for the statute and at each turn avoided a meaningful analysis of the statute's impact on the market for corporate control and the role of state chartering and antitakeover statutes in that market. This Part sets the stage for evaluating different hypotheses for the Court's sophism and my conclusion that *CTS* reaffirms an incorporation-based corporate federalism that essentially defers to private ordering.

THE DEALT HAND—INDIANA'S STATUTE. The Indiana statute was a less intrusive version of Ohio's control share statute.[133] Like many other second-generation statutes, local management had requested its enactment in reaction to hostile out-of-state bids.[134] A couple weeks after enactment, CTS's management opted into the regime in response to an unsolicited 27.5 percent tender offer by Dynamics, already the firm's largest shareholder.

Like other second-generation statutes, Indiana's sought to overcome *MITE*.[135] It applies only to public corporations incorporated in Indiana with significant operational and shareholder contacts to the state.[136] A bidder that passes a triggering share threshold (20%, 33-1/3% or 50%) does not acquire voting rights for its "control shares" until a majority of shareholders approve their enfranchisement. The shareholders' meeting

133. OHIO REV. CODE ANN. §§ 1701.01, 1701.831 (Baldwin 1985). The Ohio statute, the first of the second-generation statutes, withdraws ownership rights from any acquirer that passes a 20%, 33-1/3% and 50% threshold, unless a majority of disinterested shares are voted to grant the bidder such rights. *See* Note, *Second Generation*, *supra* note 111, at 208.

134. The briefs in *CTS* did not detail the statute's genesis. Dynamics stated only that the statute "was passed after nonresidents made bids for two large Indiana corporations." Dynamics Brief, *supra* note 67, at 11 n.13 (citing 3 *Corporate Control Alert* 1, 10-11 (Mar. 1986)) (appended to Dynamics's brief). In fact, the chairman of Arvin Industries, a family-run business with deep Indiana roots, had approached the president of the Indiana Senate, a long-time friend, after Arvin management had become worried about a takeover by the Belzberg family of Canada; AMOCO management also joined in the request. Miller, *How Indiana Shields a Firm and Challenges Takeover Business*, Wall. St. J., July 1, 1987, at 1, col. 6 (describing meeting between Arvin chairman and president of Indiana senate, in which chairman sought protection from "wrenching change"); Romano, *Future of Hostile Takeovers*, *supra* note 51, at 461 n.11.

135. The formula for escaping *MITE*'s grasp had by the time of *CTS* become relatively standardized. Profusek & Gompf, *State Takeover Legislation After MITE: Standing Pat, Blue Sky or Corporation Law Concept?*, 7 CORP. L. REV. 3, 4-15 (1984).

136. Specifically, the statute applies to Indiana corporations with 100 or more shareholders which have (1) their principal offices or substantial assets in Indiana and (2) either 10% of shareholders are Indiana residents, 10% of corporation's shares are held by Indiana residents, or at least 10,000 shareholders are Indiana residents. IND. CODE. § 23-1-42-1 (1989).

to decide on enfranchising the bidder cannot be earlier than fifty days after the bidder announces a "control share" bid.[137]

This control share regime ostensibly protects shareholders from coercive hostile bids, such as Dynamics's partial bid, by allowing dispersed shareholders collectively to decide the bid's fate. The statute, however, would not apply if CTS management had not opted in or had it chosen to approve the Dynamics bid.

THE PREDICTABLE SEVENTH CIRCUIT REACTION. For Judge Posner on the Seventh Circuit, the Indiana statute's unconstitutionality proved an easy matter.[138] It failed on preemption grounds because of its effect of moving the takeover balance in favor of management, in derogation of the Act's philosophy that managers and bidders should play on a "level playing field." Admitting that the statute had been "[c]leverly drafted," Posner nonetheless concluded that its fifty-day delay went well beyond the twenty-eight-day minimum period imposed, on average, by the Williams Act regime.[139] The statute also failed under the dormant commerce clause. The mandated delay and the tactical opportunities it provided managers at the expense of out-of-state bidders imposed disparate and significant burdens on stock trading by nonresidents in the interstate market for corporate control. The Seventh Circuit was not alone. After *MITE*, no second-generation statute had withstood a constitutional challenge.[140]

CTS was a surprise.[141] Justice Powell's opinion for the *CTS* major-

137. IND. CODE § 23-1-42-7 (1989).

138. Dynamics Corp. of America v. CTS Corp., 794 F.2d 250 (7th Cir. 1986), *rev'd*, 481 U.S. 69 (1987).

139. 794 F.2d at 261. The SEC's requirement of a 20-business-day waiting period, promulgated pursuant to its authority under section 14(e) of the Act to prevent manipulative practices, constituted the federal accommodation of management's desire for delay and a bidder's for swiftness. *See supra* note 83 (discussion of adoption of Rule 14e-1).

140. *See* Fleet Aerospace Corp. v. Holderman, 796 F.2d 135 (6th Cir. 1986), *vacated sub nom.* Ohio v. Fleet Aerospace Corp., 481 U.S. 1026 (1987) (same for Ohio statute), *remanded*, 848 F.2d 720 (1988); Terry v. Yamashita, 643 F. Supp. 161, 165-68 (D. Haw. 1986) (preliminarily enjoining Hawaii control share statute on commerce clause grounds); APL Ltd. Partnership v. Van Dusen Air, Inc., 622 F. Supp. 1216, 1225 (D. Minn. 1985) (permanently enjoining a Minnesota control share statute); Icahn v. Blunt, 612 F. Supp. 1400, 1421 (W.D. Mo. 1985) (enjoining Missouri control share statute on preemption and commerce clause grounds). *See also* Langevoort, *supra* note 2, at 99 & n.19.

141. Oesterle, *Delaware's Takeover Statute*, *supra* note 2, at 933 & n.203 (commenting that "no one, nary a lower federal court nor a commentator, was even close to foreseeing the result in the *CTS* case"); Coffee, *Corporate Federalism*, *supra* note 51, at 776.

ity[142] sparks as much interest for the tacks it takes as for those it does not. It is a careful and tenuous weaving of regulatory thread and doctrinal fabric. It has become protocol to dissect the sentences and words of the opinion, not believing what is said.[143] The opinion's deficiencies are many and not trivial; most of them argue for the statute's invalidity. In the end, the opinion leaves a clear impression that the Court had an unarticulated agenda and was sketching the design for a permissible state antitakeover regime—a corporate federalism blueprint.

A. Preemption: Weak Federalization of Shareholder Control Rights

A state law that "stands as an obstacle to the accomplishment and execution of the purposes and objective of Congress"[144] undermines the supremacy of federal law and is preempted. In areas of economic regulation, the Supreme Court increasingly has become reluctant to preempt concurrent state regulation absent explicit guidance from Congress.[145]

Powell adopted, without endorsement, the preemption framework of the *MITE* plurality. That framework rested on three premises about the Williams Act: (1) neither bidders nor managers should have an advantage in the struggle for control; (2) the bidding process should not be unreasonably delayed; and (3) shareholders should decide who wins the control struggle. In effect, the *MITE* plurality assumed that shareholder control rights had been federalized, the Williams Act fixing and assuring their operation.

Under this framework, the prospects for the Indiana statute seemed daunting. By imposing delays on unwanted bidders, the statute effec-

142. Justices Rehnquist, Brennan, Marshall, and O'Connor joined Powell's opinion. Justice Scalia filed a concurring opinion. 481 U.S. at 94. Justice White dissented and was joined by Justices Blackmun and Stevens on only the commerce clause issue. *Id.* at 97.

143. *See, e.g.*, Langevoort, *supra* note 2, at 102, 111; Oesterle, *Delaware's Takeover Statute*, *supra* note 2, at 934; Regan, *Siamese Essays*, *supra* note 2, at 1870; Shipman, *The Case for Reasonable State Regulation of Corporate Takeovers: Some Observations Concerning the Ohio Experience*, 57 U. CIN. L. REV. 507, 520-25 (1988). Courts have also reached into the minutiae of the opinion. *See, e.g.*, Hyde Park Partners, L.P. v. Connolly, 839 F.2d 837, 850 (1st Cir. 1988) (focusing on note 7 of the opinion, which rejects that the Indiana statute's additional burdens reflect a preference for management).

144. Hines v. Davidowitz, 312 U.S. 52, 67 (1941).

145. Chicago & N.W. Transp. Co. v. Kalo Brick & Tile Co., 450 U.S. 311, 317 (1981) (requiring "unmistakabl[e]" congressional decision); Florida Lime & Avocado Growers, Inc. v. Paul, 373 U.S. 132, 147 (1963) (requiring "an unambiguous congressional mandate"). Congress, of late, has understood this, frequently providing explicit preemptive guidance. *See, e.g.*, 134 CONG. REC. S8867 (daily ed., July 6, 1988) (remarks of Sen. Mitchell) (stating that states can continue to regulate plant closings after the passage of the federal plant-closing statute).

tively preferred target managers. By effectively mandating a waiting period three weeks longer than the minimum established by the Williams Act rules, the statute regulated the bidding process.[146] By diluting the efficacy of a hostile tender offer while exempting management-approved mergers, the statute weakened shareholder control and undermined the disciplining effect of a robust control market.

But Powell applied the *MITE* framework half-heartedly, raising serious questions about whether it had been abandoned. To Powell, the Indiana statute's proffered and superficial purpose, not its broader effects, were relevant. First, Powell disregarded White's view that the Williams Act's balance was intended to "provide a check on entrenched but inefficient management," diluting (if not eliminating) the level-playing-field principle as a preemptive guidepost.[147] Powell's opinion assumes the statute was meant to protect shareholders from coercive bids. It fails to appreciate the irony that Indiana's scheme for shareholder collective action may well have chilled bids to the overall detriment of shareholders.[148] By approaching the preemption question from the perspective of a shareholder presumably coerced into selling rather than a shareholder frustrated in an attempt to sell, it is not difficult to assume that the Williams Act would countenance collectivization.

This marked a departure from the *MITE* plurality, which had taken lengthy notice of the economic effects of delay on a tender offer.[149] *CTS* presented the same opportunity. The briefs of the parties and amicus in

146. The relevant federal period—the SEC rule's 20-business-day minimum—was established after much debate about whether it unduly favored managers. Anything beyond 20 days, the SEC had concluded, would be inconsistent with the Williams Act's even-playing-field philosophy. *See supra* note 83.

147. *CTS*, 481 U.S. at 82 (quoting Piper v. Chris-Craft Indus., 430 U.S. 1, 30 (1977)).

148. The irony was the principal reason for White's dissent and the heart of Dynamics's argument. *See* Dynamics Brief, *supra* note 67, at 32 (arguing that the Indiana statute "deprives individual shareholders of the free choice guaranteed them" by the Williams Act). *See* Johnson & Millon, *Misreading the Williams Act*, *supra* note 82, at 1873 (concluding Powell "fastidiously avoided any serious analysis of purpose or effect").

149. White's *MITE* opinion accepted the view that "delay can seriously impede a tender offer", relying on support from (1) the Williams Act's legislative history, S. REP. No. 550, 90th Cong., 1st Sess. 4 (1967); (2) subsequent legislative history, H.R. REP. No. 1373, 94th Cong., 2d Sess. 12 (1976) (legislative history of Hart-Scott-Rodino Antitrust Improvement Act) (discussing waiting period under tender offer rules and effect of delay); (3) the SEC's brief at 10 n.8; (4) academic commentary; Langevoort, *State Tender-Offer Legislation, Interests, Effects, and Political Competency*, 62 CORNELL L. REV. 213, 238 (1977); and (5) practitioners, Wachtell, *Special Tender Offer Litigation Tactics*, 32 BUS. LAW. 1433, 1437-42 (1977).

CTS, although lacking record support,[150] analyzed the significant added costs the statute imposed on bidders.[151]

Second, Powell emphasized that the statute did not interfere with the bidding process mandated by the Williams Act. A bidder could still consummate its offer on the twentieth business day, the earliest day permitted under the Williams Act rules. Although acknowledging that a bidder might be reluctant to do this without an assurance of voting rights, Powell focused narrowly on regulatory conflict, not effects.[152] He glibly discounted the cost of the mandated fifty-day delay, suggesting that a bid could be conditioned on receiving voting rights and that shareholders who tendered would in all likelihood be the ones voting to enfranchise the bidder.[153]

Third, Powell cautioned that the Indiana statute's effect on shareholders' exercise of their control should not guide the preemption analysis. Powell pointed out that invalidating the Indiana statute would jeopardize the validity of other state regulation that gives management discretion to delay or discourage a change in control.[154] Powell assumed, without explanation, that this realignment of corporate federalism could not be countenanced.

150. In *CTS*, despite an expedited one-month discovery period, the one-day evidentiary hearing before the trial court had not produced a record on the motives or effects of the Indiana statute. *See* 794 F.2d at 251; CTS Brief, *supra* note 8, at 27 n.13 (commenting no evidentiary record existed on the question of the legislative motives). The state, which had not appeared at the trial court, intervened on appeal.

151. Dynamics argued that the uncertainty created by management's prerogative to opt into the statutory scheme, to redeem a bidder's shares that are not given voting rights, and to recommend against enfranchisement "imposes heavy costs" on bidders. Dynamics Brief, *supra* note 67, at 14. *See also* Amicus Curiae Brief of the Securities Industry Ass'n at 4, CTS Corp. v. Dynamics Corp. of America, 481 U.S. 69 (1987) (Nos. 86-71 & 86-97) (describing the costs of uncertainty in the tender offer process).

152. To the extent Powell deals with the Indiana statute's principal effect—its 50-day delay—he misconstrued the Williams Act. Powell asserted in the original version of the opinion that the Indiana statute's 50-day period "is within the 60-day maximum period Congress established for tender offers in 15 U.S.C. § 78n(d)(5)." 107 S. Ct. at 1637. The cited section neither sets a minimum nor maximum for tender offers. It merely allows shareholders to withdraw tendered shares during the first seven days of the offer or after the offer has been open for sixty days. A tender offer could remain open for more than 60 days. This mistake in the opinion was corrected in the official reporter: "This period is within the 60-day period Congress established for reinstitution of withdrawal rights in 15 U.S.C. § 78n(d)(5)." 481 U.S. at 85.

153. 481 U.S. at 73-74 n.2 (assuming vote would be largely in the hands of shareholders who had tendered their shares, but who remained shareholders of record for purposes of voting); *id.* at 84 (suggesting that a bidder could condition its bid on receiving shareholder approval).

154. *Id.* at 85-86 (referring to staggered boards and cumulative voting as examples of delaying tactics authorized by generic corporate codes).

As White pointed out in dissent, the majority's coercion perspective and its blindness to effects abandons *MITE*. In one fell swoop, Powell trivializes the Indiana statute's regulatory burden and significantly retracts the preemptive scope of the Williams Act. Although the level-playing-field philosophy may guide interpretation of the Act, it no longer has preemptive significance.[155] Under this restrictive view of *CTS* preemption, the Williams Act neither federalizes shareholder control rights nor adopts a comprehensive philosophy of takeover regulation; it narrowly regulates only the tender offer process.[156] Not surprisingly, the SEC took the same position in its amicus brief, arguing that the Act only preempted state law that conflicted with the mandated bidding process,[157] a position consistent with the view that federal law regulates only disclosure, not the substance of the manager-shareholder relationship.

Powell's majority opinion, however, could have further departed from *MITE*. Section 28(a) of the 1934 Act provides the seed for a conclusive preemption analysis. Inserted in the original 1934 legislation to preserve concurrent state blue sky jurisdiction, it safeguards the "jurisdiction of the securities Commission . . . of any State" that does not conflict with the federal act or rules. Arguably, a fortiorari, traditional state shareholder-management regulation was also carved to the states.[158] Therefore, any additional state tender offer regulation could not offend the Williams Act so long as concurrent compliance with the Act's regime and the more stringent state rules were possible.[159]

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155. This seemingly inconsistent use of the level-playing-field philosophy is consistent as a federalism matter. Not using it as a preemptive sword limits federal incursions into state antitakeover statutes; using it as a regulatory shield limits federal expansion into state-based corporate governance.

156. *See* Langevoort, *supra* note 2, at 112. Professors Johnson and Millon present a persuasive and well-researched argument that the Williams Act was intended to do no more. From this they argue that whatever the legislative assumptions about tender offers in 1968, as opposed to intentions, they should have no preemptive effect. Johnson & Millon, *Misreading the Williams Act*, *supra* note 82, at 1868, 1920. *See also* Amanda Acquisition Corp. v. Universal Foods, 877 F.2d 496, 503 (7th Cir.), *cert. denied*, 110 S. Ct. 366 (1989) (Easterbrook, J.) ("There is a big difference between what Congress enacts and what it supposes will ensue").

157. SEC Brief, *supra* note 101. Curiously, the SEC seems to have reversed its preemption view, and since CTS, the SEC staff has pursued a vigorous campaign in court against third-generation statutes, arguing that they interfere with shareholder autonomy. Johnson & Millon, *Misreading the Williams Act*, *supra* note 82, at 1882 (describing SEC's position in recent cases challenging Delaware's and Wisconsin's antitakeover statutes).

158. This was CTS's principal preemption argument. *See* CTS Brief, *supra* note 8, at 14. Justice Scalia accepted it in his concurrence. 481 U.S. at 96 (asserting that if any state laws were to survive under the anti-preemption provision "surely the States' corporation codes are among them").

159. The Court could also have taken up Judge Posner's suggestion that a fair reading of the

Moreover, the Indiana statute's essentially enabling and facilitative character—much like a generic corporate code authorizing firm-specific adoption of a control share regime—suggested that there was no state action to preempt. While alluding to this argument, which CTS made in connection with commerce clause balancing,[160] Powell nonetheless chose to treat the statute as regulatory.[161]

By his inconclusiveness, Powell suggests that preemptive limits still bound antitakeover statutes. Just because *CTS* abandons the Act's neutrality principle as a preemptive benchmark does not mean that there are no basal federal standards.[162] For example, a state statute that abolished

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Williams Act indicated a congressional purpose to tilt the takeover playing field in favor of management, and state antitakeover statutes that furthered this tilt would not be preempted. *See* 794 F.2d at 262. *See also* Carney, *Toward a More Perfect Market for Corporate Control*, 9 DEL. J. CORP. L. 593, 597-609 (1984) (Williams Act leads to fewer bids); Fischel, *Efficient Capital Market Theory, the Market for Corporate Control, and the Regulation of Cash Tender Offers*, 57 TEX. L. REV. 1, 13 (1978); Jarrell & Bradley, *The Economic Effects of Federal and State Regulations of Cash Tender Offers*, 23 J. L. & ECON. 371 (1980) (asserting that Williams Act increased the price a bidder must pay in a takeover, citing an increase in shareholder returns from 22% to 40% with passage of the Act, and a decline of bidder returns from 9% to 6%); Manne, *Cash Tender Offers for Shares — A Reply to Chairman Cohen*, 1967 DUKE L.J. 231 (arguing that an earlier version of the Williams Act would impinge on the market for corporate control).

Such a tack would surely have dealt with the issue more honestly, but at a number of levels was not viable. In other Williams Act cases the Supreme Court had already rejected this cynical reading of the Act's legislative history. Piper v. Chris-Craft Indus., 430 U.S. 1, 30-31 (1977) (finding that Congress sought to provide a level playing field for the benefit of shareholders). Further, it would have assumed congressional protectionism and captivity, inviting a congressional defense. Finally, the analysis would have gutted any preemption limits, a federalism tool the *CTS* majority seemed unprepared to discard.

160. 481 U.S. at 94 n.14 ("Because we reverse the judgment of the Court of Appeals on other grounds, we have no occasion to consider this argument.")

161. 481 U.S. at 82 n.7 (stating that "by regulating tender offers" the statute does alter the balance between management and bidder significantly).

162. Others share this view. Pinto, *The Constitution and the Market for Corporate Control: State Takeover Statutes After CTS Corp.*, 29 WM & MARY L. REV. 699, 727, 778-79 (1988) [hereinafter Pinto, *Takeover Laws After* CTS] (concluding that a "strong showing that state regulation interferes with investor protection will be required before that regulation will preempted"). It is not necessarily inconsistent with Professor Johnson's and Millon's reading of the Williams Act legislative history, which indicates Congress *intended* only to regulate the bidding process, even while *assuming* some things about shareholder control rights under state law. They argue that assumptions cannot control and corporate governance powers, including the power to protect non-shareholder constituents at the expense of shareholders, were left to the states. Johnson & Millon, *Misreading the Williams Act*, *supra* note 82, at 1887. In the end, the Johnson and Millon critique of a broader understanding of *CTS* preemption is not that the Court necessarily misread the Williams Act, but that it applied an overly encompassing standard for measuring a federal statute's preemptive reach. Whether legislative assumptions carry preemptive force is not a question of statutory reading, but one of federalism, a matter as to which the Court has shown great (and sometimes confounding) flexibility.

shareholder voting rights, though without interfering with the federally-prescribed (though futile) process of tendering for voteless shares, would seem problematic.[163] Significantly, *CTS* entertained the questions whether the Indiana statute conceivably promoted shareholder voting rights and whether bidders for Indiana targets realistically could bid despite the statute. Built on a corporate federalism in which shareholder control rights were ubiquitous and relatively uniform, the Williams Act was meant to preserve the tender offer mechanism.[164] Powell's preemption analysis still has some bite—the Williams Act assuming and protecting some shareholder capacity in the control market. Given the Court's overarching concern to preserve state corporate law, it seems unlikely that it would tolerate a state of affairs begging for a federal legislative solution. As a result, the Williams Act's assumptions about the rights that drive a tender offer weakly federalize shareholder transfer and control rights.[165]

Under the restructured *CTS* preemption framework, the antitakeover blueprint starts to take shape: states need only avoid a regulatory conflict with the bidding process prescribed by the Williams Act; they

163. Judge Easterbrook might disagree. In his opinion in Amanda Acquisition Corp. v. Universal Foods, 877 F.2d 496 (7th Cir.), *cert. denied*, 110 S. Ct. 366 (1989), he suggests that just as states allow firms—such as hospitals, universities, and other charities with self-perpetuating boards—to organize without traded shares, states could also adopt devices to make tender offers highly unattractive or impossible. He points to such devices as dual-class stock, poison pills, and the previous practice under which mergers required unanimous shareholder approval. *Id.* at 504. At two levels, this seems overstated. First, the question is not whether the state can authorize the creation of such devices, but whether share ownership carries with it certain inherent rights that the state cannot alter. Although shareholders may have no power to compel others to make tender offers for their shares, they do have rights arising from share ownership. Just as the Constitution places limits on how far states can go in redefining contract and property rights under the due process clause, so it may place limits on state redefinition of shareholder transfer/control rights. Second, if states could go to the lengths Easterbrook suggests, it would mean either that chartering markets are wholly dysfunctional—with which Easterbrook would probably disagree—or that *CTS* would tolerate a state of affairs that would beg for a federal legislative solution. Both seem unlikely.

Instead, Easterbrook's opinion in *Amanda* should not be taken at face value. While it may seek to highlight the emptiness of *CTS*, it also taunts the Supreme Court to at least assert some gatekeeping role. The Court refused the dare, for now.

164. Kozyris, *Corporate Wars*, *supra* note 29 (citing to legislative history of the Williams Act; at the time the Act was enacted, state antitakeover statutes were unknown).

165. Johnson & Millon, *Misreading the Williams Act*, *supra* note 82, at 1873 (pointing out that the Court seemed willing to evaluate "how shareholders fare under Indiana's law" and concluding that "a statute significantly precluding the occurrence of takeover bids would run afoul of the Williams Act"). The Court thus rejected the SEC concession that "the chartering state is responsible for the very existence of the corporation and its shares, and it may define the latter as it wishes notwithstanding effects on their transferability." SEC Brief, *supra* note 101, at 10.

should employ the rhetoric, as well as some substance, of shareholder protection;[166] this protection should take the form and arise under the aegis of corporate law. Evaluation of the shareholder effects is relevant only in the most flagrant cases, when a statute calls into question the existence of shareholder transfer and control rights. *CTS*'s federalization under the preemptive banner is temperate.

B. *Dormant Commerce Clause: Constitutionalization of the Internal Affairs Doctrine*

The commerce clause provides virtually unlimited federal legislative power over interstate commerce.[167] Nonetheless, when Congress fails to legislate on a matter affecting the national economy, states retain significant regulatory power. Only if state regulation either discriminates against out-of-state interests or unduly burdens free trading in national markets is this power restrained.[168] To foster the efficiency and unifying values of the commerce clause, the "dormant" commerce clause safeguards free trading in national markets and political representation by out-of-state interests, even in the absence of an explicit congressional

166. Powell's opinion identifies four separate forms of shareholder protection that were arguably reflected in the Indiana statute: (1) protection of dispersed shareholders "from the coercive aspects of some tender offers," 481 U.S. at 83; (2) allowing "shareholders to evaluate the fairness of the offer collectively . . . [thus not allowing] the state to interpose its view of fairness between willing buyers and sellers of shares of the target company," *id.* at 83-84; (3) not giving "either management or the offeror an advantage in communicating with the shareholders about the impending offer," *id.* at 83; and (4) not imposing "unreasonable delay" upon the offeror. *Id.* at 85. Professor Oesterle suggested that these might serve as guidelines for judging the sufficiency of other statutory schemes. Oesterle, *Delaware's Takeover Statute*, *supra* note 2, at 950 n.256. *See also* Johnson & Millon, *Misreading the Williams Act*, *supra* note 82, at 1882 (focusing on autonomy versus protection in the post-*CTS* preemption cases). The argument assumes, however, that the Williams Act and the Supreme Court have some specific notion of the extent and nature of shareholder control/transfer rights that create an even playing field. It reads into the *CTS* preemption analysis far more judicial intrusion than the Court's general deference to state corporate law allows.

167. This has been so since the early 1940s. *See, e.g.*, Wickard v. Filburn, 317 U.S. 111 (1942); United States v. Darby, 312 U.S. 100 (1941). It extends today into matters with at best a tenuous connection to what is generally conceived of as commerce. *See, e.g.*, Garcia v. San Antonio Metro. Transit Auth., 469 U.S. 528 (1985) (upholding federal minimum wage regulation to state and local public entities); Katzenbach v. McClung, 379 U.S. 294 (1964) (upholding federal regulation of local restaurants). *See generally* 1 R. ROTUNDA, J. NOWAK & J. YOUNG, TREATISE ON CONSTITUTIONAL LAW: SUBSTANCE AND PROCEDURE §§ 4.1-4.10 (1st ed. 1986) [hereinafter 1 R. ROTUNDA]. Little doubt exists that Congress could preempt or occupy the field of corporate law.

168. *See, e.g.*, Pike v. Bruce Church, Inc., 397 U.S. 137 (1970) (invalidating state statute that prescribed packaging for native fruit sold outside state); Bibb v. Navajo Freight Lines, 359 U.S. 520 (1959) (invalidating state statute that specified type of rear fender mudguard for trucks moving across state borders). *See generally* 1 R. ROTUNDA, *supra* note 167, at §§ 11.1-11.10.

directive.[169]

Powell built his dormant commerce clause analysis in *CTS* on much the same foundation as the preemption analysis, though in some respects it is more deferential and in others more demanding. Completely shunning a meaningful analysis of the statute's effects or purposes, Powell focused on the chartering state's asserted interest in shareholder protection and accepted on faith the traditional view that because corporations arise under state law, the chartering state necessarily and constitutionally has the power to define corporate rights and responsibilities.

1. Discrimination and protectionism: CTS *sidesteps the quagmire*

The commerce clause was meant to foster national free markets.[170]

169. Different explanations are given for the dormant commerce clause doctrine. Some commentators argue that the dormant commerce clause "is concerned and should be concerned only with preventing purposeful [state] protectionism." Regan, *The Supreme Court and State Protectionism: Making Sense of the Dormant Commerce Clause*, 84 MICH. L. REV. 1091, 1093 (1986) [hereinafter Regan, *The Dormant Commerce Clause*]. *See also* L. TRIBE, AMERICAN CONSTITUTIONAL LAW 408-09 (2d ed. 1988); Varat, *State "Citizenship" and Interstate Equality*, 48 U. CHI. L. REV. 487, 568-71 (1981). Others view it as a doctrine to accommodate competing national and local interests. *See, e.g.*, Smith, *State Discriminations Against Interstate Commerce*, 74 CALIF. L. REV. 1203, 1206 (1986) (arguing that the Court consistently applies an amorphous balancing test). A few maintain that the commerce clause offers no independent "dormant" protection, but dormant commerce clause jurisprudence merely interprets the will of Congress in those areas in which it has been silent. *See* Tyler Pipe Indus., Inc. v. Washington Dep't of Revenue, 483 U.S. 232, 262 (1987). Some argue that the doctrine concerns not only protecting free trade, but also protecting nonresidents who are not politically represented in the regulating state. L. TRIBE, *supra*, at 408-09; Eule, *Laying the Dormant Commerce Clause to Rest*, 91 YALE L.J. 425, 442-43 (1982); Levmore, *Interstate Exploitation and Judicial Intervention*, 69 VA. L. REV. 563, 623-24 (1983) (maintaining that dormant commerce clause cases fall into two categories: state interference that can be remedied so long as the political process is allowed to function and state exploitation of a monopoly position that can be remedied only by judicial intervention).

Others argue that the doctrine should be abandoned. *See* Redish & Nugent, *The Dormant Commerce Clause and the Constitutional Balance of Federalism*, 1987 DUKE L.J. 569. They point out that resort to the dormant commerce clause effectively reverses the result of political inertia—a form of majoritarian expression—and thus is antithetical to majoritarian government. Further, to the extent protectionism undermines values of efficiency and national unity, they assert it can be covered under an invigorated privileges and immunities clause. If so, protection of incorporated businesses would require rethinking of *Paul v. Virginia*, which excludes corporations from the protection of the privileges and immunities clause. 75 U.S. (8 Wall.) 168, 176 (1868). *See* Carpinello, *State Protective Legislation and Nonresident Corporations: The Privileges and Immunities Clause as a Treaty of Nondiscrimination*, 73 IOWA L. REV. 351, 353 (1988) (arguing that the reasons for excluding corporations from protection under the privileges and immunities clause "were largely rooted in the political and economic problems of the nineteenth century and that these reasons are no longer of any practical importance").

170. City of Philadelphia v. New Jersey, 437 U.S. 617, 623 (1978). It has also been suggested that a unified nation—bound by commercial attachments—would be a more effective deterrent and

Free trading in national markets detrimentally is eroded when states seek to protect local interests by discriminating, explicitly or tacitly, against out-of-state interests unrepresented in the local political process.[171] Dormant commerce clause doctrine teaches that even in the face of congressional silence, such discrimination intolerably interferes with the free functioning of national markets and invites state retaliation. The discrimination need not be overt. Facially neutral regulatory schemes that discriminatorily impose unwarranted costs on out-of-state traders carry the same risks and therefore have been invalidated.[172]

Disregarding powerful extrinsic evidence of the Indiana statute's protectionist purpose,[173] Powell nonchalantly rejected the argument that the statute was discriminatory. Because the statute on its face treated in-state and out-of-state bidders identically, Powell refused to measure its constitutionality according to its effects. The statute, however, advantaged in-state incumbent managers compared to out-of-state control seekers, and protected the local tax and employment base from out-of-state relocation.

The majority's blindness to the statute's purpose was hardly confused

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force against outside aggression. *See, e.g.*, Collins, *Economic Union as a Constitutional Value*, 63 N.Y.U. L. REV. 43 (1988); Varat, *supra* note 169, at 518.

171. *City of Philadelphia*, 437 U.S. at 624 (invalidating New Jersey's explicit prohibition against local landfills accepting out-of-state waste); Hunt v. Washington State Apple Advertising Comm'n, 432 U.S. 333 (1977) (invalidating North Carolina's labeling program which permitted producers in the state to refer only to USDA grade in reference to quality, thus preventing Washington State producers from using their state's distinctive and costly supplemental labeling).

172. *See* Brown-Forman Distillers Corp. v. New York State Liquor Auth., 476 U.S. 573 (1986) (invalidating liquor price affirmation statute that, although applied evenhandedly, directly regulated other liquor pricing in other states); Hunt v. Washington State Apple Advertising Comm'n, 432 U.S. 333 (1977) (invalidating apple labeling statute on basis of discriminatory impact).

173. Dynamics cited to a statement by CTS's counsel of record:

> When asked why Indiana had decided to adopt such a virulent statute, James Strain . . . says, "We don't like having all our companies taken over by East Coast firms." On further reflection, Strain says Midwestern and West Coast acquirors are no better.

Dynamics Brief, *supra* note 67, at 11 (quoting from 3 *Corporate Control Alert* 1, 10 (Mar. 1986) (appended to Dynamics's brief). *See also* Garfield, *supra* note 116, at 572 n.208 (noting Justice O'Connor's questioning of Strain at oral arguments); United Shareholders Ass'n Brief, *supra* note 113, at 14-15 (arguing that the Indiana law promotes local "jobs and industries . . . by erecting barriers to corporate control at the state borders"); Securities Industry Ass'n Brief, *supra* note 151, at 6-8 (similar). Further, Dynamics pointed out that antitakeover statues in other states "are typically the product of the local business community," citing Professor Romano's empirical research on the political economy of such statutes. Dynamics Brief, *supra* note 67, at 18, 19-20 (indicating that the article would be available in February 1987, before oral argument in the case) (citing Romano, *Political Economy*, *supra* note 37).

or inadvertent. In *MITE*, Powell had clearly stated his understanding of the reasons for antitakeover statutes:

> Inevitably there are certain adverse consequences in terms of general public interest when corporate headquarters are moved . . . . [T]he State and locality from which the transfer is made inevitably suffer significantly.[174]

Indeed, as White pointed out in his *CTS* dissent, Indiana admitted in its brief to a protectionist purpose: to prevent bidders from "remov[ing Indiana companies] from the State."[175] Powell in his majority opinion referred to such a purpose obliquely when he justified state chartering: "A State has an interest in promoting stable relationships among parties involved in the corporations it charters . . . ."[176] The *CTS* majority's casual indifference to the statute's purposes is surprising. In other dormant commerce clause cases, the Court has shown little reluctance to probe a state's motives.[177]

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174. 457 U.S. at 646 & n.*.

175. White stated:

> The State of Indiana, in its brief, admits that at least one of the Chapter's goals is to protect Indiana Corporations. The State notes that the Chapter permits shareholders "to determine . . . whether [a tender offeror] will liquidate the company or remove it from the State." Brief for Appellant in No. 86-97, p. 19.

CTS, 481 U.S. at 100-101 (White, J., dissenting). White described this protectionism as "the archetype of the kind of state law that the Commerce Clause forbids." *Id.* at 101. *See also* Ind. Chamber of Comm. Brief, *supra* note 68, at 18 (arguing that the corporate governance "benefits [of the statute] accrue to the advantage of the corporations, their employees, and the communities in which they are located").

176. 481 U.S. at 91 (stating this interest was in addition to one "ensuring that investors in such corporations have an effective voice in corporate affairs"). Further, in discussing the coercive aspects of some tender offers, Powell explained that individual shareholders might tender their shares "even if they doubt the tender offer is in the corporation's best interest." *Id.* at 83. But the very reason that coercive bids work is that shareholders act in their own interests, not those of shareholders or the corporation as a whole. Instead, Powell seems to suggest that somehow, paradoxically, shareholders will act in the best interests of nonshareholder constituents. More to the point, the statute's real effect is to hinder shareholders from acting in their own interests and at the expense of non-shareholder constituents.

177. *See, e.g.*, Minnesota v. Clover Leaf Creamery Co., 449 U.S. 456, 470-74 (1981) (allowing Minnesota to ban sales of milk in non-returnable plastic cartons, even though Minnesota pulpwood producers would be helped and out-of-state plastic producers would be hurt); City of Philadelphia v. New Jersey, 437 U.S. 617 (1978) (holding New Jersey cannot ban imports of solid and liquid wastes while allowing locally generated wastes to be dumped in state landfills); Exxon v. Governor of Maryland, 437 U.S. 117, 125-29 (1978) (upholding Maryland's prohibition on ownership of retail gas service stations by oil producers or refiners, despite evidence that the burden of the ban fell solely on out-of-state companies); Hunt v. Washington State Apple Advertising Comm'n, 432 U.S. 333 (1977) (invalidating North Carolina's labeling program which permitted producers in the state to refer only to USDA grade in reference to quality, thus preventing Washington State producers from using their state's distinctive and costly supplemental labeling). Nonetheless, the Court has been criticized for being in general too superficial. Professors DeBow and Lee conclude that the Court's reluctance to

Faced with an admittedly protectionist scheme, the *CTS* Court had a range of choices. First, it could have faced the issue squarely, found the statute to be protectionist and invalidated it—which many commentators have argued the Court should have done.[178] Second, it could have downplayed the statute's protectionist effects and found on balance its discrimination against out-of-state interests was the only means to promote legitimate local interests.[179] Third, it could have rejected the doctrinal tradition that equates protectionism with discrimination and recharacterized the statute as nostalgic or paternalistic, even though its effects fall disproportionately on out-of-staters.[180] Fourth, the Court could have carved out a special exception for protectionism packaged as corporate regulation—which is what it did.

Can a corporate law exception be justified? At first glance, it seems possible. As we have seen, states participate in a corporate chartering market, selling their chartering services to a variety of local and national firms. Viewed in this way, state protectionism through the chartering process might be tolerated under the Court's "market participant" rule.[181] In other contexts, the Court has tolerated state protectionism

probe a public-choice explanation for the Indiana statute was not unusual. DeBow & Lee, *Understanding (and Misunderstanding) Public Choice: A Response to Farber and Frickey*, 66 TEX. L. REV. 993, 994 n.4 (1988) (citing *CTS* as an example of the Court's "complete lack of interest in the public choice explanation for the statutes under review").

178. *See, e.g.*, Cox, *The Constitutional "Dynamics" of the Internal Affairs Rule — A Comment on* CTS Corporation, 13 J. CORP. L. 317, 343 (1988); Garfield, *supra* note 116, at 57; Langevoort, *supra* note 2, at 106-07 (criticizing the Court's failure to see that the statute was meant to protect Indiana's economic interests); Oesterle, *Delaware's Takeover Statute*, *supra* note 2, at 937; Regan, *Siamese Essays*, *supra* note 2, at 1871.

179. Support exists for such a cost-benefit analysis. Maine v. Taylor, 477 U.S. 131, 140 (1986) (holding that a state law that discriminates against interstate commerce can be constitutional if its non-protectionist purposes "could not be served as well by available nondiscriminatory means"); Dean Milk Co. v. City of Madison, 340 U.S. 349, 354 (1951) (upholding state regulation that, although discriminatory, effectuated a valid local objective for which no "reasonable and adequate alternatives are available").

180. Regan accepts the possibility of this argument. Regan, *Siamese Essays*, *supra* note 2, at 1871, n.33. In some respects Exxon Corp. v. Governor of Maryland, 437 U.S. 117 (1978), cited by Powell in *CTS*, 481 U.S. at 88, 94, supports a theory of nondiscriminatory protectionism. Maryland's prohibition against oil companies' vertical integration into the local retail gas station market apparently responded to market data that revealed inequitable gasoline distribution among retailers during shortages. Although the Maryland prohibition had the effect of protecting local retailers, such protectionism is tolerated when designed nondiscriminatorily to address a perceived evil the state can legitimately address.

181. *See* Coenen, *Untangling the Market-Participant Exception to the Dormant Commerce Clause*, 88 MICH. L. REV. 395 (1989) (summarizing current "market participant" doctrine); Levmore, *supra* note 169, at 577 (concluding Court respects "state operations in the free market").

when a state participates in one market—buying or selling resources—and prefers local residents over out-of-state parties.[182] For example, South Dakota may during a concrete shortage sell from its state-operated plant only to in-state buyers.

The market-participant rule rests on the notion that state residents, who as a group create state resources, should be able to choose with whom they deal and channel "their own" resources back to themselves.[183] State regulation, although in some sense a product that competes in a national market, stands on a different footing because a state's use of its virtually limitless regulatory machinery to prefer local over out-of-state interests is relatively costless.[184] The cost to national markets imposed by a state's market-participant subsidy is limited, however, by the amount of resources expended by the state, because the cost imposed

182. The "market participant" rule thus operates to allow a state to use its buying or selling power to create a competitive advantage for its residents in interstate markets in which they compete with non-residents. For example, when Maryland adopted a program to subsidize the recycling of Maryland-titled abandoned cars, becoming in effect a purchaser of hulks, it could prefer Maryland scrap processors over out-of-state processors, Hughes v. Alexandria Scrap Corp., 426 U.S. 794, 806 (1976); when South Dakota sold cement produced in a state-operated cement plant during a cement shortage, it could choose local buyers over out-of-state buyers. Reeves, Inc. v. Stake, 447 U.S. 429, 435-39 (1980); when Boston funded public construction projects, it could require that work be performed by firms whose work force was at least fifty percent local. White v. Massachusetts Council of Const. Employers, Inc., 460 U.S. 204 (1983).

183. *See* Coenen, *supra* note 181, at 409; Varat, *supra* note 169, at 529. In effect, the state becomes less competitive in the market in which it participates in order to create an advantage for local residents in another related market. For example, in White v. Massachusetts Council of Constr. Employers, Inc., 460 U.S. 204 (1983), the Court upheld a Boston requirement that all public construction projects funded by the city be performed by firms whose work force was at least 50% local. Although this local-content requirement insulated the local labor market from nonlocal competition, it also reimbursed the local community for underwriting public construction. Boston's subsidy of local participants in the private labor market made the city a less competitive participant in the construction market. There may be limits, however, on the extent to which the state can spite itself. In South-Central Timber Dev., Inc. v. Wunnicke, 467 U.S. 82 (1984), a plurality of the Court invalidated Alaska's requirement that out-of-state buyers of Alaska-owned timber have the timber processed in Alaska prior to shipment. This local processing requirement gave local processors an advantage in the private processing market, while at the same time making the state less competitive in the timber market. The Court plurality said the special circumstances of foreign commerce (most of the timber was shipped to Japan), a natural resource, and restrictions on resale distinguished the case from other market participant cases. *Id.* at 96.

184. Coenen, *supra* note 181, at 427. Even if a state may be disciplined for protectionist use of its regulatory power because the inefficiency of the state's protectionism eventually produces political costs, dormant commerce clause doctrine embodies the conclusion that the costs of delay, the costs created by retaliation, and the loss of national unity may sometimes prove too great for a market solution. *See* Levmore, *supra* note 169, at 573-74 (arguing that when state interference is subject to political correction, the Court uses a more deferential standard of review).

cannot exceed the resources expended. Thus the label attached to the challenged state activity—participation or regulation—has been critical.[185]

The market-participant theory has some usefulness to the question of preferences in the state chartering market. For example, if a state chose to offer its chartering service only to local firms, thus preferring residents who subsidized directly and indirectly the incorporation regime, the cost imposed on excluded out-of-state firms would seem negligible, provided that as foreign corporations they could still do business in the state. If the state's regime were particularly attractive, it could be duplicated elsewhere. No one has questioned on constitutional grounds that some states have failed to make themselves attractive incorporation havens for out-of-state firms.

Corporate law's dual participatory and regulatory character complicates broader use of the market-participant theory. Generic corporate codes do not produce, on balance, extraterritorial regulatory burdens. In general, their regulatory aspects—such as rules governing corporate distributions for the protection of creditors or those limiting liability of corporate participants—visit their regulatory burden through the internal affairs doctrine wherever the incorporated firm does business or its participants reside; the regulation falls indiscriminately on local and nonlocal residents. Because of the pervasiviness and uniformity of generic corporate codes, no one state bears this regulatory burden more than any other, at least by design. To the extent generic corporate codes subsidize a local incorporation regime, the subsidy relates to contributions (drafting, updating, and dissemination services) by the local corporate bar.

Antitakeover statutes are far more problematic than generic corporate codes. The statutes can be seen as a form of market participation—a chartering service improvement intended to protect shareholders' transfer/control rights or to memorialize implicit promises of stability made to management[186]—and arguably any subsidy is at the expense of the

185. In New Energy Co. v. Limbach, 486 U.S. 269 (1988), the Court invalidated Ohio's tax credit program for Ohio-produced ethanol, but not for ethanol produced in other states that did not offer reciprocal treatment for Ohio-produced ethanol. The Court distinguished Ohio's program from other valid subsidy programs on the ground taxation is "a primeval governmental activity." *Id.* at 277. But it is difficult to see how the Ohio tax credits were not also a partial purchase of ethanol. Presumably, an Ohio program giving state residents vouchers to purchase Ohio-produced ethanol at reduced prices would have passed muster.

186. Coffee, *Strain in the Web*, *supra* note 34 (arguing that managers and other non-shareholder constituents subsidize shareholder opportunism).

state's chartering competitiveness. Aside from the question whether antitakeover statutes actually accomplish these purposes, the argument misconceives the market-participant rule, which is meant to tolerate in-state subsidies paid with state-created resources, a state of affairs that by definition does not promote state competitiveness. Thus, even if we were to conclude that some states, such as Delaware, are driven by market-participant and not subsidizing motives,[187] this has little relevance to a market-participant analysis. Antitakeover statutes impose costs on national stock trading markets that are unrelated to, and predictably much greater than, any loss to the state's chartering revenues.[188] For these reasons, the antitakeover subsidy, far from being a return to managers and shareholders on their investment in the chartering state's incorporation regime, is more appropriately characterized as a regulatory taking from shareholders unrepresented in the state political process for the benefit of managers and other constituents who are. Because in a publicly-held firm this regulation will typically fall more heavily on out-of-state than in-state shareholders, we must return to our original question: should this disparate impact be of concern under the dormant commerce clause?

The participant-regulator dilemma can only be resolved by addressing

187. In some states, such as Delaware, the market-participation motive may be stronger than the forced-subsidy motive. Although it might seem useful to categorize states according to which set of motives predominates—setting the stage for applying a market-participation or state-regulation rule—the categorization would gain little. The motives are hopelessly intertwined: effective protectionism requires sensitivity to the chartering market and effective marketing of charters requires being suitably protectionist. In either event, the cost of the protectionism will not relate to the value of the chartering change.

188. No direct linkage exists between the subsidy's cost and the effect on chartering revenues. In fact, antitakeover statutes may increase chartering revenues by making the state more attractive to managers. Assuming counter-intuitively, that a protectionist antitakeover statute dried up all a state's chartering business, the loss could well pale compared to cost of the statute's subsidy to nonshareholder constituents. To illustrate, assume that Delaware enacted a relatively restrictive antitakeover statute. Assuming (modestly) such a statute would cause share prices to fall 2% among potential targets—as happened in Ohio—average control premiums for Delaware targets would fall from 30% to 28%. *See infra* note 245 (empirical evidence on antitakeover statutes). Because this negative effect should be felt in the prices for all takeovers, hostile and non-hostile, a loss of approximately 7% in control premiums to shareholders would occur. Given that Delaware charters about half of likely takeover targets, the cost of its statute would be 7% of half of total takeover premiums (which have been estimated at between $200 billion to $300 billion during the last decade). Thus, Delaware would have imposed costs of between $14-21 billion over a ten-year period. On the other hand, Delaware annually receives about $17 million in chartering revenues from incorporation and franchise fees—$170 million over a decade. Even factoring in the value of indirect chartering revenues, they would certainly fall short of the cost to shareholders.

the underlying corporate federalism question: How does the current system of incorporation-based ordering compare to the federal alternatives? Although Powell's opinion does not foreclose the possibility that the Court might inquire into the political process underlying state antitakeover statutes, it was not part of the *CTS* thinking. Like a cheater in a game of Blind Man's Bluff, *CTS* avoids this quagmire, adopting an uncharacteristic indifference to the economic and political motives of a facially neutral statute. I return to this point later in my discussion of the wisdom of the *CTS* gambit.

2. *Inconsistent regulation:* CTS *constitutionalizes the internal affairs doctrine*

Dormant commerce clause doctrine also teaches that national markets cannot survive in an environment of multiple state regulation. When multiple inconsistent regulation renders interstate economic behavior legally impermissible, or when multiple overlapping regulation becomes so burdensome as to make such behavior economically infeasible, the Court has intervened to limit state action.[189] But the Court has tolerated overlapping state regulation when it imposes only incremental requirements, neither inconsistent nor overly burdensome.[190] In the end, an inconsistency analysis balances national and local interests.[191]

Because of the internal affairs doctrine, multiplicity in state corporate law rarely occurs. But antitakeover statutes have an agenda different

189. *See, e.g.*, Brown-Forman Distillers Corp. v. New York State Liquor Authority, 476 U.S. 573 (1986) (invalidating New York requirement that liquor vendors in New York charge no more than is charged in other states for the same products); Southern Pac. Co. v. Arizona, 325 U.S. 761 (1945) (invalidating Arizona's limits on the maximum lengths of trains).

Multiple regulation can be either overlapping or inconsistent. *See* Buxbaum, *supra* note 57; Kozyris, *Corporate Wars*, *supra* note 29. Overlapping regulations—such as one that requires majority voting and the other two-thirds voting—can be complied with by satisfying the more demanding standard. Inconsistent regulations—such as one that mandates cumulative voting and another straight voting—cannot be complied with simultaneously.

190. *See, e.g.*, Raymond Motor Transp., Inc. v. Rice, 434 U.S. 429, 441-46 (1978) (invalidating Wisconsin law limiting truck length to 55 feet, since other states permit 65-foot double-trailer trucks whose comparable safety Wisconsin did not contest).

191. The Supreme Court has protested that it is not balancing state and federal interests. *See, e.g.*, Kassel v. Consolidated Freightways Corp., 450 U.S. 662, 670, 691 (1981) (Powell, J., for plurality and Rehnquist, J., dissenting). But it is difficult to see how the Court is not balancing when it determines, or not, that a state statute interferes with free-trading rights. Inevitably, the extent of its interference and the weight of its justification must be compared—that is, balanced. For example, in *Kassel*, cited by Powell in *CTS*, 481 U.S. at 88, a plurality of the Court held that national interests in an efficient highway system outweighed a state's safety interests, given the costs of compliance with truck-size limits. 450 U.S. at 671.

from generic corporate codes, sometimes desperately seeking to protect local businesses incorporated elsewhere. If more than one state's antitakeover statute were to apply to a particular takeover activity, and some of them prescribed inconsistent behavior, national markets in corporate shares would be impaired.[192]

Powell presents in *CTS* a simplistic and sweeping solution to the inconsistency problem. Assuming that publicly-held corporations are subjects of regulation that "are in their nature national, or admit only of one uniform system . . . of regulation,"[193] Powell concludes that the risk of inconsistency would be removed if only the chartering state regulates. He makes no mention that Indiana's statute reaches only Indiana corporations with operational and shareholding contacts to the state.

By transforming the question into one of risk, rather than actual inconsistency,[194] and by treating the corporation as a creature of its chartering state, the *CTS* decision constitutionalizes the internal affairs doctrine, at least as it concerns antitakeover statutes.[195] The risk of incompatible, inconsistent antitakeover regulation disappears if only the chartering state regulates; the risk is inevitable if two or more states can

192. Even multiple overlapping regulation, by virtue of the uncertainty of compliance, adds costs.

193. 481 U.S. at 88-89 (quoting Cooley v. Board of Wardens, 12 U.S. (1 How.) 299, 319 (1852)). Powell also cited the Restatement (Second) of Conflicts of Laws § 304, which states:

> The local law of the state of incorporation will be applied to determine the right of a shareholder to participate in the administration of the affairs of the corporation . . . except in the unusual case where with respect to the particular issue, some other state has a more significant relation under [interest-analysis] principles . . . .

194. In other cases the Supreme Court has focused on *actual* inconsistency. *Compare* Kassel v. Consolidated Freightways Corp., 450 U.S. 662, 670, 691 (1981) (striking down Iowa law even though no other midwestern state regulated truck lengths) *with* Southern Pac. Co. v. Arizona, 325 U.S. 761 (1945) (invalidating Arizona's limits on the maximum lengths of trains because other states set different limits).

195. Others, though without taking this final plunge, have commented on the importance of the internal affairs doctrine to the *CTS* dormant commerce clause analysis. *See* Brilmayer, *Rights, Fairness, and Choice of Law*, 98 YALE L.J. 1277, 1298-99 n.72 (1989) (commenting that the internal affairs doctrine "received something of an imprimatur" in *CTS*); Buxbaum, *supra* note 57, at 31-32 (stating that the "limited jurisdictional reach [of the second-generation statutes] now turns out to be critical to the fate of these statutes under dormant commerce clause scrutiny"); Garfield, *supra* note 116, at 582 (concluding *CTS* "made highly suspect any legislation which extended its jurisdiction to foreign corporations"); Kozyris, *Some Observations*, *supra* note 32, at 515 (describing *CTS* as the "virtual canonization" of the internal affairs doctrine); Pinto, *Takeover Laws After CTS*, *supra* note 162, at 762, 764 (concluding that the internal affairs doctrine should be a "significant factor" in determining state corporate law's constitutionality, but does not "establish a constitutional requirement").

meaningfully regulate takeovers of public corporations.[196] As to multistate publicly-held firms, no "moderate reading" of *CTS* on this point seems possible.[197] Although economically the shareholder-manager relationship is not isolated from other relationships among corporate constituents—equity investment is inextricably linked to other inputs and outputs of the firm—the Court imbues it with an artificial autonomy by accepting the "inside-outside" dichotomy of the internal affairs doctrine.

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196. Antitakeover statutes apply only to publicly-held firms, the only ones prone to hostile takeovers. *See, e.g.*, IND. CODE § 23-1-42-4(a) (Supp. 1986) (defining "issuing public corporation" as one with 100 or more shareholders). Although it may be possible to imagine deviations from the internal affairs doctrine in the case of a single-state pseudo-foreign corporation—that is, a corporation whose business and investors are almost exclusively in one state, but which is incorporated elsewhere—the *risk* of inconsistency is unavoidable as a practical matter in public corporations. Almost by definition, public corporations have multistate investors who trade in interstate markets. An interest-based choice of law rule would suggest, at the least, the regulatory power of the chartering state.

In fact, the only state statutes that extend some of their generic corporate rules to foreign corporations limit their extraterritorial application to nonpublic firms that conduct a majority of their business in-state. *See* CAL. CORP. CODE § 2115(a), (e) (Deering Supp. 1990) (exempting foreign corporations whose securities are listed on a national stock exchange certified by the California Commissioner of Corporations or that conduct less than half their business in California); N.Y. BUS. CORP. LAW § 1320(a) (McKinney 1986) (exempting foreign corporations whose stock is listed on a national securities exchange or that have less than one percent of their business income in New York).

197. Powell commented that deviation from the internal affairs doctrine occurred only in the "rarest situations." 481 U.S. at 90. It has never occurred with respect to a multistate public corporation. *See* Kozyris, *Some Observations*, *supra* note 32, at 513 n.46 (finding that all such cases have involved pseudo-foreign corporations).

Soon after *CTS*, Professor Buxbaum argued that the decision does not and should not be understood to constitutionalize the internal affairs doctrine. Buxbaum, *supra* note 57, at 35. The argument seems correct if limited to single-state (essentially non-public) businesses. Otherwise, nothing in *CTS* supports the view that non-chartering state legislatures are constitutionally empowered to use *corporate law* to "do something" about the social consequences of takeovers. *Id.* at 32. Professor Buxbaum argued that the Supreme Court's "minimal scrutiny" choice of law analysis developed in other contexts should inform any reading of *CTS* and that even inconsistent corporate regulation might survive commerce clause scrutiny if the impact is minimal. *Id.* at 54 ("The less directly a state law impacts on that stock market trading institution, however, the less sensitive the commerce clause scrutiny need be.") Unfortunately, Professor Buxbaum cannot point to how *CTS* assimilates this more fluid choice of law analysis. In the end, it indeed seems to be wishful thinking:

> The concurrent apotheosis of the state of incorporation's primacy, however, though announced in order to reduce the separate confusions assertedly implicit in conflicting state involvement in share transactions, may be too high a price to pay for that policy shift.

Id. at 53. *CTS* saw it differently. Professor Buxbaum's prediction that "we soon may have a moderate amount of interstate conflict regarding substantive regulation of these structural changes," *id.* at 34, has not materialized. State antitakeover statutes increasingly have been limited to domestic corporations. *See infra* note 318. Nor have we seen, as Professor Buxbaum feared we might, the "Delawarization" of state corporation law. *Id.* at 54. Delaware's antitakeover statute turned out to be among the mildest in the third generation. *See infra* note 320.

CTS's constitutionalization of the internal affairs doctrine, the linchpin of the *CTS* corporate federalism, is remarkable. To avoid multiplicity, the doctrine elevates national interests in predictability, stability, certainty, and ease of application—treating them as essential to corporate free-trading rights—yet fixes all corporate rights and duties with the chartering state. The effect is to overrule *Paul v. Virginia*,[198] to the extent it held that recognition of corporate relationships is within the regulatory power of each state in which the corporation does business. The internal affairs doctrine thus refines the "artificial entity" conception of the corporation, which treats the corporation as a creature or concession of state law.[199] The doctrine, applicable only to matters of corporate governance, recognizes only the law of the chartering state. In other words, under the constitutionalized internal affairs doctrine, the manager-shareholder relationship in public corporations is a creature of the law chosen by management.

CTS's artificial entity solution to the inconsistency problem runs contrary to the Court's own evolving view of the corporation and takes a doctrinal step backward, encouraging decision by metaphor rather than balanced analysis. A "natural entity" theory in which the corporation, like an association of persons, has a status because of the aggregation of constituents finds support in recent cases involving corporate rights under the first and fifth amendments.[200] For example, in *First National Bank of Boston v. Bellotti*—which invalidated state limits on the speech prerogatives of corporate managers—it was irrelevant to both the challenged statute and the divided Court where the business was incorporated.[201] This is surprising, since one of the principal arguments for the

198. Buxbaum, *supra* note 57, at 54.

199. Under an "artificial entity" or "creature of law" theory, the corporation exists only because of a government grant. This view traces its origins in American jurisprudence to Justice Marshall's opinion in Trustees of Dartmouth College v. Woodward, 17 U.S. (4 Wheat.) 518, 636 (1819):

> 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. These are such as are supposed best calculated to effect the object for which it was created.

Powell quoted this passage with approval in *CTS*. 481 U.S. at 89.

200. *See, e.g.*, Braswell v. States, 487 U.S. 99 (1988); First Nat'l Bank of Boston v. Bellotti, 435 U.S. 765 (1978). *See* Comment, *The Personification of the Business Corporation in American Law*, 54 U. CHI. L. REV. 1441, 1442 n.3 (1988).

201. First Nat'l Bank of Boston v. Bellotti, 435 U.S. 765 (1978) (invalidating Massachusetts statute prohibiting certain political contributions by any corporation incorporated in the state or doing business in the state). In the case, two national banks (chartered by the United States) and three business corporations challenged a Massachusetts statute. None of the Justices attached any

statute was that shareholders were captive speakers.[202] According to the "creature of law" conception of the corporation, the extent of their captivity presumably would have been measured by the law defining the manager-shareholder relationship. Instead, the majority and dissenting opinions treated the corporation as having a status independent of state law—a natural, constitutional status.

A "nexus of contracts" theory, which treats the corporation as having no independent status but merely as an aggregation of voluntary and contractual relationships, also finds support.[203] In *CTS*, Powell alludes to a partnership analogy, suggesting that just as a partner may transfer

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importance to the fact that the Massachusetts statute prohibited political advertising by both domestic and foreign corporations.

In separate dissents, Justices White and Rehnquist justified the Massachusetts statute on the grounds that corporations are merely "creatures of law." White argued Massachusetts had an interest in regulating corporate political spending to assure that managers' political ideologies would not affect investment decisions, seemingly without regard to where the corporation is incorporated. Why Massachusetts would have such an interest with respect to non-resident investment in non-Massachusetts corporations is unclear, though elsewhere in his opinion he suggests that *Massachusetts* "has a strong interest in assuring that its citizens are not forced to choose between supporting the propagation of views with which they disagree and passing up investment opportunities." 435 U.S. at 818. Justice Rehnquist finessed the question of the statute's reach by assuming that Massachusetts had an interest in regulating corporations "created by the Commonwealth or . . . admitted into the Commonwealth . . . and regulated by state law," an attempted revival of *Paul v. Virginia* conditioning power. *Id.* at 823-24.

If nothing else, *Bellotti* confirms that the Court uses the different conceptions of the corporation as rhetorical devices. In *CTS*, White dissented from Powell's "creature of law" analysis on the theory that CTS shareholders had free-trading rights that existed independently of how Indiana chose to define them. 481 U.S. at 100. Rehnquist joined the *CTS* majority.

202. It is a remarkable omission, especially since at least some of the corporate challengers were not incorporated in Massachusetts. The Court rejected the argument that the statute sought to prevent shareholders from subsidizing corporate speech with which they disagreed. *Bellotti*, 435 U.S. at 792-95. Although apparently accepting the premise that Massachusetts could legitimately concern itself with such a captive speaker problem, it rejected that that was the statute's purpose. The majority, surprisingly, did not advance the obvious "artificial entity" argument that Massachusetts can have no interest in whether corporate resources are used to further views with which *non-Massachusetts* shareholders of non-Massachusetts corporations may disagree.

203. The nexus theory is not terribly new. *See* W. HOHFELD, FUNDAMENTAL LEGAL CONCEPTIONS 197 (1923) (arguing that corporation is "simply another mode by which *individuals* or *natural persons* can enjoy their property and engage in business. Just as several individuals may transact business collectively as partners, so they may as members of a corporation . . . ."); V. MORAWETZ, A TREATISE ON THE LAW OF PRIVATE CORPORATIONS OTHER THAN CHARITABLE § 1, at 2 (1882) (arguing that "the rights and duties of an incorporated association are in reality the rights and duties of the persons who compose it, and not of an imaginary being"). Economists have been largely responsible for the recent resurgence of the notion. *See, e.g.*, Jensen & Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 311 (1976). *See* Bratton, *The New Economic Theory of the Firm: Critical Perspectives from History*, 41 STAN. L. REV. 1471 (1989).

his property and income interests, but not his voting interest without the consent of the other partners, Indiana's statute creates a similar bifurcation.[204] Once the corporate and partnership forms are seen as conceptually identical, it is a short step to recognize rights that exist independent of state law. For example, White ultimately based his opinion in *MITE* on the notion that shareholder transfer and control rights exist independently of the chartering state—that is, they are not mere creatures of state law.[205]

Each of these other theories, particularly a nexus theory, cuts through accretions of corporate metaphor.[206] Under both, shareholders' transfer/control rights, like property and contract rights, have independent constitutional stature.[207] Neither weds the corporation to the chartering state any more than a person's state of residence governs his natural sta-

204. 481 U.S. at 91 n.12. *See* CTS Reply Brief, *supra* note 115, at 14 (arguing that there is no "meaningful *constitutional* distinction between partnerships and corporations"). Powell's analysis, although it demonstrates the thin differences between the corporate and partnership forms, should have led Powell to a different conclusion. If a partnership agreement, like Indiana's generic corporate code, allowed share transferability and a state law prohibited it so as to protect local partners from an unwanted dissolution by out-of-state partners, there would seem to be little doubt that searching constitutional scrutiny of the state prohibition would follow. It would make little difference that state law defines partnerships and partner rights. Although perhaps enough state-based interests would justify the state's re-writing of the partnership agreement, it would not be a foregone conclusion.

205. Although in *MITE* White attempted to take stock trading out of the sphere of "internal corporate affairs," 457 U.S. at 645, the two are inextricably bound together, if not identical. *See* Coffee, *Strain in the Web*, *supra* note 34, at 94. In other corporate federalism cases, White has adopted the "creature of state law" metaphor. *See* Santa Fe Indus. v. Green, 430 U.S. 462, 478 (1977) (White, J.).

206. Each model serves as a surrogate for preferring one corporate constituency over another. The "artificial entity" model prefers the constituency that has access to the relevant political machinery—at the state level, managers. The "natural person" entity prefers the constituency that controls the corporate decision-making machinery—managers. The "nexus of contracts" model, using its proponents' theory of shareholder wealth maximization, prefers shareholders.

207. Adopting this approach, Professors Butler and Ribstein argue that antitakeover statutes, which give managers through the legislative process what they cannot obtain from shareholders through the charter-amendment process, impair shareholder transferability expectations arising under the corporate contract, in violation of the Constitution's contract impairment clause. *See* Butler & Ribstein, *The Contract Clause and the Corporation*, 55 BROOKLYN L. REV. 767 (1989) [hereinafter Butler & Ribstein, *The Contract Clause*]; Butler & Ribstein, *State Anti-Takeover Statutes*, *supra* note 4. Their analysis, however, takes significant liberty with current contract impairment doctrine, which has not yet come to grips with the clause's original purpose of preventing private contract avoidance through the legislative process.

In other contexts, the Supreme Court has federalized contract and property rights. In its replevin cases, the Court made clear that a state cannot redefine due process rights that attach to contract and property expectations on the basis that such expectations are state-defined. *See* Fuentes v. Shevin, 407 U.S. 67 (1972); Sniadach v. Family Finance Corp., 395 U.S. 337 (1969). *See, e.g.*, Van tus and behavior, or any more than the state where a contract was signed creates and regulates a contract. But each theory would have cast state antitakeover and corporate law into uncertain dormant commerce clause, choice of law and contract impairment waters, inevitably changing the straight-forward *CTS* antitakeover blueprint. While validating the process of state corporate law in the rest of its opinion, the *CTS* Court limits it to assure stability in the process.

Professor Regan has suggested that *CTS*'s use of the internal affairs doctrine expresses a view that corporate events all occur in the state of incorporation. But viewing the inconsistency problem as territorial solves little; the metaphor is not terribly useful.[208] As Professor Gergen correctly points out, a state denied direct extraterritorial powers can accomplish the same things indirectly and territorially.[209] For example, if CTS had not been chartered in Indiana, but nonetheless had significant operations in the state, Indiana could satisfy a formal territorial rule simply by requiring that any change in control of the firm's in-state operations be pursuant to a control-share regime, accomplishing indirectly what Regan suggests it could not directly. Territorial formalism directs the question of corporate federalism away from a full-fledged inquiry about the nature of the corporation and of corporate law, and instead toward another doctrinal layer of metaphoric muck. The real question, from both a constitutional choice of law and ultimately federalism perspective, should not be *where* in some abstract sense transactions among parties having interstate contacts occur, but *what reasons* we have for permitting or disabling states from regulating those transactions. Locating a transaction merely marks the conclusion of an explicit or implicit

Alstyne, *Cracks in "The New Property": Adjudicative Due Process in the Administrative State*, 62 CORNELL L. REV. 445 (1977).

208. Regan would rephrase the inquiry as: In what state did the relevant corporate transaction take place? If there is value, as Regan suggests, in returning to the halcyon days of formal territorialism—and its attendant certainty and stolid legitimacy—then *CTS* becomes wrong and *MITE* right. Under this view, the magic transfer of shares, their ownership, and corporate control occur in a tender offer at the agent bank, usually somewhere near Wall Street in Manhattan. But this is silliness if it means that only New York has authority to regulate transactions routed to the computers of its financial institutions. By this analysis, state blue sky regulation of securities transactions on national exchanges is extraterritorial and constitutionally infirm. Choosing any other single locus creates equal silliness, and expanding to multiple loci only forces us to an interest-based analysis of which loci are sufficient in theory and fact. *See* Oesterle, *Delaware's Takeover Statute*, *supra* note 2, at 941-42.

209. Gergen, *Territoriality and the Perils of Formalism*, 86 MICH. L. REV. 1735 (1988).

analysis of a theory of the transaction and the interests (public and private) we view as meaningful under that theory.

Modern choice of law theory, which the Supreme Court has adopted in other contexts, admits of transactions subject to more than one set of state regulation.[210] Under an interest analysis in the corporate context, incorporation simply emerges as an important referent, not a locator of power. The internal affairs doctrine reflects that private parties have chosen and expect to be bound by governance rules established by the chartering state.[211] States, which have a collective interest in assuring certainty for consumers in the chartering market (managers and shareholders), have with rare exceptions adhered to this incorporation-based choice of law regime.[212] Nonetheless, if managers behave opportunisti-

210. Under an interest-based analysis, the application of more than one state's laws to a set of facts is constitutionally possible. *See* Allstate Ins. Co. v. Hague, 449 U.S. 302, 305-06, 312-13, (1981) (plurality opinion) (upholding Minnesota court's application of its insurance rule permitting "stacking" of uninsured motorist coverage, even though decedent and the drivers involved in the accident were all Wisconsin residents and the insurance policies had been delivered in Wisconsin; because the decedent worked and commuted in Minnesota, his insurance company did business in Minnesota, and his surviving spouse had moved to Minnesota, Minnesota had a "significant aggregation of contacts, creating state interests, such that application of its law was neither arbitrary nor fundamentally unfair"). *See also* Brilmayer, *supra* note 195, at 1296.

An example employed by Professor Regan illustrates the possibility of multiple rules governing the same behavior. Suppose Georgia prohibits the mailing of pornography to Georgia residents and fines those who do. If an Illinois resident mails pornography to a Georgian, may Georgia (assuming it had jurisdiction) fine the Illinois pornographer? Could Illinois at the same time have a licensing scheme for pornographic mailers? It would seem possible to characterize the pornography transaction as occuring in both states. Moreover, both states arguably have significant interests in the transaction; Georgia in deterring its residents' gaining access to pornography and Illinois in avoiding becoming a pornography repository and trading center.

Multiple rules are also possible in the international context. Recently, Colombia sought to prosecute an Israeli citizen for training Colombian drug terrorists; Israel is prosecuting the same person for divulging Israeli military secrets during the training. Wall St. J., May 9, 1990, at 1 col. 1. Each country's interest in the transaction is largely unrelated to where the transaction occurred.

211. *See* Brilmayer, *supra* note 195, at 1298-99 (arguing that though few object to applying the law of the incorporating state, a corporation often wields considerable political influence in states other than its state of incorporation). That corporate law is partially regulatory suggests that this private choice should not be conclusive. Although the Supreme Court has upheld the constitutionality of the internal affairs doctrine as a state choice of law rule, Broderick v. Rosner, 294 U.S. 629, 642-43 (1935), this hardly implies that the doctrine is the only legitimate choice of law rule. *See* Horowitz, *The Commerce Clause as a Limitation on State Choice of Law Doctrine*, 84 HARV. L. REV. 806, 816 (1971); Kozyris, *Corporate Wars*, *supra* note 29.

212. *See supra* note 29 and accompanying text (widespread prevalence of doctrine). If states were parochially to deviate from the internal affairs doctrine, certainty would be lost. Because certainty reduces planning costs, states interested in promoting incorporation—as opposed to the use of other, less-lucrative forms of business organization—have a collective interest in assuring a stable incorporation environment.

cally toward investors, or shareholders toward non-shareholder constituents, the private-ordering justifications for an incorporation-based regime may and should give way.

The possibility of opportunism by managers explains territorial state blue sky laws, which are not incorporation-based.[213] Perceived opportunism by shareholders explains antitakeover statutes, many of which extend to foreign corporations. That managers have chosen to incorporate, and the values of certainty, predictability, stability, and ease of application implicated in the choice, should not end the inquiry as a constitutional matter.[214] To illustrate, consider the case of a multiparty, high-interest note, usurious under some states' laws. If the parties choose to have the note governed by the law of a state without a usury law, their choice—though presumably entitled to some weight—should not be controlling. The states of the co-obligors' residences, where the effects of usurious interest will be felt, could require that their state courts apply their usury limits; the state chosen by the parties might decide differently. In general, our federalism does not preclude the possibility.

This more fluid choice of law perspective has relevance to *CTS*. Indiana's interest in regulating transactions affecting firms with significant management, employee, tax, and community ties to Indiana would seem to be as great whether a firm is incorporated in Indiana, whether it is incorporated elsewhere, or whether it is incorporated at all.[215] Although managers' choice to incorporate the firm in Indiana and shareholders' investment in an Indiana corporation might warrant significant defer-

213. *See* Kozyris, *Some Observations*, *supra* note 32, at 520 n.67 (recognizing statutes as exceptions to internal affairs doctrine, but describing them as "limited to intraterritorial distributions"). They nonetheless interfere with national capital markets by regulating from whom managers can raise capital and set the terms of the transactions, including how the capital may be used—both extraterritorial effects. The Supreme Court has upheld their constitutionality, despite their incidental effects on interstate commerce. Hall v. Geiger-Jones Co., 242 U.S. 539, 554-56 (1917); Merrick v. N.W. Halsey & Co., 242 U.S. 568, 590 (1917); Caldwell v. Sioux Falls Stock Yards Co., 242 U.S. 559, 564-66 (1917). *See also* Levmore, *supra* note 169, at 619 (arguing that the market will correct excessive interference because a state that unduly limits its citizens' ability to participate in national capital markets will eventually be compelled by local political forces to correct its stridency).

214. Blue-sky regulation illustrates this point. States are constitutionally empowered to regulate securities transactions involving residents, regardless of whether or where the seller is incorporated. *See supra* note 213 (cases upholding constitutionality of such statutes). In addition, more than one state may apply its regulation to the same securities offering, thus creating the possibility of multiple and even inconsistent disclosure and fairness rules.

215. Many have noticed the incongruity that one and only one state—the state of incorporation—should decide indirectly the fate of a multistate business relationship. *See, e.g.*, Cary, *supra* note 11, at 672-73; Schwartz, *Federalism and Corporate Governance*, 45 OHIO ST. L.J. 545 (1984).

ence,[216] only an unthinking passion for certainty and predictability can explain why these private choices should always control. Just as a theory of political legitimacy suggests that states should not have regulatory power over those without political access in the state, states should presumptively have such power if a firm's activities give it political access. So long as this access does not place the firm in a position through which unrepresented, out-of-state interests can be exploited, private choice should not automatically trump public policy.[217]

To summarize, by treating the corporation as a creature only of its chartering state, *CTS* carves out a niche for corporate transactions unlike that for any other economic activity. Unlike an interstate train, whose unitary nature no single state can regulate, or an interstate sales contract, whose multiple effects a number of states can regulate, *CTS* leaves the corporation to the regulatory power only of the state chosen by the corporate parties—in particular, by management.[218] Stripped of its metaphoric adornments, it is the height of *laissez faire* government. By shunning any meaningful analysis of the allocative, efficiency, or predictability implications of incorporation-based ordering, Powell's constitutional embrace of the internal affairs doctrine leaves intact and unassailable states' abdication to management-controlled ordering. At the very least, it is constitutional doctrine resting on a shaky foundation.

3. *Balancing:* CTS *places nothing in the national pan*

Inconsistency analysis under the dormant commerce clause is a subset of the broader balancing that is inevitable when national, free-trading rights conflict with local interests. While the inconsistency analysis fo-

216. The parties' private expectation and the chartering state's interest become stronger as the participants' need for legal certainty increases. Thus, the case for the chartering state's exclusivity is strongest for public corporations and weakest for pseudo-foreign corporations.

217. *See* Brilmayer, *supra* note 195, at 1298; Levmore, *supra* note 169, at 623; L. TRIBE, *supra* note 169, at 408-13. Even Professors Butler and Ribstein, who advocate a contract impairment analysis of antitakeover statutes, admit constitutional analysis should balance (1) the impairment of shareholder "contract" rights taking into account countervailing appraisal, redemption or proxy voting rights and (2) the state justifications for the impairment. *See* Butler & Ribstein, *State Anti-Takeover Statutes*, *supra* note 4, at 633.

218. This returns the Court to a discredited full-faith-and-credit line of cases that had enshrined the internal affairs doctrine for unincorporated mutual insurance companies. Order of United Commercial Travelers of America v. Wolfe, 331 U.S. 586 (1947); Sovereign Camp of the Woodmen of the World v. Bolin, 305 U.S. 66 (1938); Modern Woodmen of America v. Mixer, 267 U.S. 544 (1925); Supreme Council of the Royal Arcanum v. Green, 237 U.S. 531 (1915). The Court's full-faith-and-credit analysis is of doubtful continuing validity, replaced by a "minimal scrutiny" rational basis analysis. *See* Weinberg, *Choice of Law and Minimal Scrutiny*, 49 U. CHI. L. REV. 440, 444 (1982).

cuses on impediments to such rights when multiple states regulate, the balancing test of *Pike v. Bruce Church, Inc.*[219] takes into account a single state's interference, weighing the state and national interests.

But the *CTS* majority refused to weigh. On the premise that power over corporate governance resides with the chartering state and that the Indiana statute's "primary purpose" to assure shareholder collectivization was rationally related to this power, Powell's inquiry ended.[220] The Court's conclusion that state law fixes shareholder free-trading/control rights[221] essentially guts the premise of *MITE* that the commerce clause protects the interstate market for corporate control—and the control rights freely traded in the market—from local intervention. *CTS* beats a retreat from the federalizing potential of *MITE*, whose logical limits extended well beyond antitakeover statutes to, at least, generic corporate law affecting control transactions.[222]

The *CTS* Court's refusal to balance can be seen in two lights. First, it may have been a broader rejection of *Pike v. Bruce Church, Inc.*; Powell does not mention the case.[223] But this seems unlikely. Cases of overlapping state regulation—such as truck mudflap cases—appear to survive *CTS*.[224] These inconsistency cases inevitably force judicial weighing of the costs imposed on a free-trading activity—the switching and re-

219. 397 U.S. 137, 142 (1970) (stating that state statute is invalid under the commerce clause if its burden on commerce "is clearly excessive in relation to the putative local benefits").

220. 481 U.S. at 91.

221. The Court adopted the argument of CTS and the SEC that "a share of stock has no inherent rights except those that state law and the relevant corporate documents give it." *See* SEC Brief, *supra* note 101, at 16 n.15; CTS Brief, *supra* note 8, at 42 (arguing that the " 'market for corporate control' is a market *created only by State law defining property rights and ownership interests*") (emphasis in original); CTS Reply Brief, *supra* note 115, at 7-8.

222. For example, the predominant state rule that board approval is a pre-condition to a merger has many of the characteristics of an antitakeover statute. *See* Levmore, *supra* note 169, at 624 (pointing out that "[n]o case or commentator seems to notice the rather startling potential for commerce clause claims in corporate law after *MITE*"); Coffee, *Strain in the Web*, *supra* note 34, at 94-100 (also criticizing this federalism lapse).

223. *See* Langevoort, *supra* note 2, at 103 & n.45. In fact, both Powell (481 U.S. at 87) and Scalia (481 U.S. at 95) cite to Professor Regan's article in which he argues that the Court should not, and in fact does not, balance state interests against the burdens on interstate commerce; rather the Court should only prevent purposeful economic state protectionism. *See* Regan, *The Dormant Commerce Clause*, *supra* note 169, at 108.

224. Powell cited to a number of them. 481 U.S. at 88. *See, e.g.*, Bibb v. Navajo Freight Lines, Inc., 359 U.S. 520 (1959) (invalidating Illinois requirement of contoured rear fender mudflaps on trailer trucks in the state because 45 states permitted, and contiguous Arkansas required, straight mudflaps; switching mudflaps caused a two hour delay); Southern Pac. Co. v. Arizona, 325 U.S. 761 (1945). *See also* Regan, *Siamese Essays*, *supra* note 2, at 1883 (agreeing that transportation and communication cases are proper even under a protectionism standard).

switching of mudflaps—against the state interest in public welfare, safety, and aesthetics. By the same token, if one state alone imposes a significant burden, balancing would be implicated.

Second, and more persuasive, *CTS* simply takes an easy out and follows the lead of its inconsistency analysis, reaffirming the artificial entity conception and the inviolacy of the internal affairs doctrine. Powell's language hardly seems equivocal:

> This beneficial free market system [in ownership of 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.[225]

Although White's plurality opinion in *MITE* had taken care not to challenge explicitly state corporate law or the internal affairs doctrine,[226] *MITE*'s concern for unimpeded share transferability had actually crossed into corporate governance. *CTS* steers a clear course away, returning the Court to mainstream corporate federalism.

After *CTS*, any justification by the chartering state for its corporate regulation, including an amorphous "interest in promoting stable relationships among parties involved in the corporations it charters," is sufficient.[227] Free-trading/control rights need not be placed in the balance because, according to *CTS*, corporate federalism is not constrained by "any particular economic theory."[228] This contrasts with the Court's preemption analysis, which admitted the possibility of unacceptable *effects*.[229]

On the tricky question of what interest Indiana could have in protecting non-Indiana shareholders, Powell wrote enigmatically of the state's "substantial interest in preventing the corporate form from becoming a shield for unfair business dealing."[230] However understood, the statement suggests that the chartering state can blithely insulate managers from the interstate market for corporate control. Whether Powell's "un-

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225. 481 U.S. at 90.

226. 457 U.S. at 645-46 ("Tender offers do not . . . implicate internal affairs of target company.").

227. 481 U.S. at 91.

228. In fact, Powell treated the coercive nature of some tender offers as simply "additional justification" for state power. 481 U.S. at 92. State chartering authority would seem to be its own justification. In the process, federal courts are effectively removed from discerning economic efficiency, at least explicitly. *See* Exxon Corp. v. Governor of Maryland, 437 U.S. 117, 127-28 (1978).

229. *Cf.* Oesterle, *Delaware's Takeover Statute*, *supra* note 2, at 947 (arguing that the commerce clause and Williams Act standards in *CTS* "appear to merge to a substantial degree").

230. 481 U.S. at 93.

fair business dealings" refer to layoffs and plant closings that sometimes follow takeovers or simply the "possibility of coercion in some takeover bids,"[231] Indiana can premise its regulatory power on the most tenuous of interests. Whether to protect non-shareholder constituents from opportunistic shareholders or to protect shareholders from themselves, the state's incorporation-based power is nearly limitless. Rational basis review in constitutional law, as in corporate law, is tantamount to no review at all.

This result and the Court's spurning of the role of the control market were not inadvertent. The control market had been a central feature of *MITE* and of Posner's Seventh Circuit opinion,[232] but Powell concluded that the market's value presented too unsettled a question to justify a judicial response.[233] Built on the same foundation, *CTS*'s refusal to balance is as shaky as its inconsistency analysis.

III. THE MEANING OF THE *CTS* GAMBIT—SOME HYPOTHESES

To appreciate the *CTS* federalism gambit, it is useful to contemplate some hypotheses that might explain the decision and the Court's real agenda. Who were the winners and losers of the Court's doctrinal and analytic liberties? Five nonexclusive hypotheses seem possible:

(1) *CTS* had few ulterior motives; it accepted that Indiana sought merely to protect shareholders from coercive takeover bids—the Pro-shareholder Hypothesis.

(2) *CTS* underwrote protectionism; it sought to strengthen the position of local stakeholders in takeovers—the Pro-stakeholder Hypothesis.

(3) *CTS* was reactionary; it followed the Court's traditional corporate jurisprudence, which generally defers to corporate managers—the Pro-management Hypothesis.

(4) *CTS* had misgivings about the regulatory vacuum left by *MITE* and federal inaction; it sought to invigorate the states' regulatory power over corporate relationships—the Pro-state Hypothesis.

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231. *Id.* at 92.

232. The importance of the market for corporate control was the central fixture both of White's dissent, 481 U.S. at 100-01 (charging the majority with ignoring "the practical impact" of the Indiana statute to "frustrate any transfer of control"), and of Posner's opinion below. 794 F.2d at 250.

233. In a footnote Powell stated:

> [T]here is no reason to *assume* that the type of conglomerate corporation that may result from repetitive takeovers necessarily will result in more effective management . . . . The divergent views in the literature—and even now being debated in the Congress—reflect the reality that the type and utility of tender offers vary widely.

481 U.S. at 92 n.13 (emphasis in original).

(5) *CTS* was wary of federal intervention; it sought to keep federal courts, the SEC, and Congress out of the business of takeover regulation and more generally out of corporate governance—the Anti-federal Hypothesis.

Despite the charm and insights offered by a search for the Court's purposes, it should be undertaken warily. Discerning the psychology of decided cases, like probing the intent of a legislature, has its limits. For example, Powell's opinion in *CTS* reflects a remarkable adoption of the content, form, and structure of petitioner CTS's brief.[234] Divining the Court's real agenda can quickly deteriorate into meaningless conjecture and anthropomorphic rambling about the Court's motives. Of greater interest is the decision's *effect*: the *CTS* antitakeover blueprint and incorporation-based private ordering.

This Part tests these hypotheses and in the process clarifies the *CTS* corporate federalism. It lays the groundwork for exploring how this federalism has operated since *CTS*, for making predictions about how it will play out, and for evaluating its wisdom.

A. Pro-shareholder Hypothesis

CTS pivots on the assumption that Indiana was protecting shareholders from potential coercion. Some have found the pro-shareholder explanation attractive;[235] others are suspicious.[236] If the hypothesis is right, the Court was co-opted into the charade of the second-generation antitakeover statutes.[237] Although the rhetoric of shareholder control

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234. *See* CTS Brief, *supra* note 8, at 9-12 (Summary of Arguments). Powell, however, did not pick up on CTS's explicit federalism theme.

235. Booth, *State Takeover Statutes Revisited*, 88 MICH. L. REV. 120 (1989); Booth, *Tender Offer Law*, *supra* note 106, at 762 (arguing that *CTS*'s collectivization analysis counterbalances the Williams Act regime's preference for bidders, which can acquire control without paying each shareholder the price the shareholder would demand if there were no pressure to sell); Davis, *supra* note 52, at 505; Oesterle, *Delaware's Takeover Statute*, *supra* note 2, at 944 (concluding that the "*CTS* opinion can be read without strain as consistent with . . . whether the statute is intended to serve, and does, arguably, in fact serve the interests of the shareholders"); Oesterle, *The Rise and Fall*, *supra* note 95, at 236 (concluding that the *CTS* Court was "clearly impressed" by the Indiana statute's protection of shareholder autonomy); Pinto, *Takeover Laws After* CTS, *supra* note 162, at 750 n.223 (1988); Pinto, *Takeover Statutes: The Dormant Commerce Clause and State Corporate Law*, 41 U. MIAMI L. REV. 473 (1987) [hereinafter Pinto, *Takeover Statutes*].

236. *See, e.g.*, Langevoort, *supra* note 2, at 111 (concluding Court's acceptance of the "dubious legislative purpose of promoting shareholder autonomy" is "thoroughly unconvincing").

237. A close relative of the Pro-shareholder Hypothesis is the Confusion Hypothesis—that the Court was confused by the real stakes of state antitakeover legislation and failed to understand its effect on hostile bids. The hypothesis, at least in this simple form, can be easily discarded. Undoubt-

rights must be treated as an element of the *CTS* antitakeover blueprint,[238] it was not the inspiration.

The Pro-shareholder Hypothesis falters at a number of levels. Antitakeover statutes, passed at the behest of local management in response to takeover fears, reveal decidedly non-shareholder motives. Nothing indicates that the Indiana legislative process represented shareholder interests or that the legislature worried about them. Research on the political economy of other states' antitakeover statutes confirms this assumption. Shareholder groups have never supported state antitakeover statutes and, when given a chance, have been vehemently critical.[239] Powell acknowledges that generic corporate codes' authorization of shark repellants, such as staggered boards and cumulative voting,[240] shifts the governance advantage toward management; antitakeover statutes merely continue the trend.

The actual workings of the Indiana control-share statute also suggest shareholders were not the intended beneficiaries. The statute, like most antitakeover statutes, is both underinclusive and overbroad. Its optional character, requiring management to opt into the statutory regime and, once in, allowing management to opt out in a management-approved bid, leaves shareholders unprotected in a number of situations. For example, the statute offers no protection if managers opportunistically decide to sell to a bidder who offers them a side deal. Only when management

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edly, Powell understood the Indiana statute's reach and purposes. The antitakeover issue was not new to the Court; Powell's *MITE* opinion had grappled directly with Illinois's purpose; White's cogent *CTS* dissent properly framed the issue as state interference in a national control market; the subtle but indisputable abandonment of *MITE* evidenced significant sophistication; the blueprint for constitutionally-sufficient antitakeover legislation could not be more clear.

A more respectable version of the Confusion Hypothesis, however, can be advanced. It posits that the Court neither understood the true nature of the chartering market nor that the internal affairs doctrine is not so much a choice of law rule, but governmental deference to private ordering. *See infra* notes 264-65 and accompanying text.

238. Post-*CTS* antitakeover statutes have slavishly adhered to the rhetoric. For example, Delaware's official synopsis of its antitakeover statute refers to striking "a balance between the benefits of an unfettered market for corporate shares and the well documented and judicially recognized need to limit abusive takeover tactics." 66 DEL. LAWS § 204 (1988). The official name of North Carolina's fair-price statute is "The North Carolina Shareholder Protection Act." N.C. GEN. STAT. § 55-75 (Supp. 1988).

239. The Securities Industry Association (representing a variety of securities firms) and T. Boone Pickens's United Shareholders Association submitted briefs in *CTS* arguing against the statute. *See also* Coffee, *Corporate Federalism*, *supra* note 51, at 770 (describing Wall Street's opposition in New York); Oesterle, *Delaware's Takeover Statute*, *supra* note 2, at 892 & n.63 (describing opposition by shareholder groups in Delaware).

240. 481 U.S. at 85-86.

chooses the statutory regime must the shareholders enfranchise a bidder. Even if one views collectivization as a problem limited to hostile bids, the purpose was inartfully expressed. The statute broadly regulates bids whether for all shares or only some, failing to distinguish between the more coercive partial or two-tier bid and the less coercive any-and-all bid.[241] By the time the Court decided *CTS*, partial and front-end bids—the subject of the literature cited by the Court—were becoming a thing of the past.[242]

But Indiana may still have done an effective, though sloppy, job for shareholders. Some have argued that control share statutes actually encourage bids by giving bidders a mechanism to appeal directly to shareholders,[243] although this tactic has not been used. Moreover, even if antitakeover statutes discourage bidders, shareholders on balance may

241. The Indiana control share statute, for example, would disenfranchise a bidder who acquired control shares from a dominant shareholder in a negotiated sale.

242. *See Impact of Corporate Takeovers: Hearings Before the Subcomm. on Securities of the Senate Comm. on Banking, Housing, and Urban Affairs*, 99th Cong., 1st Sess. 380 (1985) (study by Office of the Chief Economist of the SEC) (reporting that "incidence of two-tier offers has fallen to nine percent of the total in 1984"); *id.* (statement of SEC Chairman Shad) (commenting that "of the 65 tender offers commenced during the first five months of fiscal year 1985, only one was a two-tier offer"); Johnson & Millon, *Missing the Point*, *supra* note 34 (decrying the *CTS* antitakeover regime because its justification—structurally coercive bids—is a practice that has become a rarity). This decline seems to have resulted from firm-specific defenses, such as poison pills, and the easy availability of takeover funds from bank syndicates and the junk bond market, which made partial or front-end-loaded bids tactically dangerous and unnecessary. Although Professor Booth has argued that the decline in structurally coercive bids can be attributed to state antitakeover statutes, Booth, *State Takeover Statutes Revisited*, *supra* note 235, this explanation is unconvincing. The decline had begun long before *CTS* was decided in mid-1987; before *CTS*, lower courts had uniformly invalidated second-generation statutes.

243. A number of commentators argued that control share statutes may, in fact, facilitate hostile bids. *See* R. GILSON, THE LAW AND FINANCE OF CORPORATE ACQUISITIONS 308-12 (Supp. 1988) (arguing that control share statutes "actually may work in favor of the acquirer"); Goldman, *Delaware Anti-Takeover Legislation Is Needed*, Nat'l L.J., Feb. 8, 1988, at 31, 34 (describing the Council of the Corporation Law Section of the Delaware State Bar Association's concern that an Indiana-type statute would "turn every offer into a plebiscite that by its nature would favor the bidder, and could actually promote takeovers"); Lipton, *supra* note 41, at 30 (arguing that control share statutes, far from discouraging bust-up mergers, may be counterproductive since they allow a bidder to buy a 20% block and then demand a shareholder vote, conditioned on a tender offer or other control transaction).

Moreover, because the record date for the enfranchising vote will likely be set to fall before the bidder's tender offer closes, the enfranchising vote will include the shareholders most likely to favor the bid. *See* 481 U.S. at 74 n.2 (assuming that the board will be duty-bound to set the record date so that it falls before the Williams Act first permits purchases of shares). *Cf.* Booth, *Tender Offer Law*, *supra* note 106, at 771 (assuming that because the bidder will hold the shares most likely to have been voted for enfranchisement and the Indiana statute sterilizes the bidder's shares, voting at the meeting will be by non-tendering shareholders, the ones least likely to favor enfranchisement).

benefit.[244] The statutes tread a fine line. While they drive away some bids, they increase the price when bids are made. A bidder must offer a higher price to gain approval for its bid in order to satisfy the statute's pricing formula or to receive enough tenders to avoid the statute. On balance, fewer but higher-priced bids may represent a positive gain for shareholders. Event studies on how the statutes affect stock prices, however, produce a negative picture of the Indiana statute specifically and other second-generation statutes in general.[245]

The Court's territorial analysis and its refusal to weigh shareholders' transfer/control rights in the commerce clause balance confirm that shareholder protection did not inspire the *CTS* blueprint. By effectively closing any opening for statutes that are not incorporation-based, *CTS* prevents a state from regulating bids directed at resident shareholders of foreign corporations. Although Powell vaguely suggests that a state's takeover regulation must also be shareholder-based, not just incorporation-based,[246] it is unlikely both are necessary. For if *CTS* means that

244. Professor Romano, for example, has speculated that antitakeover statutes and shark repellants may benefit shareholders because they raise bid prices and the proportion of shares acquired. Romano, *Future of Hostile Takeovers*, *supra* note 51, at 501; Romano, *State Competition Debate*, *supra* note 60, at 737-39. Empirical evidence supports this. According to one study, Jarrell & Bradley, *supra* note 159, Table 1, antitakeover legislation has produced higher premiums and a greater percentage of shares acquired:

Period	TO premium	% shares
Pre-Williams Act	32%	42%
Williams Act	53%	61%
Widespread state antitakeover statutes	73%	72%

245. *See* Ryngaert & Netter, *Shareholder Wealth Effects of Ohio Antitakeover Law*, 4 J.L. Eco. & Organiz. 373 (1988) (finding 2% drop in stock prices among firms subject to takeovers following the passage in Ohio of an antitakeover package that included a non-shareholder constituent statute, one validating poison pills and another allowing limitations on director liability); Schumann, *State Regulation of Takeovers and Shareholder Wealth: The Effects of New York's 1985 Takeover Statutes*, Bureau of Economics Staff Report to the Federal Trade Commission (1987) (finding overall 4.4% drop in the price of New York firms during enactment of New York's moratorium statute); Woodward, *How Much Indiana's Anti-Takeover Law Cost Shareholders*, Wall St. J., May 5, 1988, at 32, col. 3 (finding 6% drop in share value related to Indiana statute).

The effect on shareholders of antitakeover statutes, however, is often difficult to measure. The events surrounding the legislative process were sometimes ambiguous or slow, making it difficult to identify when the market incorporated the antitakeover information. For example, Professor Romano could not find any significant price changes after the adoption of second-generation antitakeover statutes in Connecticut, Missouri or Pennsylvania. Romano, *Political Economy*, *supra* note 37, at 184-85.

246. Powell, in justifying the Indiana statute under the Court's one-sided balancing analysis, stated: "Moreover, unlike the Illinois statute invalidated in *MITE*, the Indiana Act applies only to corporations that have a substantial number of shareholders in Indiana." 481 U.S. at 93. Professor Oesterle places great weight in the word "moreover," suggesting it may indicate that antitakeover

shareholder contacts are a necessary condition to state antitakeover power, the decision creates a huge shareholder-protection gap.[247] Most Fortune 500 firms are incorporated in shareholder-poor Delaware.

If, as seems a better reading of *CTS*, incorporation-based jurisdiction is both necessary and sufficient, the political economy of the second-generation antitakeover statutes and the chartering market raise doubts that shareholder interests are necessarily represented. In the end, *CTS*'s rhetoric of shareholder protection masked other purposes.

B. Pro-stakeholder Hypothesis

Takeovers are destabilizing. They are pointed symbols of an economy in the throes of wrenching adjustment. Those with stakes in the corporation's business—employees, labor unions, suppliers, communities—are inevitably affected. Their interests have a silent presence in state antitakeover legislation and are an explicit part of the political rhetoric surrounding takeovers.[248]

This motivation was not lost on Powell in *MITE* and could not have been lost on the *CTS* Court. A plausible explanation for the *CTS* turnaround was to assure political representation for stakeholder constituents, who had been disregarded in White's plurality opinion in *MITE*. It has been said that *CTS* reflects a pervasive disenchantment with the effects of an unconstrained control market.[249] A surprising number of commentators have understood and justified *CTS* on the basis of its ostensible pro-stakeholder purpose.[250]

Much supports this view. Justices Brennan and Marshall, who had

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statutes must be jurisdictionally grounded in shareholder contacts. Oesterle, *Delaware's Takeover Statute*, *supra* note 2, at 934.

247. Langevoort, *A Comment on* CTS, *supra* note 2, at 107.

248. *See* Coffee, *Strain in the Web*, *supra* note 34, at 68-70; Langevoort, *A Comment on* CTS, *supra* note 2, at 116-17; Macey, *State Legislation*, *supra* note 3, at 475; Romano, *Future of Hostile Takeovers*, *supra* note 51, at 462 & n.12.

249. *See, e.g.*, Coffee, *Strain in the Web*, *supra* note 34, at 100 (arguing before *CTS* was decided that "it is doctrinally indefensible to trim the federal statute by deferring to state law and then emasculate the state's power in deference to the federal government's control over interstate commerce"); Langevoort, *A Comment on* CTS, *supra* note 2, at 102-05 (concluding Court had an "intellectual ambivalence" about unregulated bids).

250. Coffee, *Uncertain Case*, *supra* note 118, at 460-65; Davis, *supra* note 52, at 517; Garfield, *supra* note 116, at 565, 569 (concluding that Indiana's statute, like other antitakeover statutes, was based on protectionist motives, and that such legislation "is not a product of the market for corporate charters"); Johnson & Millon, *Misreading the Williams Act*, *supra* note 82, at 1887; Millon, *supra* note 4, at 925 (concluding "recent state takeover legislation represents a first step toward reshaping corporation law [to] protect various interests of nonshareholders").

dissented in *MITE* on mootness grounds, joined the *CTS* majority.[251] Justice Scalia's famous *CTS* concurrence—"a law can be both economic folly and constitutional"—carries with it a strong sense of Indiana's pro-stakeholder purpose.[252] A popular perception persists that a lack of takeover regulation most affects non-shareholder constituents. The rhetoric of shareholder autonomy provided Indiana, with the help of the *CTS* Court, a useful ruse for protecting these constituents indirectly.[253] Powell's failure to address this fundamentally protectionist purpose is understandable. Although (as discussed before) protectionism should not necessarily be invalidating, the Court's sleight of hand avoids the quagmire.

The Pro-stakeholder Hypothesis, however, suffers from a number of fallacies. Most significant, it conflicts with the Court's territorial analysis. If protecting stakeholders from takeovers were a significant component of the Court's silent agenda, it is remarkable that the Court would have so clearly limited the extraterritorial reach of antitakeover statutes and thus the power of stakeholder-interested states. *CTS* leaves most vulnerable extraterritorial state antitakeover statutes, arguably the most solicitous of stakeholder interests.[254]

Further, little indicates that the structure of antitakeover statutes protects stakeholders, although it may occasionally be one of the side-effects. The statutes provide broad opt-out possibilities for management-approved takeovers and recapitalizations, whose stakeholder effects have been as devastating as hostile bids.[255] Little suggests that managers, when given antitakeover prerogatives, watch out for stakeholders, whose disciplining and oversight compulsion of management behavior is even less than that of shareholders.

251. In Rondeau v. Mosinee Paper Corp., 422 U.S. 49 (1975), Brennan and Marshall dissented from the Court's construction of the Williams Act to require a showing of irreparable harm before a bidder who had violated the Act's disclosure requirements could be enjoined from pursuing his bid.

252. 481 U.S. at 96-97 (Scalia, J., concurring) (suggesting that entrenching management or promoting industrial stagnation can be sufficient state purposes).

253. Langevoort, *supra* note 2, at 107.

254. Davis, *supra* note 52, at 521 (arguing that allowing only the state of incorporation to regulate takeovers "is clearly at odds with the objective of state protection of local stakeholders").

255. Empirical studies confirm that employment effects are as much related to changing economic conditions as they are to takeovers. *See supra* note 81 (summary of empirical evidence on employee effects). In fact, evidence suggests that hostile takeovers are less responsible for economic dislocations than management takeovers structured as leveraged buyouts or recapitalizations. *Id.*

C. *Pro-management Hypothesis*

Hostile takeovers threaten incumbent management. Antitakeover statutes chill hostile bids, thus insulating managers from the market for corporate control. Managers' jobs are perpetuated; their performance is shielded from the disciplining effects of a robust control market.

A Pro-management Hypothesis—one that posits that *CTS* empowers managers to insulate themselves from control markets—finds little direct support in the *CTS* opinion. Nonetheless, the statute's pro-management effect was the principal defect identified by Posner in his Seventh Circuit opinion[256] and by appellee Dynamics. Some commentators have seen it as *CTS*'s principal effect.[257] Studies of the political economy of antitakeover statutes,[258] as well as the opt-in and opt-out nature of the statutes themselves, strongly support the hypothesis.

Managers, particularly of firms with significant employment and other business ties to the state, represent a cohesive, well-funded interest group that wields significant political clout.[259] To attract and maintain local incorporation and to foster a favorable climate for business, a state legislature must offer firm-specific accessibility and responsiveness. In fact, this promise of fealty may be a principal reason for maintaining a non-Delaware incorporation.[260] The history of second-generation antitakeover statutes confirms that state legislatures outside of Delaware have been prepared to make good on this promise.

Even though a pro-management lean is ingrained in the Court's corpo-

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256. 794 F.2d at 264.

257. Butler, *supra* note 3, at 373 (arguing that anti-takeover statutes are not evidence of a market for corporate charters but "the triumph of [the managers of] a particular corporation in a state's interest-group battles"); Macey, *State Legislation*, *supra* note 3, at 470-71 (stating takeover laws "are nothing more than extremely costly devices for providing job protection for inefficient top level managers of poorly run firms").

258. *See supra* note 116 (discussion of political economy of second-generation statutes). In *CTS*, the Indiana Chamber of Commerce, "the largest association of businesses in Indiana, having more than 1,500 business firms as members" filed an amicus brief supporting the statute. Ind. Chamber of Comm. Brief, *supra* note 68, at 2.

259. *See, e.g.*, Cahill, *Foreign Investors, Local Politics*, N.Y. Times, May 27, 1990, § 3, at 13, col. 2 (managing director and chief executive of BTR P.L.C., a British conglomerate) (describing Massachusetts legislature's swift and hostile reaction to BTR's tender offer for Norton, a Massachusetts firm; "state governments are clearly setting a precedent to become the unquestioning defenders of local management").

260. *See* Romano, *Law as Product*, *supra* note 28, at 265 (finding that the firms that did not reincorporate in Delaware tended to be older firms, presumably with long-time and valuable ties to the state's political community).

rate jurisprudence,[261] a number of defects exists in this version of the Pro-management Hypothesis—which posits that *CTS* operates as a carte blanche for blatant management entrenchment. For example, the alignment of the Court is equivocal: Justices Marshall and Brennan joined the majority;[262] Justice White wrote the dissent.[263]

In addition, *CTS* leaves intact important constraints on management's use of the state legislative process to withdraw from the control market. The *CTS* preemption analysis, although weaker than *MITE*'s, makes clear that antitakeover statutes cannot interfere with the bidding process and sets a vague floor on interference with shareholders' transfer/control rights. The *CTS* territorial analysis effectively removes the legislative option for firms incorporated in takeover-neutral Delaware.

A weaker, subtler version of the Pro-management Hypothesis, however, proves far more convincing. By reaffirming state preeminence in corporate law, the Court validates an incorporation-based system of private ordering.[264] Because managers control the incorporation and

261. *See, e.g.*, Santa Fe Indus. v. Green, 430 U.S. 462 (1977) (denying shareholders standing under § 10(b) to challenge "internal corporate mismanagement"); Piper v. Chris-Craft Indus., Inc., 430 U.S. 1 (1977) (denying standing under § 14(e) of the Williams Act to an unsuccessful bidder claiming that management had deceived investors during the takeover fight); Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976) (interpreting § 10(b) of the Securities Exchange Act as requiring "scienter" to impose liability on corporate managers who fail to uncover corporate fraud).

In the first amendment context, the Court has viewed the corporate entity from a management perspective. *See* Pacific Gas & Elec. Co. v. Public Utilities Comm'n of California, 475 U.S. 1 (1986) (plurality) (declaring unconstitutional state regulation requiring utility to include messages by consumer group); Consolidated Edison v. Public Service Comm'n of New York, 447 U.S. 530 (1980) (declaring unconstitutional state law banning management-written inserts in monthly utility bills, despite ratepayers' protests); First Nat'l Bank of Boston v. Bellotti, 435 U.S. 765 (1978) (holding that state cannot, consistent with the first amendment, forbid corporate management from expressing its views on a state referendum, even though the referendum does not materially affect the corporation's business).

262. Brennan and Marshall have advocated the view that the federal securities laws impose significant managerial constraints. *See* Dirks v. SEC, 463 U.S. 646, 674-75 (1983) (Blackmun, Brennan and Marshall, J.J., dissenting) (deploring effect of "personal gain" rule to excuse a knowing and intentional violation of an insider's duty to shareholders); Santa Fe Indus. v. Green, 430 U.S. 462, 469-70, 480 (1977) (Brennan, J., dissenting) (agreeing with appeals court ruling that a breach of management fiduciary duties constitutes a fraud on minority shareholders); Ernst & Ernst v. Hochfelder, 425 U.S. 185, 217 (1976) (Blackmun and Brennan, J.J., dissenting) (questioning Court's technical and restrictive "scienter" requirement).

263. White joined the majority, and even wrote the Court's opinion, in decisions that insulated management from federal review. *See* Dirks v. SEC, 463 U.S. 646 (1983); Santa Fe Indus. v. Green, 430 U.S. 462 (1977) (White, J.); Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976).

264. This version of the Pro-management Hypothesis can also be seen as a modification of the Pro-shareholder Hypothesis, if one accepts the law-and-economics argument that rules apparently favoring management will predictably be in the best interest of shareholders. *See* Baysinger & But-

reincorporation of their firms, as well as the coverage of antitakeover statutes, a federalism regime that encourages state activism essentially defers to management ordering.[265] If so, this invites a more searching inquiry into the Pro-state Hypothesis.

D. *Pro-state Hypothesis*

The hypothesis that *CTS* sought to strengthen states' corporate regulatory hands can be seen as deriving from two sources. First, the Court sympathized with the plight of states in deterring takeovers that cause local dislocations—a recasting of the protectionist Pro-stakeholder Hypothesis. Second, the Court refused to stray into uncharted federalism water and to place state corporate law in doubt. The opinion addresses the latter explicitly, the former implicitly.

As we have seen, a protectionist justification would have run into a doctrinal thicket. Although the Court might have avoided it on some theory of nondiscriminatory protectionism or a market-participant analysis, the Court would have been forced to sanction state intervention in interstate markets to protect local interests.[266] Further, this version of the Pro-state Hypothesis, like the Pro-stakeholder Hypothesis, falters when one considers the Court's territorial analysis.

A more convincing explanation is the one presented to and chosen by the Court: the tradition of corporate federalism.[267] References to the traditional power of states to regulate corporate internal affairs marble

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ler, *Role of Corporate Law*, *supra* note 47; Fischel, *The Race Revisited*, *supra* note 47; Posner, *supra* note 47, at 389-92; Winter, *Government and the Corporation*, *supra* note 47, at 28-42.

265. CTS argued in its brief:

> There is no substantive difference between the [Indiana statute] (which corporations may elect not to follow) and an otherwise identical statute that would authorize a corporation to adopt the [statute's] definition of voting rights as a charter provision.

CTS Reply Brief, *supra* note 115, at 29-30. *See also* Ind. Chamber of Commerce Brief, *supra* note 68, at 4 (arguing that the Indiana statute "is in the nature of a shareholder rights charter provision"). *See also supra* note 115 (both parties made this argument).

266. Powell posed this possibility in his *MITE* concurrence. 457 U.S. at 646-47 & n.*; *see supra* note 174. Professors Johnson and Millon accept that states, consistent with the Williams Act, may prefer stakeholders at the expense of shareholders on the theory that "state law is the source of law defining stock rights . . . [including] the conditions under which, and the degree to which, shareholders will participate in the takeover decisionmaking." Johnson & Millon, *Misreading the Williams Act*, *supra* note 82, at 1886. But this analysis, if correct, is conclusive. If corporate rights were entirely a matter of state law, the Court's preemption inquiry into effects on shareholder transfer/control rights would be beside the point. As I have already argued, the Court seems to retain some supervisory role, at least under the Williams Act. *See supra* notes 163-65 and accompanying text.

267. *See supra* note 8 (CTS's federalism argument).

the opinion.[268] While *MITE* suggested that out-of-state share transfers could not be a chartering state's concern, *CTS* corrects this federalism lapse and deftly sweeps the full shareholder-manager relationship back under the state rug. Some commentators have understood *CTS* in this light.[269]

The tradition can be justified on a number of levels, to many of which the Court alludes. State antitakeover statutes are legislative, thus more legitimate than federal judicial solutions. Placing corporate regulation with the states avoids casting on the federal judiciary the task of resolving the economic and policy debate of corporate responsibility, particularly in the takeover context. In *CTS*, for example, the evidentiary record was virtually nonexistent,[270] and Judge Posner's Seventh Circuit opinion was built largely on his own empirical views of takeovers, applied to Dynamics's bid for CTS.

A Pro-state Hypothesis also is consistent with the view that takeover regulation was needed from some quarter. From appearances, states had been performing the function, their legislatures and courts adapting quickly to changes in the dynamic takeover market. With no promise of federal action, *CTS* defaulted to the states.

In the end, however, the Pro-state Hypothesis is unsatisfying because corporate law is and can be only weakly regulatory. The *CTS* territorial analysis would have barred Indiana from regulating Dynamics' takeover of CTS had the business been incorporated in another state. *CTS* effectively limits Indiana's interests to those chosen by the consumer of its chartering service—corporate managers.

E. Anti-federal Hypothesis

To say that *CTS* reflected a preference for state-based private ordering

268. 481 U.S. at 86 (noting in preemption analysis "[t]he longstanding prevalence of state regulation in this area"); *id.* at 89 (noting in analysis on inconsistency that "[n]o principle of corporation law and practice is more firmly established than a State's authority to regulate domestic corporations"); *id.* at 91 (noting in balancing analysis "State's role as overseer of corporate governance"). Scalia went further, describing a state's authority over the structure of domestic corporations as "sacrosanct." *Id.* at 96.

269. *See* Langevoort, *A Comment on* CTS, *supra* note 2, at 106 (stating the "Court [is] committed to maintaining a separation between the federal and state spheres of influence in matters of corporate law"); Pinto, *Takeover Laws After* CTS, *supra* note 162, at 778-79.

270. There had been a one-day evidentiary hearing before the trial court, *see* 794 F.2d at 251, but apparently no evidentiary record on the motives or effects of the Indiana statute. CTS Brief, *supra* note 8, at 27 n.13.

does not fully describe the Court's federalism gambit.[271] The decision also repudiates, and thwarts the inevitability of, a concurrent federal role—effectively stanching the federalization of corporate law.[272]

That *CTS* sought to avoid corporate federalization finds some support in the makeup of the Court majority, which included Justices Rehnquist, O'Connor, and Scalia.[273] But this is hardly conclusive: Justices Brennan and Marshall also joined the majority. Nevertheless, the way *CTS* forestalls each of the different ways in which corporate federalization might occur is revealing.

1. Williams Act preemption

The *CTS* antitakeover blueprint shuns significant judicial federalization using the Williams Act and creates a highly tolerant environment for antitakeover statutes.[274] Federal courts need only ask whether the statute avoids interfering with the bidding process and leaves intact some federally-protected shareholder transfer/control rights. The judicial preemptive role is not terribly intrusive. Only a state statute undercutting the assumption implicit in the Exchange Act or Williams Act of a state-based proxy or tender offer mechanism calls for judicial intervention.[275] In effect, only a statute (or pattern of statutes) raising a significant risk of federal legislative intervention triggers the judicial gatekeeping function. This is a far cry from *MITE*, which had opened a gaping federalism hole with the possibility that firm-specific defenses authorized by state statute could be subject to preemption review.

271. Although an Anti-federal Hypothesis would seem the necessary flip side to the Pro-state Hypothesis, a Pro-regulation Hypothesis could accommodate them both. But the two are necessarily antithetical if one understands the Pro-state Hypothesis as essentially one deferring to private ordering. In that light, the real regulation implicated by federal intervention could not operate concurrently with a private-choice corporate federalism.

272. Professor Langevoort was the first to recognize that *CTS* carried forward the Court's tradition of corporate federalism. Langevoort, *A Comment on* CTS, *supra* note 2, at 110 (noting the "Court's well-established belief that corporate law is the business of the various states, not (without a clear indication from Congress) of the federal government").

273. O'Connor, along with Powell, represented the swing in the Court, originally joining the majority in *MITE* and then reversing course to steer away in *CTS*.

274. *See* Langevoort, *A Comment on* CTS, *supra* note 2, at 110.

275. At least one lower court has seen Williams Act preemption as a question of preserving base-level control rights. Amanda Acquisition Corp. v. Universal Foods Corp., 708 F. Supp. 984, 1002 (E.D. Wis.) (stating preemption test as whether antitakeover statute "foreclos[es] a proxy contest opportunity"), *aff'd*, 877 F.2d 496 (7th Cir.), *cert. denied*, 110 S. Ct. 367 (1989).

2. *Protection of transfer/control rights*

Under the *CTS* blueprint, the judiciary assumes a formal and simple commerce clause role. After *CTS*, lower courts need only ask whether an antitakeover statute is facially discriminatory or extraterritorial. *CTS* squelches *MITE* and avoids the uncharted waters of judicially federalized shareholder rights. Had *CTS* not embraced the "creature of law" metaphor and the internal affairs doctrine, federal courts would have been forced to arrive at some constitutionally-based notion of the proper shareholder-manager relationship—well beyond the Exchange Act and the Williams Act assumptions about shareholder control rights. Because firm-specific defenses authorized by state law are in many respects functionally identical to statutory antitakeover regimes, the breadth of the federal judicial task could have become almost limitless.

By doing precisely the opposite—constitutionalizing the chartering state's power over corporate governance, at least for publicly-held firms with multistate activities—the Court avoided a host of problems. Federal judges are saved from the elusive and enormous job of discerning such matters as: the sufficiency or dominance of state contacts under an interest-based choice of law regime; the precise nature of state rules of corporate governance;[276] the motives and political economy of state corporation and antitakeover statutes; the participatory or regulatory nature of these statutes; the impact of particular governance rules on the control market; the efficiency of takeovers; and the sources for takeover premiums.

Powell's opinion illustrates how unprepared the federal judiciary is for the task. On the question of the merits and demerits of tender offers, Powell stated that "in many situations the offer to shareholders is simply a cash price substantially higher than the market price prior to the offer."[277] Powell does not hint at why this cash is available, nor how it relates to providing "more effective management or . . . needed diversification."[278] Judge Posner's decision in the Seventh Circuit was no better.

276. The problem came up both in *MITE* and *CTS*. On the question whether the Illinois administrative hearing interfered with the bidding process, the Seventh Circuit was forced to delve into whether state law allowed review of a tender offer's substantive fairness. 457 U.S. at 639 n.15. On the question whether the Indiana statute called for a record date before or after the 20-day open period, the Supreme Court assumed that state fiduciary law would compel the target's board to set a record date before the tendering deadline. 481 U.S. at 74 n.2.

277. 481 U.S. at 92 n.13.

278. *Id.*

3. *Explicit federal preemption*

CTS also minimizes the possibility of explicit federal legislative or administrative preemption. The Court's abandonment of *MITE* preemption not only expands the reach of state law, but reduces the level-playing-field philosophy of the Williams Act to an interpretative tool, not a source of federal power. *CTS* thus narrows the SEC's preemptive and rulemaking powers to instances of state interference with the bidding process. The SEC has apparently construed *CTS* in this way, seeking broader preemptive power from Congress.[279]

Further, the Court's elevation of the internal affairs doctrine to constitutional status avoids the need for explicit federal preemption, administrative or legislative. Under an incorporation-based regime, multiple state standards of behavior are impossible. Additional costs in the control market may arise because of the presence of antitakeover statutes, but not because of any confusion caused by an antitakeover patchwork. Preemption would only become an issue if states seemed to be going too far.

4. *Federal occupation of the field*

The *CTS* illusion of takeover regulation on behalf of shareholders and even stakeholders deflates the pressure for comprehensive federal occupation of the field, whether in the form of comprehensive takeover legislation or even a federal corporate code.[280] Although Congress constitutionally can occupy and preempt as much as it has the political will to do, *CTS* deftly puts off this inevitable regulatory moment.

F. Summary: The Nature of CTS *Corporate Federalism*

CTS defines a corporate federalism of incorporation-based private ordering. It is the reverse of federalism prevalent in other areas in which the residue occupied neither by Congress nor by the negative commerce

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279. In hearings before Congress, SEC Chairman Ruder suggested that the SEC should be given preemptive power, indicating doubts about the agency's current power to intrude into matters of corporate governance. *Tender Reform (Part 2): Hearings on H.R. 2172 Before the Subcomm. on Telecommunications and Finance of the House Comm. on Energy and Commerce*, 100th Cong., 1st Sess. 136 (1987) (statement of David S. Ruder, Chairman of the SEC) [hereinafter *Hearings: Tender Reform (Part 2)*].

280. CTS raised the specter of comprehensive federal corporate law: "Federal law could establish a 'comprehensive balance of power' in tender offers only by Federalizing all aspects of corporation law . . . ." Moreover, "State law has always provided the comprehensive regulation." CTS Brief, *supra* note 8, at 30.

clause defines states' regulatory powers over commerce.[281] Under *CTS*, the residue not occupied by private parties facilitated by state law defines federal power over corporate governance. In this presumptively sacrosanct private realm, making the case for federal intervention faces a stiff burden. Contrary to others' reading of *CTS*, the case's meaning is not to prefer a corporate constituency or even a particular federalism actor, but rather to ensure a *process*.[282]

CTS's concern for a process of private ordering and not regulation is found in the critical role played by the internal affairs doctrine. Dormant commerce clause review is avoided if state power extends only to the state's "own" corporations. The ironic effect is that a state, whether or not the chartering state, has no true *regulatory* power to interfere with the control market; at most, chartering states have facilitative power.[283] A chartering state that sought to regulate the market, at the expense of managers and shareholders, could well experience charter flight. In effect, *CTS* chose to see the problem as one of state interference, as to which market and political responses could correct excesses, rather than exploitation, which only judicial intervention could correct.[284]

States' facilitative powers are nonetheless limited by a vague Williams Act preemption analysis, which mandates that antitakeover statutes steer clear of interfering with the actual bidding process and leave intact some base level of transfer/control rights. Although the preservation of such rights may be a contorted reading of Congress' intent when it enacted the Exchange Act and the Williams Act, and perhaps an endeavor pursued more cleanly under the commerce clause, this minimal federalization at

281. Three federalism models have been suggested. *See* Redish & Nugent, *supra* note 169, at n.95-100.

282. This differs from the traditional conception of "process" in dormant commerce clause doctrine, which commentators have conceived of as one in which political forces may check states' regulatory excesses. *See* Eule, *supra* note 169, at 438-43; Levmore, *supra* note 169, at 567 (distinguishing "process" review to assure political representation when a state interferes with national markets and judicial "value" review to implement substantive economic policy when a state exploits a monopoly position at the expense of national markets). The *CTS* process involves the interaction of private markets, a horizontal state chartering market, and the vertical federal-state relationship as it concerns corporate governance.

283. *Cf.* Johnson & Millon, *Misreading the Williams Act*, *supra* note 82, at 1886, 1923 (assuming *CTS* leaves to states the regulatory role to "step into the breach" and make "the crucial policy judgments about the appropriateness and frequency of takeovers"). With a constitutionalized internal affairs doctrine, it is hard to see how states can do this unless managers agree.

284. *See* Levmore, *supra* note 169, at 619-26 (characterizing *MITE* as a case of exploitation on the assumption no *political* forces would correct a state's adoption of a burdensome antitakeover statute).

least roots the Court in congressional assumptions.[285] Federalism accommodations are sometimes inelegant.

Beyond this, shareholders' transfer/control rights find virtually no constitutional protection. To the extent the Court retained a federalism gatekeeping function, the reason seems not to have been to prevent manager opportunism or to protect stakeholders, but rather to deflate pressure for a greater federal role. To have granted the states meaningful power to protect shareholders or stakeholders would have required sanctioning some fluid choice of law rule, inviting a patchwork of state regulation and inevitably a comprehensive federal response. Noticeably lacking from *CTS* federalism of incorporation-based private ordering is any supervisory responsibility in the courts over the process, in particular the state legislative process. *CTS* blindly shunts aside the question of protectionism and the likely reaction the decision set into motion.

Whether *CTS* actually forestalls the political necessity for a comprehensive federal response to the takeover phenomenon is another question, which I address next, first by considering post-*CTS* corporate federalism and then its merits.

IV. HOW THE *CTS* GAMBIT HAS PLAYED OUT

A. CTS Corporate Federalism in Practice

The reaction to *CTS* confirms its federalism ploy; the corporate regulators have played their hands much as a federalism explanation of the case would predict. Except to host a preemption debate, Congress has not reacted; the SEC has been cautious, reluctantly filling the one-share, one-vote vacuum left by Congress and the states; federal courts have adhered closely to the *CTS* antitakeover blueprint, invalidating only extraterritorial statutes; state legislatures have continued to enact antitakeover laws, some pressing *CTS*'s outer limits; and state courts have filled in the legislative gaps.

1. A stalemated Congress

CTS withdraws the invitation made in *MITE* for Congress to intervene to regulate takeovers. *CTS* leaves little confusion about the reach of state antitakeover statutes or who ostensibly has regulatory power.

285. *See id.* at 569 (arguing that judicial review is appropriate when the myriad complexity of an area warrants case-by-case review; congressional inaction can be seen as deferral to the courts).

A spate of congressional bills and hearings followed *CTS*.[286] The bills, many repackaging proposals pre-dating the decision, spanned the spectrum: requiring that takeovers be accomplished only by tender offer;[287] extending the open period for tender offers to forty-five business or sixty calendar days;[288] prohibiting bidders from making purchases during a cooling-off period after a tender offer terminates;[289] banning poison pill defenses;[290] preempting state laws that allow reductions of existing common shares' per-share voting rights;[291] and declaring congressional approval of the internal affairs doctrine.[292]

The prevalent sentiment among members of Congress was that *CTS* had properly left corporate governance matters with the states: corporate federalism is a powerful mindset.[293] Senator Proxmire, for example, commented soon after *CTS*: "The States are . . . looking to us [to act]. . . . I think we should leave as much as we can to the States."[294]

Management groups, such as the Business Roundtable and the National Association of Manufacturers, supported the proposals to further regulate tender offers, but vehemently opposed any preemption of state corporate governance rules.[295] Bidders and shareholder groups were also

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286. *See, e.g., Supreme Court Decision on Indiana Law Remains Prime Topic at Takeover Hearings*, 19 Sec. Reg. & L. Rep. (BNA) 1011 (July 10, 1987).

287. *See, e.g.*, S. 1323, 100th Cong., 1st Sess. § 7 (1987), *reprinted in* 133 CONG. REC. S7594-95 (daily ed. June 4, 1987) (requiring that any acquisition of more than 15% be by tender offer); *see also* Oesterle, *The Rise and Fall*, *supra* note 95, at 245 & n.202.

288. *See, e.g.*, S. 1324, 100th Cong., 1st Sess. (1987) (45 business days); H.R. 2172, 100th Cong., 1st Sess. (1987) (60 calendar days).

289. *See, e.g.*, S. 1324, 100th Cong., 1st Sess. § 9(3)(D) (1987), *reprinted in Regulating Hostile Corporate Takeovers: Hearings on S. 227, S. 678, S. 1264, S. 1323, and S. 1324, Before the Senate Comm. on Banking, and Housing, and Urban Affairs*, 100th Cong, 1st Sess. 58-59 (1987) (prohibiting purchases for 30 days after tender offer expires) [hereinafter *Hearings: Regulating Corporate Takeovers*]. *See also* Oesterle, *The Rise and Fall*, *supra* note 95, at 245 n.203.

290. *See, e.g.*, S. 678, 100th Cong., 1st Sess. (1987); S. 1324, 100th Cong., 1st Sess. (1987).

291. *See, e.g.*, H.R. 2172, 100th Cong., 1st Sess. (1987).

292. *See, e.g*, S. 1323, 100th Cong., 1st Sess. (1987); S. 1324, 100th Cong., 1st Sess. (1987).

293. *See, e.g.*, *Hearings: Regulating Corporate Takeovers, supra* note 289, at 321 (comments of Sen. Proxmire) (expressing the view that "we should leave as much as we can to the States"); *id.* at 329 (comments of Sen. Wirth) (stating that regulating bidders has "been a purview of the States before").

294. *Hearings: Regulating Corporate Takeovers*, *supra* note 289, at 80, 321 (comments by Sen. Proxmire during hearings). *Cf.* Proxmire, *The M&A "Game" Is Not a Productive Enterprise*, Nat'l L. J., Nov. 9, 1987, at 21-22, col. 1 (arguing that to "service debts, especially [from] hostile takeovers, companies must retrench research and development as well as terminate otherwise productive workers").

295. *See, e.g., Hearings: Regulating Corporate Takeovers*, *supra* note 289, at 328 (statement of H. Brewster Atwater, Chair of the Business Roundtable's Task Force on Corporate Responsibility)

represented, decrying management-led state interference in the control market and the "failure of states to enact effective laws."[296] The securities industry also participated, favoring federal preemption for national firms.[297] State government, including the National Conference of State Legislatures, argued that antitakeover statutes responded to local conditions and the interests of individual shareholders, employees, and communities.[298] No representatives of labor or local state government participated in the hearings.

With only three exceptions, none of the post-*CTS* takeover bills left

(stating support for closing 10-day window, lowering notification levels and increasing disclosure requirements); others have echoed this view. *See, e.g.*, *Tender Offer Reform (Part I): Hearings on H.R. 2172 Before the Subcomm. on Telecommunications and Finance of the House Comm. on Energy and Commerce*, 100th Cong., 1st Sess. 38 (1987) [hereinafter *Hearings: Tender Offer Reform (Part I)*] (statement of H. Brewster Atwater) (stating that bill's preemption of state corporate governance rules was "one major flaw, which could counteract all of its otherwise positive features"); *id.* at 215 (statement of James P. Carty, Vice President, Government Regulation, National Association of Manufacturers) (warning that "[a]ny diminishing of the state role would result in NAM not supporting such legislation").

296. *Hearings: Tender Offer Reform (Part I)*, *supra* note 295, at 460-61 (statement of Robert Monks, President of Institutional Shareholder Services, Inc.) (stating also that "the current abuses are made possible by the failure of States to enact effective laws . . . worthwhile experimentation . . . is becoming seriously flawed"). *See also id.* at 127 (statement of Nelson Peltz, on behalf of the Alliance for Capital Access) (stating that state takeover regulation "will do very little to assure that basic economic policy questions affecting this Nation and its competitiveness are answered in an appropriate manner"); *id.* at 481 (statement of T. Boone Pickens) (stating that after *CTS* "the Business Roundtable was nowhere to be found on Capitol Hill" and that "[t]hey discovered that it was much easier to get their way in the States"); *id.* at 447 (statement of Roland M. Machold, Director, Division of Investments for the State of New Jersey) (stating that "corporate influence at the State level is very powerful, and . . . investor interests are dispersed and very weak"); *Corporate Takeovers: Hearings on S. 1323 Before the Subcomm. on Antitrust, Monopolies and Business Rights of the Senate Comm. on the Judiciary*, 100th Cong., 1st Sess. 97 (1988) [hereinafter *Hearings: Corporate Takeovers*] (statement of T. Boone Pickens) (stating that the "Business Roundtable wants hostile takeovers stopped, but would allow 'friendly' mergers to continue").

297. *See, e.g.*, *Hearings: Tender Offer Reform (Part 2)*, *supra* note 279, at 38 (statement of Bruce Wasserstein, then-managing director of First Boston) (criticizing the "crazy quilt of overlapping protective laws" and recommending federal preemption of regulation of all but truly "local" companies).

298. *See, e.g.*, *Hearings: Tender Offer Reform (Part 2)*, *supra* note 279, at 9 (statement of Joseph W. Harrison, majority leader of the Indiana State Senate and sponsor of Indiana control-share statute, on behalf of the National Conference of State Legislatures) (stating that "I stress that because I want you to know it was just not at the insistent (sic) of an Indiana corporate management that we reacted to this problem"); *id.* at 22-23 (statement of Joseph I. Lieberman, Attorney General of Connecticut) (stating support of *CTS*, even though Dynamics has significant operations in Connecticut, and arguing that State representatives have knowledge of local circumstances and companies); *id.* at 120 (letter of National Governors' Association) (opposing any federal preemption). *Cf. id.* at 98 (statement of Michael J. Connoly, Massachusetts Secretary of State) (favoring "limited preemption" under a federal one-share/one-vote rule).

committee.[299] One that did, the House Ways and Means tax bill to eliminate deductibility of interest incurred in takeovers, may have triggered the 1987 stock market crash and was ultimately deleted in conference.[300] Another, which became the federal plant-closing statute, was a mild palliative that may have done more harm than good.[301]

The rate at which bills related to takeovers have been filed in Congress has fallen off since *CTS*.[302] This decline coincides with Professor Romano's findings that in the pre-*CTS* period, the rate of congressional

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299. One of the three bills reported out of committee, S. 1323, would have lowered the section 13(d) reporting threshold to 3%, narrowed the ten-day window to 24 hours, required that any acquisition above 15% be by tender offer, and increased the open period for tender offers to 35 business days, as well as increased insider trading penalties and criminal sanctions. Only the insider trading provisions survived. *See* Insider Trading and Securities Fraud Enforcement Act of 1988, Pub. L. No. 100-704, 102 Stat. 4677 (1988), *codified at*, Securities Exchange Act § 21A, 15 U.S.C. § 78u-1 (1988).

Characteristic of congressional paralysis on takeovers has been Congress's long-standing inability to narrow the § 13(d) ten-day window for disclosing a 5% foothold acquisition, a relatively noncontroversial proposal. S. 227, 100th Cong., 1st Sess. (1987) (Sen. D'Amato) (closing 10-day window to 24 hours); S. 1323, 100th Cong., 1st Sess. (1987) (proposing reduction of window to five days and prohibiting additional purchases prior to filing). *See* Macey & Netter, *Regulation 13D and the Regulatory Process*, 65 WASH. U.L.Q. 131 (1987) (discussing costs of ten-day window); Oesterle, *The Rise and Fall*, *supra* note 95, at 231 & n.136 (describing Congress as "intent on closing the window to a few days"); Note, *Proposed Legislation to Close the 13(d) Window*, 66 WASH. U.L.Q. 433 (1988).

300. *See infra* note 383 (describes empirical study that indicates the stock price decline of October 14 and 16, which led to structural sell pressure, triggered the October 19, 1987 crash).

301. Pub. L. No. 100-379, 102 Stat. 890 (1988) (codified at 29 U.S.C. §§ 2101-2109 (1988). Known as the Worker Adjustment and Retraining Notification Act (WARN), the law requires that businesses with more than 100 employees give sixty days notice to workers of a plant closing or mass layoff (both of which the law defines), unless the employer is actively seeking to avoid the action or it was necessitated by unforeseeable circumstances. Failure to give the required notice entitles employees to back pay and benefits for each day the notice was not given, and allows local communities to recover at most a $30,000 civil penalty. Under WARN, injunctive relief is specifically not available.

Some argue that state plant closing laws hurt those they mean to protect. Macey, *Externalities, Firm-Specific Capital Investments, and the Legal Treatment of Fundamental Corporate Changes*, 1989 DUKE L.J. 173, 197. *See also* Note, *State Plant Closing Legislation: A Modern Justification for the Use of the Dormant Commerce Clause as a Bulwark of National Free Trade*, 75 VA. L. REV. 845, 862 (1989) (arguing that "[s]tate plant closing statutes alone, without other far-reaching reforms, punish the very activity upon which the economy relies without promoting a substitute").

302. For the period from 1982 to April 1987 when *CTS* was decided, Professor Romano counted 62 bills dealing with regulation of tender offers in general (11.3 per year), 27 dealing with acquisitions in specific industries such as airlines and oil (4.9 per year), 26 dealing with taxation of acquisitions (4.7 per year), and 8 dealing with acquisitions by non-U.S. firms (1.3 per year). Romano, *Future of Hostile Takeovers*, *supra* note 51, at 479 (based on a review of the subject index of CCH's Congressional Index). Using the same tabulation method for the period from May 1987 to December 1990, I count 12 bills dealing with regulation of tender offers in general (3.3 per year), 7 dealing with acquisitions in the same particular industries (1.9 per year), and 8 dealing with taxation of acquisitions (2.2 per year), and 6 dealing with acquisitions by non-U.S. firms (1.7 per year).

takeover bills related statistically to actual takeover activity.[303]

Nonetheless, the rate of congressional hearings on takeovers—perhaps an even more accurate measure of congressional interest in the subject—increased during the period after *CTS*, up until takeover-poor 1990.[304] During the unsettled period between *MITE* and *CTS*, Congress held twenty-one hearings on takeovers, approximately 2.2 per year; since *CTS* there have been thirty-three such hearings, approximately 9.2 per year.[305] This relative increase suggests that congressional activity (even though

Year	Gen TO	Spec Indus	Tax	For Inv
1982	1	—	9	—
1983	1	1	2	2
1984	14	11	3	1
1985	22	10	9	—
1986	—	4	—	—
1987 (pre-*CTS*)	24	3	3	5
1987 (post-*CTS*)	5	—	1	3
1988	1	—	—	—
1989	4	6	4	—
1990	2	1	3	3

303. The rate also correlates to the perceived constitutionality of state antitakeover statutes.

304. Professor Romano does not explain her preference for using bills as indicators of congressional interest. *See* Romano, *Future of Hostile Takeovers*, *supra* note 51, at 470-79.

305. To tabulate hearings, I used the subject index of the Congressional Information Service (COMPETITION, CORPORATIONS, ECONOMIC CONCENTRATION, SECURITIES) for hearings related to takeovers, tender offer regulation, mergers and acquisitions, leveraged buyouts.

Year	Sets of Hearings	Number of Hearings
1982	1	1
1983	0	0
1984	1	1
1985	4	8
1986	2	4
1987 (Pre-*CTS*)	3	7
TOTAL	11	21
1987 (post-*CTS*)	3	8
1988	2	11
1989	3	14
1990	0	0
TOTAL	8	33

For the post-*MITE* and pre-*CTS* period, I counted hearings held between June 1982 and April 1987. For the post-*CTS* period I only included hearings through the end of 1990. There were no hearings held during 1990, a year in which takeover activity declined by one-half.

That hearings were held (shown in the "Set of Hearings" data) may not tell as much as the days hearings were held (shown in the "Number of Hearings" data). A set of hearings would seem to reflect that a committee or sub-committee chair considered a topic of sufficient interest to warrant having it aired. The number of hearings would seem to reflect the depth of that interest and the variety of sources considered worth hearing. Whichever data on hearings better reflect congressional interest, both data indicate an increased interest during the post-*CTS* period.

no legislation emerges) may serve an end in itself. Congress has become a useful forum for the takeover debate, but is stalemated by the competing factions.[306]

2. *An ambivalent SEC*

While continuing to argue against antitakeover statutes in court,[307] lobbying unsuccessfully against such statutes before state legislatures, and seeking federal legislation preempting state antitakeover statutes,[308] the SEC has not itself taken a significant regulatory or preemptive role. In the federalism process set into motion by *CTS*, the SEC has advocated for the control market.

The SEC came closest to a regulatory role when it reluctantly intereceded in 1988 in the one-share, one-vote controversy, the recent high point in SEC activism in corporate governance. Rule 19c-4 prohibits the stock exchanges and the National Association of Securities Dealers Automated Quotation (NASDAQ) service from listing the common stock of any firm that undertakes a recapitalization which reduces existing common shareholders' per-share voting rights.[309] At first the SEC had sought to leave the question to the exchanges, but when they balked, it stepped in.[310] Reluctant and cautious, the SEC clearly kept in mind

306. Two statements by Senator Metzenbaum summarize where Congress stands:

> The answer does not lie in banning hostile takeovers. Despite the abuses, some takeovers do improve management and help achieve a company's potential. Congress shouldn't tilt the takeover playing field one way or the other.

Hearings: Corporate Takeovers, supra note 295, at 2.

> I would strongly urge you to discuss with your colleagues and friends at the Business Roundtable and the Chamber of Commerce and NAM that it is time that they deliver a few votes on this issue and we will move this subject.

Id. at 113 (comment by Sen. Metzenbaum to Robert E. Mercer, Chairman and CEO of Goodyear Tire and Rubber Co.).

307. *See* Johnson & Millon, *Misreading the Williams Act, supra* note 82, at 1882 (describing SEC staff's mandate and position in third-generation cases).

308. *See* Oesterle, *Delaware's Takeover Statute, supra* note 2, at 929-30 & n.196.

309. Securities Exchange Act Rule 19c-4, 17 C.F.R. § 240.19c-4 (1990); Voting Rights Listing Standards—Disenfranchisement Rule, Exchange Act Release No. 25,891, [1987-1988 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,247 (July 7, 1988) [hereinafter Final Release]. *See also* Comment, *Rule 19c-4: The SEC Goes Too Far in Adopting a One Share, One Vote Rule*, 83 Nw. U.L. Rev. 1057 (1989) [hereinafter Comment, *SEC Goes Too Far*].

310. The rules of the New York Stock Exchange prohibit the listing of dual-class stock. In 1984 the NYSE, fearful of losing listings to exchanges that allowed non-voting or low-voting stock, suspended its rule against such listings. At the same time it sought, with the SEC's assistance, to negotiate a uniform listing standard with the other exchanges. When the exchanges refused to agree voluntarily to listing standards for multiple classes of stock with disparate voting rights, the SEC proposed a uniform standard. Voting Rights Listing Standard—Proposed Disenfranchisement

commentators' admonitions that low-voting stock was a governance matter "in the realm of state rather than federal control."[311] As adopted, the rule not only recognizes "valid business and economic purposes" for low-voting stock and exempts it when issued in a registered public-offering or to effect a "bona fide merger or acquisition,"[312] it also excludes various takeover defense mechanisms on the theory that state law properly governs.[313] Nonetheless, the rule signals SEC doubts about the ability of state voting rules and fiduciary law to deal with shareholder "collective

Rule, Exchange Act Release No. 24,623, [1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,143 (June 22, 1987) [hereinafter Proposing Release]. A year later it adopted the rule. Final Release, *supra* note 309.

311. Proposing Release, *supra* note 310, at 88,771; Final Release, *supra* note 309, at 89,213. Commentators pointed to the remark of a Senate staffer following the 1975 amendments to the Exchange Act:

> [I]n drafting these new sections of the law which give the SEC power over exchange rules, I can tell you that there never was any intent to go into this [corporate governance] area. The Congress would look at it as a grave breach of Congressional intent . . . .

Symposium on Federal and State Roles in Establishing Standards of Conduct for Corporate Management, 31 BUS. LAW. 1091, 1096 (1976) (remarks by Stephen Paradise, former Assistant Counsel to the Senate Banking, Housing and Urban Affairs Committee), *quoted in* Proposing Release, *supra* note 310, at 88,776 n.70.

Other commentators argued that a uniform listing standard would undermine the federalism structure that allows private parties to "fashion the relationship between capital and control in the manner best suited to the enterprise" and would in effect establish a federal corporation law of voting rights. *See* Proposing Release, *supra* note 310, at 88,776 (citing Dent, *Dual Class Recapitalization: A Reply*, 54 GEO. WASH. L. REV. 725 (1986)); Lipman, *"One-Share, One-Vote" Rule: Smothering Stock Owners with Love?*, Legal Times, Nov. 14, 1988, at 23. *See also* Seligman, *Equal Protection in Shareholder Voting Rights*, 54 GEO. WASH. L. REV. 687 (1986).

312. Securities Exchange Act of 1934, Rule 19c-4(d)(1),(2),(3), 17 C.F.R. § 240.19c-4(d)(1),(2),(3) (1990); Final Release, *supra* note 306, at 89,219. Ironically, this was the very kind of transaction—half-voting stock issued by General Motors to purchase EDS and Hughes Aircraft—which prompted the NYSE to suspend its one-share, one-vote rule. *See* Booth, *Tender Offer Law*, *supra* note 106, at 757 & n.142.

313. The rule excludes control share statutes, which can operate to disenfranchise controlling shareholders. Securities Exchange Act of 1934, Rule 19c-4(d)(4), 17 C.F.R. 240.19c-4(d)(4) (1990). The Commission stated its belief that "deference to state-legislated control share acquisition statutes designed to specifically regulate change in control is appropriate." Final Release, *supra* note 309, at 89,225. *See also* Davis, *supra* note 52, at 509.

In addition, the SEC's release states that the rule excludes poison pills, although the assertion finds no textual support. A typical pill's exclusionary flip-in rights have the effect of disparately reducing the per share voting rights of the excluded bidder, an effect falling squarely under the rule's prohibition. The SEC implies that since poison pills are never supposed to be triggered they are not covered. Final Release, *supra* note 309, at 89,226. Further, low-priced stock issued in a defensive stock lock-up would seem to be covered since such stock operates much as high-voting stock to give its holder voting rights disproportionate to the holder's investment. Nonetheless, the SEC stated that the "fairness of the compensation paid for voting stock [in a lock-up] generally should be determined by state law." *Id.*

action" problems.[314] The Business Roundtable challenged the rule, and the D.C. Circuit invalidated it on federalism grounds.[315]

3. *Pressing, but more deliberative, state legislatures*

States have accepted the *CTS* invitation. Within six months of the decision, fourteen states adopted third generation statutes;[316] others revised their second-generation statutes. Today more than forty states have some version of an antitakeover statute, and state antitakeover statutes cover approximately eighty percent of United States assets.

Since *CTS*, antitakeover statutes have continued to fall into much the same categories as the second-generation statutes. Each follows the *CTS* blueprint: none interferes with the bidding process; each employs a structure arguably designed to further shareholders' individual or collective interests; and each is grafted onto existing corporate law structures, such as voting or appraisal rights. They remain facilitative, largely optional for managers. Some state statutes have addressed the uncertainty of particular firm-specific takeover defenses, explicitly authorizing poison pill plans and their discriminatory flip-in feature.[317] Few third-generation statutes have been extraterritorial; those few that at first were, along with others in the second generation, have been pared back to fit the *CTS* blueprint's territorial mandate.[318]

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314. Final Release, *supra* note 309, at 89,216.

315. Business Roundtable v. SEC, 905 F.2d 406 (D.C. Cir. 1990). The Business Roundtable is a lobbying group representing 200 chief executives of the nation's largest corporations. *See infra* notes 365-369 and accompanying text (discussion of rule's validity under a federalism perspective).

316. *See* Romano, *Future of Hostile Takeovers*, *supra* note 51, at 461.

317. Such plans allow shareholders to exercise rights to redeem their shares or buy new securities at a substantial discount (usually 50% from market) if the target engages in a flip-in transaction—that is, a merger into or other self-dealing transaction with the bidder. To ensure the dilution of the bidder's stock, and thus the effectiveness of the plan, flip-in plans exclude the bidder from exercising its redemption rights. Some states have invalidated this discrimination among shareholders of the same class. Bank of New York v. Irving Bank Corp., 142 Misc. 2d 145, 536 N.Y.S.2d 923 (Sup. Ct. 1988) (interpreting corporate statute to require equal treatment of all shareholder of same class). Given its nearly impenetrable nature—provided it stands—the poison-pill defense is more potent than the statutory defenses.

318. In 1988, Professor Kozyris identified ten states that had extraterritorial antitakeover statutes: Arizona, Florida, Idaho, Massachusetts, Nebraska, North Carolina, Ohio, Oklahoma, Tennessee, and Washington. *See* Kozyris, *Some Observations*, *supra* note 32, at 530-31 & n.113. Three of them have since repealed or amended their laws to apply only to locally incorporated firms. *See* ARIZ. REV. STAT. ANN. § 10-1201(6) (WESTLAW AZ library, legis file); N.C. GEN. STAT. § 55-9A-01(5) (WESTLAW NC library, stat file); OHIO S.B. 321 § 1101.10(3)(Y), (Z) (approved Apr. 11, 1990) (WESTLAW OH library, legis file). Courts struck down the extraterritorial application of two others, though the statutes remain on the books. Tyson Foods Inc. v. McReynolds, 865 F.2d 99 (6th

A significant development in the third generation has been the explosion of non-shareholder constituency (or stakeholder) statutes.[319] The statutes, which are generally limited to takeovers and other control changes, are designed to give directors greater latitude in structuring and justifying takeover defenses. Although some have expressed the hope that the statutes might realign corporate governance to reduce the externalities of manager and shareholder opportunism, the statutes may cause precisely the opposite effect. None gives stakeholders enforcement rights; none applies extraterritorially to foreign corporations doing business in the state.

The third-generation enactments in Delaware and Pennsylvania are illustrative.

a. *Moderated Delaware statute*

In January 1988, Delaware enacted a mild third-generation statute. The statute, which applies only to Delaware-incorporated targets, prohibits a fifteen percent acquiror from entering into any business combination with the target for three years after a hostile takeover, but gives bidders at least eight routes by which to avoid the prohibition.[320] Most

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Cir. 1989) (holding that the Tennessee Authorized Corporation Protection Act, TENN. CODE. ANN. §§ 48-35-401 to 48-35-406 "guarantee[s]" inconsistent regulation); TLX Acquisitions Corp. v. Telex Corp., 679 F. Supp. 1022 (W.D. Ok. 1987) (invalidating OKLA. STAT. ANN. tit. 18, §§ 1145 et seq.). Despite rewriting their corporation codes, Florida, Massachusetts, and Washington still have extraterritorial antitakeover provisions. Florida Business Corporations Act, ch. 89-154, § 95(4) (WESTLAW Fla. library, legis file) (to be codified at FLA. STAT. ANN. § 607.0901); MASS. GEN. L. ch. 110D, § 1 (3)(e) (Lawyer's Co-Op Supp. 1990); Washington Business Corporations Act, ch. 225, § 198 (13), 1989 Wash. Legis. Serv. 520 (West). Idaho and Nebraska have not changed their extraterritorial statutes. IDAHO CODE § 30-1601(6) (Supp. 1988); NEB. REV. STAT. § 21-2442 (Supp. 1988).

319. The statutes allow, and in one case even mandate, directors to consider the effect of a takeover bid on non-shareholder stakeholders, such as "employees, suppliers, creditors and customers, the economy of the state, region and nation, community and societal considerations." *See, e.g.*, MASS. GEN. LAW ANN. ch. 156B, § 65 (West Supp. 1989). Others presume validity if a majority of disinterested directors makes the determination based on such interests. *See* Hanks, *supra* note 114. Despite their revolutionary abandonment of the rhetoric of shareholder wealth maximization, the statutes (like other antitakeover statutes) have been adopted with little legislative debate. *Id.* at 20.

320. DEL. CODE ANN. tit. 8, § 203 (1990). Some exclusions are contained in the statute; others arise from its operation: (1) the acquisition of 85% of the target's stock in one transaction; (2) the target board's election (within 90 days of the statute's effective date) to opt out of the statute; (3) an opt-out amendment of the articles or bylaws effective after a 12-month waiting period; (4) approval by the board and two-thirds of disinterested shares of a business combination with a 15% acquiror; (5) approval by the board of such a transaction before a triggering 15% acquisition; (6) the bidder's conditioning of its tender offer on receiving sufficient consents to replace the board before acquiring stock; (7) the use of a "cleansed" wholly-owned subsidiary into which the target's assets are trans-

significant is an exemption for tender offers of eighty-five percent or more of the target's shares.[321]

The legislative history of the Delaware statute reflects both the concerns of possible migration from Delaware if it did not act, and the risk of a federal response if it was too aggressive. As originally proposed, the antitakeover bill, drafted by the state bar's Corporation Law Section, would have applied to ten percent acquirors and exempted only tender offers for ninety percent or more of a target's stock (without excluding insider holdings from the calculation).[322] In response to comments from SEC Commissioners and institutional investors,[323] the bill's drafters moderated the bill's antitakeover effects. The chairman of the Corporation Law Section later reported to the Delaware legislature that the revised bill "is a product of a series of compromises" reflecting the comments by "attorneys, academics, corporations, pension funds, federal officials and others to an earlier draft."[324] Professor Jensen, a leading academic proponent of an unregulated chartering market, pointed out to the drafters that if Delaware adopted the statute as proposed, it would add "considerably to the pressures for Federal chartering."[325]

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ferred in a squeeze-out merger; (8) a proxy contest in which the bidder seats a new board to approve the bidder's proposed business combination. *See* Oesterle, *Delaware's Takeover Statute*, *supra* note 2, at 886-88, 916-17; Romano, *Future of Hostile Takeovers*, *supra* note 51, at 464.

321. DEL. CODE ANN. tit. 8, § 203(a)(2) (1990). In computing the 85%, shares held by management and management-controlled ESOPs are excluded. The effect is that the statute exempts tender offers that attract 85% or more of publicly-held shares. *See also* Garfield, *supra* note 116, at 584 (pointing out that the statute discourages any-and-all bids that attract less than 85% tenders, even if followed by a squeeze-out merger offering the same consideration).

322. The first draft by the Council of the Corporation Law Section of the Delaware State Bar Association was circulated publicly in November 1987. *See* Oesterle, *Delaware's Takeover Statute*, *supra* note 2, at 889 & n.49 (citing *Business and the Law: Compromise Near in Delaware*, N.Y. Times, Dec. 21, 1987, at D2, col. 1).

323. Commissioners Grundfest, Cox and Ruder wrote in opposition to the first draft. *See* Oesterle, *Delaware's Takeover Statute*, *supra* note 2, at 889 & n.51 (concluding that the "principal reason for the modifications" were the SEC letters); Garfield, *supra* note 116, at 584-85 & n.264 (describing comments by institutional investors and SEC Commissioner Cox questioning anti-coercive purpose). Wilmington Trust, Delaware's largest bank, wrote: "We urge you to scrap the proposed measure or to consider substantial modification." *See id.* Institutional investors were among the 150 who wrote letters commenting on the draft. *See* Sontag, *A Takeover Law Grows in Delaware*, Nat'l L. J., Apr. 11, 1988, at 1, 19-20. *See also* Romano, *Future of Hostile Takeovers*, *supra* note 51, at 463.

324. *Testimony of A. Gilchrist Sparks, III Before the Delaware Senate and House Judiciary Committees* (Jan 20, 1988), *reprinted in* Smith & Furlow, *Guide to the Takeover Law of Delaware*, Corporate Practice Series (BNA) 297 (1988). In addition, labor unions were represented in legislative hearings on the Council's bill. *See* Smith & Furlow, at 271-75.

325. Letter from Michael C. Jensen to David B. Brown (Dec. 8, 1987), *cited in* Oesterle, *Dela-*

The Delaware statute was also a product of the state chartering market. Delaware's secretary of state reminded legislators of the $170 million in chartering fees, representing seventeen percent of the state's total revenues, produced by Delaware's corporate law. He stated that "at least half" of the correspondence from managers of the largest Delaware-incorporated firms suggested that they "would look seriously at . . . changing their Delaware incorporation" if the statute were not adopted.[326] It is worth noting that the Delaware legislature showed none of this solicitude when it later adopted a labor-contract protection law to insulate *local* workers from both incumbent managers and outside bidders.[327]

b. Pennsylvania's daring disgorgement statute

In April 1990, Pennsylvania enacted an antitakeover package that includes a novel and potentially potent disgorgement statute.[328] Under the statute, any controlling person (defined as a twenty percent shareholder, a twenty percent bidder or any other person *seeking* control by proxy contest or otherwise)[329] must disgorge to the company any profits realized from the sale of the target's stock during an eighteen-month period after becoming a controlling person; disgorgement applies to all stock acquired twenty-four months before or eighteen months after coming under the statute.[330]

Surprisingly, the legislative history of the statute reflects moderation and a more fully-represented process than in the typical second-generation enactment. An early version of the bill that was finally enacted into

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ware's Takeover Statute, *supra* note 2, at 890 n.51 ("I am convinced that this law will do enormous damage to corporate America and to the shareholder of Delaware corporations").

326. *Testimony Before the Delaware House and Senate Judiciary Committees* (Jan. 20, 1988) (statement of Secretary of State, Michael E. Haskings), *reprinted in* Smith & Furlow, *supra* note 324, at 259. In the drafting committee, A. Gilchrist Sparks, chairman of the Delaware bar, argued against an opt-in statute on the theory that if shareholders would approve opting into the statute, managers "would be much more likely to pursue a reincorporation merger out of Delaware . . . [into] some state with opt-out legislation already in place." *See* Smith & Furlow, *supra* note 324, at 299. *See also* Romano, *Future of Hostile Takeovers*, *supra* note 51, at 463-64 (describing the decision to adopt an opt-out, rather than opt-in, statute apparently because of management pressure).

327. DEL. CODE ANN. tit. 19, § 706 (1988). The Delaware statute applies to Delaware-based businesses, wherever incorporated.

328. 1990 PA. S.B. 1310 (to be codified at 15 PA. CONS. STAT. ANN. §§ 2571-74). The package also includes a relatively non-descript control-share statute and a revised non-shareholder constituency statute. 15 PA. CONS. STAT. ANN. §§ 1721, 2561-67 (Purdon 1990).

329. *See* 1990 PA. S.B. 1310 (to be codified at 15 PA. CONS. STAT. §§ 2573, 2573.1(a)).

330. *Id.* (to be codified at 15 PA. CONS. STAT. ANN. § 2574).

law had been introduced in October 1989 in response to a proxy contest by the Belzberg family for Armstrong World Industries, incorporated and based in Pennsylvania.[331] It contained relatively standard stakeholder-constituency and control-share provisions.[332] The Pennsylvania Senate originally passed the measure in December.[333] The House, however, substantially modified the bill, adding a provision to clarify that the state's 1983 redemption statute applied to proxy insurgents, which would have the effect of converting every proxy contest into an any-and-all tender offer. It also added the disgorgement provision, a novelty among antitakeover statutes.[334] As proposed, the disgorgement provision applied to any person seeking to influence control and had no opt-out procedure; its ostensible purpose was to preclude greenmail, but its effect was to withdraw much of the financial incentive for any takeover or proxy contest.[335]

Reaction from shareholder groups to the House bill was quick and harsh, focusing principally on the proposed clarification to the redemption statute. Institutional shareholders, including the Pennsylvania State Employees' Retirement System, stated they would stop investing in Pennsylvania companies if the state rendered proxy fights impossible.[336]

331. *See Controversial Pa. Bill Would Make Takeovers More Difficult*, 22 Sec. Reg. & L. Rep. (BNA) 474 (Mar. 30, 1990) [hereinafter *Controversial Pa. Bill*]; *Takeovers Face New Obstacles*, N.Y. Times, Apr. 19, 1990, at D1, col. 3. A Washington, D.C. lawyer drafted the bill for the Pennsylvania Chamber of Business and Industry. Ironically, it was a threatened takeover by the Belzbergs of an Indiana corporation that prompted the statute upheld in *CTS*.

332. *See Legislative Brief: Pennsylvania*, 21 Sec. Reg. & L. Rep. (BNA) 1772 (Dec. 1, 1989) (describing bill's authorization to directors to consider the interests of communities, employees, suppliers, and the corporation's long-term health when faced with a bid); *Controversial Pa. Bill*, *supra* note 331, at 474 (describing bill's control-share provisions).

333. *See Pa. Rules Committee Curtails Reach of Takeover Bill Disgorgement Section*, 22 Sec. Reg. & L. Rep. (BNA) 600-01 (Apr. 20, 1990) [hereinafter *Committee Curtails Reach*].

334. *See* 15 PA. CONS. STAT. ANN. §§ 2541-48 (Purdon Supp. 1989). The redemption statute requires that if any person gains control of 20% or more of a firm's shares, shareholders may redeem their shares for a judicially-determined fair price, including a control premium. The statute does not explicitly exempt management buyouts, although Pennsylvania courts have read it to do so. The House bill sought to clarify lingering uncertainty about whether the redemption statute applied to shareholders who mounted a proxy fight, without actually buying stock. *Controversial Pa. Bill*, *supra* note 331, at 475.

335. *Id.* Greenmail is the practice of buying a substantial block of stock and threatening to launch a tender offer or proxy contest to take control unless management agrees to have the firm repurchase the block at a premium.

336. The chief investment officer of the $9.6 billion Pennsylvania State Employees' Retirement System said he would recommend that the fund stop investing in Pennsylvania companies if the bill were to pass. Cooney, *Debate Heats Up on Controversial Takeover Bill*, Reuters, Feb. 14, 1990 (reporting statement of Kenneth G. Mertz). The Institute of Shareholder Services in Washington,

They argued that the measure would be counter-productive, costing Pennsylvania jobs in the long run and making it hard for Pennsylvania firms to raise capital. Westinghouse and other Pennsylvania-incorporated firms threatened to reincorporate unless the bill was moderated, such as with an opt-out procedure.[337] SEC Chairman Breeden also criticized the bill for depriving shareholders of their proxy and governance rights, stating that the SEC "won't hesitate to enforce federal interests" in protecting shareholders' rights.[338]

In response to this criticism, the House deleted its clarification to the redemption statute.[339] Under the revised bill passed by the House in early April, any disgorged funds would have to be plowed back into expansion of the company's Pennsylvania operations.[340] The Senate amended the bill to clarify that disgorgement does not apply to those mounting a proxy fight for purposes other than gaining or changing con-

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which advises institutional investors on proxy and governance issues, said Pennsylvania corporations' stock would become "junk stock." *Controversial Pa. Bill*, *supra* note 331, at 475. Public pension funds in California, New Jersey, New York, Massachusetts, and Florida threatened to reassess their Pennsylvania holdings. *See id.*; *Takeovers Face New Obstacles*, *supra* note 331.

The threat of the Pennsylvania retirement fund to disinvest brought a vitriolic attack by the Pennsylvania Chamber of Commerce and Industry, the bill's principal proponent. *See Chamber of Business and Industry Responds to Statement of Ken G. Mertz*, PR Newswire, Feb. 14, 1990 ("Mr. Mertz's threats or warnings not-withstanding, it is the legislature of this commonwealth that sets the laws. Fund managers do not.... [T]o the extent a pension fund is a long-term shareholder, and not a speculator, Senate Bill 1310 will protect the long-term investments made in Pennsylvania companies by pension funds.")

The support of one institutional investor, the mutual-fund group Fidelity, created some controversy. Soon after weighing in against the bill, Fidelity was chosen to manage Armstrong's $180 million employee savings plan; it then changed course and backed the bill. *Pennsylvania Delays Takeover Vote Amid Disputes*, Reuters, Apr. 18, 1990.

337. Westinghouse, for instance, reluctantly supported the bill only after a provision was added allowing it and other companies to opt out. *See Takeovers Face New Obstacles*, *supra* note 331; Troy, *Takeover Bill to Be Amended*, U.P.I., Apr. 16, 1990.

338. Speaking to the Council of Institutional Investors, Breeden said the bill would deprive Pennsylvania firms' shareholders of the right to use the proxy system and would leave "management free to run the company into the ground." *Tough Anti-Takeover Bill Approved by Pennsylvania House*, 22 Sec. Reg. & L. Rep. (BNA) 514-15 (Apr. 6, 1990) [hereinafter *Tough Bill Approved*].

339. *See Tough Bill Approved*, *supra* note 338, at 514 (reporting on House vote). The House also deleted an exemption for management from the 1983 redemption statute.

340. A House Appropriations Committee fiscal note warned that although the bill would "prevent the economic and social upheaval associated with many takeovers, it could also encourage the entrenchment of mediocre management that could eventually reduce company profits and thereby both the taxes and dividends they would pay." *See Tough Bill Approved*, *supra* note 338, at 514. It pointed out that less-restrictive anti-takeover statutes in other states at least temporarily reduced stock prices. *Id.*

trol and to allow an opt-out for existing and newly-incorporated firms.[341] The bill then went to a House-Senate conference committee, which deleted the plow-back provision because of constitutional concerns.[342] With these revisions the bill passed in time for the legislature's spring recess. The day after it was signed, a Belzberg company and two Armstrong shareholders filed separate suits challenging its constitutionality.[343]

The disgorgement statute seems to strongly discourage proxy contests and tender offers. Nonetheless, the statute has at least two significant holes. First, because a firm can opt out of the statute by reincorporating as a new Pennsylvania corporation in which the articles specify the statute to be inapplicable,[344] a bidder or insurgent could make its control initiative contingent on shareholders approving the reincorporation after acquiring control. Second, because profits "belong to and are recoverable" only by the corporation, a successful bidder or insurgent could waive the rights or simply not exercise them after acquiring control; if a shareholder brought a derivative suit, the board presumably, could refuse demand.

The real burden, then, falls on *unsuccessful* bidders and insurgents. For example, resorting to greenmail if a takeover bid goes awry is not possible; an unsuccessful tender offeror cannot sell its toehold position (typically around five percent) to compensate for the expense of the failed effort; an insurgent could gain nothing if its overtures resulted in a favorable recapitalization or a white-knight merger. The extent to which the statutorily-created risks and uncertainty will actually discourage control changes has yet to be seen. But the history of takeovers, like the history of war, demonstrates that defenses are invariably surpassed by more potent offensive weapons. For instance, despite great concern (some of it no doubt strategic) that Delaware's antitakeover statute would kill takeovers, it has not.

341. 1990 PA. S.B. 1310 (to be codified at 15 PA. CONS. STAT. ANN. § 2571 (opt-out procedure during 90 days after enactment), 2573.1 (clarifying control)). *See* 22 Sec. Reg. & L. Rep. (BNA) 600 (Apr. 20, 1990); *Pennsylvania Delays Takeover Vote Amid Disputes*, Reuters, Apr. 18, 1990. The Senate committee also revised the disgorgement provision to exempt management purchases and narrowly defeated an "any time" opt-out scheme. *Committee Curtails Reach*, *supra* note 333, at 601.

342. *See Pa. Legislature Approves Modified Anti-Takeover Measure*, 22 Sec. Reg. & L. Rep. (BNA) 630 (Apr. 27, 1990).

343. *Pennsylvania Adopts Anti-Takeover Law*, U.P.I. (Apr. 27, 1990) (reporting challenging shareholders "are prepared to take the case to the Supreme Court if necessary").

344. 1990 PA. S.B. 1310 (to be codified at 15 PA. CONS. STAT. ANN. § 2571(b)(2)(ii)).

4. *Relieved federal courts and the invalidation of rule 19c-4*

Lower federal courts have perceived and been receptive to the *CTS* antitakeover blueprint, which leaves them a remarkably easy review task. Since *CTS*, courts have uniformily struck down statutes with an extraterritorial reach.[345] Although a comparative debate has developed about which statutes are better or worse for shareholders,[346] to date it has had little immediate legal consequence. Since *CTS*, no court has invalidated any antitakeover statute solely for being a ruse.[347]

In June 1990, the D.C. Circuit invalidated rule 19c-4, the SEC's one-share, one-vote rule.[348] The SEC had promulgated the rule under the authority of section 19(c) of the Exchange Act, which allows the SEC on its own initiative to amend rules of the stock exchanges and NASDAQ as it "deems necessary or appropriate . . . in furtherance of the purposes" of the Act.[349] The court held that "[b]ecause the rule directly controls the substantive allocation of powers among classes of shareholders" it intrudes into state corporate law and is beyond the agency's powers.[350]

345. Tyson Foods, Inc. v. McReynolds, 865 F.2d 99 (6th Cir. 1989) (invalidating Tennessee statute that applied to foreign corporations); Campeau Corp. v. Federated Dept. Stores, 679 F. Supp. 735, 739 (S.D. Ohio 1988) (invalidating Ohio statute that regulated "foreign businesses" that acquired "resident" corporations); TLX Acquisition Corp v. Telex Corp, 679 F. Supp 1022, 1029 (W.D. Okla. 1987) (invalidating Oklahoma statute with a jurisdictional reach comparable to the Illinois statute in *MITE*, the court stating its unconstitutionality was "certain" because it created an "impermissible risk of inconsistent regulation").

346. *See, e.g.*, Davis, *supra* note 52, at 506; Johnson, *State Takeover Statutes: Constitutionality, Community, and Heresy*, 45 WASH. & LEE L. REV. 1051, (1988) (comparing New York's and Delaware's business combination statutes to each other and to control-share statutes); Johnson & Millon, *Misreading Williams Act*, *supra* note 82 (arguing that fair-price and moratorium statutes are better designed against coercion than control-share statutes; moratorium statutes can be expected to be most expensive to shareholders); Oesterle, *Delaware's Takeover Statute*, *supra* note 2, at 881-82 nn.19, 20 (concluding that shareholder voting is less important under the Delaware statute than under Indiana's); Pinto, *Takeover Laws After* CTS, *supra* note 162, at 736 (comparing non-shareholder constituency statutes and Delaware's business combination statute); Note, *State Regulation of Takeovers: Delaware's State Statute Is Best Choice Available*, 14 J. CORP. L. 661 (1989).

347. *See* Hyde Park Partners, L.P. v. Connolly, 839 F.2d 837 (1st Cir. 1988) (invalidating statute that required bidders to disclose their control intentions, subject to a penalty of a one-year freeze on any takeover attempt if a bidder failed to make the required disclosure, on the ground that the penalty is preempted by the Williams Act's disclosure scheme for 5% acquisitions); Batus, Inc. v. McKay, 684 F. Supp. 637 (D. Nev. 1988) (invalidating statute that required the deposit of shares for a 60-day period after the commencement of a tender offer, on the ground that the period frustrated the Williams Act goals).

348. Business Roundtable v. SEC, 905 F.2d 406 (D.C. Cir. 1990).

349. Securities Exchange Act of 1934, § 19(c), 15 U.S.C. § 78s(c) (1988). *See* Securities Exchange Act of 1934, Rule 19c-4, 17 C.F.R. § 240.19c-4 (1990); Final Release, *supra* note 309.

350. *Business Roundtable*, 905 F.2d at 407.

The court stated that state law traditionally governed "the distribution of powers among the various players in the process of corporate governance."[351] The court focused on the assumption-intent dichotomy, also present in Williams Act preemption. Although admitting that the Exchange Act "contains an implicit assumption that shareholders will be able to make use of the information provided in proxy solicitations in order to vote in corporate elections,"[352] the court concluded that the assumption could not overcome the fact that Congress had "no . . . intention[s] . . . to interfere in the management of corporations."[353] Relying on the Supreme Court's "creature of state law" metaphor, the D.C. Circuit concluded the rule could well turn "regulation of the securities markets into the vehicle for federalizing corporate law."[354]

351. *Id.* at 411-12.

352. *Id.* at 411 (quoting Final Release, *supra* note 309, at 53 Fed. Reg. at 26,391-93). The SEC based its argument primarily on its authority under § 14(a) of the Exchange Act to regulate the proxy process. Securities Exchange Act of 1934, § 14(a), 15 U.S.C. § 78n(a) (1988). In addition, it also suggested it had authority under provisions empowering it to supervise exchange and NASDAQ registration, Securities Exchange Act of 1934 §§ 6(b)(5), 15A(b)(6), 15 U.S.C. §§ 78f(b)(5), 78o-3(b)(6) (1988), and those authorizing it to set up a national market system in securities. Securities Exchange Act of 1934 § 11A(a)(2), 15 U.S.C. § 78k-1(a)(2) (1988). The court concluded that each was bounded implicitly by the Act's "purposes," as is § 19(c) explicitly. *Business Roundtable*, 905 F.2d at 415-17 (also commenting that the 1975 amendments to the Exchange Act were essentially deregulatory, hardly "justifying regulation of corporate governance").

353. *Id.* at 411 (quoting Senate Committee on Banking and Currency, 1934 Senate Report at 10). *See also id.* (citing H.R. Conf. Rep. No. 1838, 73d Cong., 2d Sess. 35 (1934) (deleting as unnecessary section 13(d) of the bill, which the court found making explicit that the SEC could not "interfere with the management of the affairs of an issuer")).

An anomaly arises because of the interaction between the exchanges and the SEC. The exchanges are empowered to regulate corporate governance under their broad conditioning power, and the SEC is empowered to oversee the exchanges' rules. *See* Securities Exchange Act of 1934, §§ 6(b)(5), 15A(b)(6), 15 U.S.C. §§ 78f(b)(5), 78o-3(b)(6) (1988) (authorizing SEC in registering exchanges or NASDAQ to consider whether the proffered rules "in general . . . . protect investors and the public interest"). If the SEC's supervisory power were as broad as the exchanges' conditioning power, Rule 19c-4's validity would be virtually unquestionable. The court dealt with this by suggesting that the SEC's veto power over exchange rules dealing with matters of internal corporate governance could well be limited. *Business Roundtable*, 905 F.2d at 409-10 (commenting that the SEC has not exercised its veto and the breadth of the exchanges' rules "tells us nothing about the criteria of judgment the Commission may apply").

354. *Id.* at 412-13 & n.7 (quoting Santa Fe Indus. v. Green, 430 U.S. 462, 479 (1977) ("Corporations are creatures of state law, and investors commit their funds to corporate directors on the understanding 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." (quoting Cort v. Ash, 422 U.S. 66, 84 (1975))). The court's concern about a "slippery slope" into federal corporate law is marbled throughout the opinion. *Business Roundtable*, 905 F.2d at 410 (stating that "purposes" of Exchange Act can be framed at any level of generality if SEC's argument that it is empowered to ensure fair shareholder suffrage were accepted); *id.* at 411-12 (worrying that approval

5. *Still astute state courts*

Since *CTS*, the pressure on state courts to take an active role in resolving the broader takeover debate has abated. Not surprisingly, state courts, particularly Delaware's Supreme Court, have been increasingly deferential to management, with firm-specific defenses receiving less exacting judicial scrutiny.[355]

Nonetheless, Delaware's Supreme Court has not lost sight of its federalism role. After Delaware passed its business-combination statute, it became clear that the statute did not prevent politically infamous "bust-up" takeovers.[356] While the statute and its exemption for acquisitions of eighty-five percent or more of a firm's stock strongly discourage coercive partial or two-tier bids, acquisitions followed by asset sales remain possible. In *Paramount v. Time*, the Delaware court corrected this legislative failure with a vengeance.[357] In an opinion, largely incomprehensible except as part of a vertical federalism dialogue, the court stated that a bust-up acquisition, whether proposed by management or by a hostile bidder, would trigger a *Revlon* auction duty.[358] Because the auctioning of Delaware corporations, at least as the accepted "fair" procedure now stands, generates an intimidating "winner's curse,"[359] the court effectively dis-

of major issues traditionally governed by state law could be subject to the SEC's "discretionary control").

355. Paramount Communications, Inc. v. Time, Inc., 571 A.2d 1140 (Del. 1990); Shamrock Holdings v. Polaroid, Inc., 559 A.2d 257 (Del. Ch. 1989); Ivanhoe Partners v. Newmont Mining Corp., 535 A.2d 1334 (Del. 1987).

356. *See* Oesterle, *Delaware's Takeover Statute*, *supra* note 2, at 914-17 & n.138 (concluding that leveraged buyouts, whose financing is premised on selling off the target's assets, are still possible under the statute, largely because "[i]t may be common for . . . any-and-all offers to attract enough stock to meet the 85% cap").

357. 571 A.2d 1140 (Del. 1990). Others have alluded to the linkage between the constitutionality of antitakeover statutes and the role played by state courts. *See* Oesterle, *Delaware's Takeover Statute*, *supra* note 2, at 951 (suggesting that "the role of Section 203 in takeovers may well depend on whether the Delaware courts will police against self-serving behavior by target managers purporting to act on behalf of shareholders").

358. *See* Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 182 (Del. 1986) (invalidating asset lock-up because board had failed to conduct an auction when bust-up of the target became "inevitable"). The nearly uniform assumption about *Revlon* before *Time-Warner* was that the auction duty was more likely to be triggered, if not exclusively so, when management had an interest in a bid. When in *Revlon* the Delaware court said that the board had an auctioneer's duty when a "sale of the company became inevitable," this cleary implied that this was because management was bidding. 506 A.2d at 182. In fact, all the auction cases until *Time-Warner* involved either management bids or a self-imposed auction. *See* Gilson & Kraakman, *supra* note 124.

359. The "fair" auction process for Delaware firms seems to require that the board solicit the bidders' "best bid" and then institute additional rounds in which new "best bids" are solicited, until

couraged all but the most committed bust-up bidders or reorganizers.

B. Legality of the Current Corporate Federalism

By viewing *CTS* as a federalism gambit intended to solidify incorporation-based private ordering and to thwart federal intervention, some possible conclusions emerge about the current antitakeover regime.

1. The clear case against extraterritorial antitakeover statutes

The only insuperable federal regulation imposed by the *CTS* antitakeover blueprint arises from its prohibition against antitakeover statutes that are not incorporation-based. Only these statutes risk a patchwork of state regulation that would invite a congressional response or force courts to balance contact-based interests, either option a deviation from the value-neutral process effected by *CTS*. Lower federal courts have understood this.

2. The clear case for Delaware's statute

If anything, the *CTS* antitakeover blueprint is one designed for Delaware. Delaware's lack of shareholder contacts presents no problem because the statute is incorporation-based; Delaware thus has an interest in "its" corporations' shareholders, wherever they reside.[360] Further, even

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one bidder refuses to bid higher. *See, e.g.*, B. BURROUGH & J. HELYAR, BARBARIANS AT THE GATE: THE FALL OF RJR NABISCO 353, 395-501 (1990) (describing the auction for RJR Nabisco).

The winner, according to theories concerning auctions involving repeat bidders, will end up paying its reserve price (what it values the assets at) plus the *aggregate* of the transaction costs incurred by all the bidders in the auction. *See* Macey, *Auction Theory, MBOs and Property Rights in Corporate Assets*, 25 WAKE FOREST. L. REV. 85 (1990). This not-so-intuitive result can be explained with an example. Suppose a repeat bidder bids against nine other bidders and can expect to win once every ten times it bids. Each time it bids it incurs transaction costs, such as those for estimating the value of the firm, obtaining legal and tactical advice, and securing financing. During the bidding, when it reaches its reservation price, it will continue to bid in order to cut its losses. Dropping out at the reservation price would force the bidder to swallow all of its transaction costs; continuing and winning may minimize the size of the loss. But the same loss-cutting incentive also shapes the behavior of the other bidders. Our bidder, to have a chance of submitting the winning bid, must take into account that each of the other bidders will keep on bidding above its reservation price up to the point that winning produces just as big a loss as losing. Thus, our bidder will continue bidding up to the sum of its reservation price plus the aggregate of all the transaction costs of all the bidders in the auction. This aggregate represents the average of all the transaction costs over the course of ten auctions, where each bidder predictably wins once. *See* French & McCormick, *Sealed Bids, Sunk Costs, and the Process of Competition*, 57 J. BUS. 417, 424 (1984).

360. *See, e.g.*, Oesterle, *Delaware's Takeover Statute*, *supra* note 2, at 935 (concluding that *CTS*'s reference to the shareholder contacts required by the Indiana statute should not be read as a requirement).

though most Delaware-incorporated public firms operate primarily out of state, the internal affairs rule avoids the risk of any conflicts. Although Delaware might seem to provide out-of-state managers the protectionism which the state where their business is headquartered does not,[361] Delaware is as even-handed as was Indiana. Delaware's statute is unique because it protects without discriminating, accomplishing its purpose even-handedly for all public firms incorporated in Delaware that do business nationwide. At most, the statute protects Delaware's chartering dominance—and with it local chartering, franchise, and corporate bar revenues—but *CTS* makes clear the Supreme Court has no intentions of inquiring into the political economy of state chartering. If such protectionism is constitutionally suspect, then so is corporate federalism. The effect of its statute falls equally on bidders from Delaware, from the target's home state, and from other states.

Although adopting a Pro-shareholder, Pro-stakeholder, or Pro-state Hypothesis to explain *CTS* raises doubts about this analysis, we have seen that each conflicts with the *CTS* blueprint. Little suggests that the Supreme Court will intercede to stop Delaware from "sacrificing shareholder interests."[362] Because the Court seems prepared to intervene only to protect the process of corporate law—for example to forestall further federal intervention—the Court will not likely intercede. Delaware's incorporation-based statute, of all the third-generation statutes, is least at risk. Invalidating the Delaware statute—particularly given the relatively full representation of interests in the statute's adoption and its, at most, mild effect on shareholders—would compel the conclusion that the process of incorporation-based private ordering is unworkable and requires federalization.

3. *A tentative case for Pennsylvania's daring disgorgement statute*

Pennsylvania's disgorgement statute interferes neither with the process

361. *See id.* at 941.

362. *See, e.g.*, *id.* at 944 (arguing that *CTS* can be "read without strain" as whether the statute "in fact serve[s] the interests of the shareholders of Delaware corporations"). Although persuasive arguments can be made that the Delaware statute is both overbroad and underinclusive and that it impinges on shareholder autonomy, these same problems plagued the Indiana statute, but were of little concern to the *CTS* majority. *See supra* note 237 and accompanying text and *supra* note 254 and accompanying text. Even though the Delaware statute leaves arguably more discretion in the hands of managers to block an unwanted bid than did Indiana's, Powell's reference to at least four different explanations for why the statute benefitted shareholders strongly suggests the Delaware statute would easily survive a transfer/control rights review.

of tender offer bidding nor proxy voting. It is incorporation-based and serves the arguably legitimate purposes of preventing greenmail and forcing any acquirer of control to focus on the long-run. Although it may do this at far greater cost than it is worth, *CTS* clarifies that this irony (and subsidy) is not part of the antitakeover blueprint. The relevant point is that tender offers and proxy contests are still possible as a technical matter. It is also significant that the Pennsylvania legislative process led to moderation of the original bill. The capital and chartering markets are not neutralized. In fact, the fight over the disgorgement statute may have invigorated the process; institutional investors threatened to disinvest, and some Pennsylvania managers sought to opt out. The process legitimized by *CTS*, although imperfect, nonetheless functions.

The Supreme Court should predictably refuse to interject itself before the repercussions of the statute, both in its operation and its reception in other states, are felt fully. At present, there is no conflict in the circuits, literally or figuratively.[363]

4. *A good case for rule 19c-4*

The D.C. Circuit's invalidation of rule 19c-4 reflects a failure to see the rule in the broader context of the process of corporate federalism set into motion by *CTS*. From this perspective, much suggests the rule should have been upheld.[364] The decision did not result from an aggressive campaign of federalization; the SEC was a reluctant mediator. The rule mildly departed from traditional corporate federalism, regulating (with a number of exceptions) only one kind of entrenching device. Its conflict with specific state governance rules has limits—it does not affect other entrenching devices (such as ESOP parking) and explicitly excludes control share statutes. It arose out of and is confined to the SEC's oversight of stock listing requirements. Apparently, state principles will guide the rule's difficult interpretive questions—such as when a merger that effects a recapitalization is "bona fide."[365]

Although the D.C. Circuit worried about the slippery slope down which the rule might take the SEC, the firebreak proposed by the SEC

363. SEC Commissioner Grundfest commented, "If enough states adopt a Pennsylvania-type statute, they are begging for pre-emption." Sontag, *Will Feds Eventually Intervene?*, Nat'l L.J., Apr. 23, 1990, at 3, 22.

364. *Business Roundtable*, 905 F.2d at 407 n.1 (collecting law review articles).

365. Furthermore, all these questions are left to the SEC in the first instance, not the courts. *See* Chevron U.S.A., Inc. v. Natural Resources Defense Council, 467 U.S. 837 (1984).

seems wholly workable. The SEC suggested that "the unique historical background of the NYSE's one share, one vote rule"[366] separates the rule from wholesale intervention into corporate governance. This limitation would empower the SEC only to preserve longstanding exchange rules, but not to erect its own governance regime. Unlike broad-brush private enforcement of corporate "fairness" under section 10(b), which the Supreme Court rejected in *Santa Fe Industries, Inc. v. Green*,[367] rule 19c-4's breadth and enforcement fall primarily to the SEC, an agency with significant currency before the Supreme Court. If the Court meant for *CTS* to establish a corporate federalism process, it is difficult to justify excluding the SEC. In any event, such exclusion may well be futile. The SEC, using its "regulation by raised eyebrow" powers, suggested soon after the D.C. Circuit decision that the exchanges and NASDAQ implement voluntarily a one-share, one-vote listing condition.[368]

V. An Evaluation of *CTS* Corporate Federalism

In many respects, *CTS* and its corporate federalism can be judged in much the same way as any other federalism gambit. Will the process legitimated by *CTS* predictably encourage state experimentation, foster responsive local government, and promote national unity—as compared to the federalized alternatives?[369] *CTS* forces a comparison of state-based corporate law, and in particular antitakeover statutes, with the likely product of federal intervention. The Court's failure even to allude to this comparison looms as the case's greatest blind spot.

This Part sketches the federalism analysis absent in *CTS*, focusing on the wisdom of *CTS* corporate federalism as it applies to antitakeover

366. Brief for Respondent SEC, at 21 n.24, *quoted in Business Roundtable*, 905 F.2d at 413. The D.C. Circuit understood the argument to mean that Congress had implicitly approved the rule; the SEC pointed out that the legislative history of the Exchange Act contained favorable references to the NYSE's rule. *Id.*

367. 430 U.S. 462 (1977).

368. *See Business Roundtable*, 905 F.2d at 410 n.5 (citing Schwartz, *Federalism and Corporate Governance*, 45 OHIO ST. L.J. 545, 571 (1984)). *See also* Wall. St. J., June 13, 1990, at A3-4, col. 2 (reporting that "SEC market regulation director Richard Ketchum called on the exchanges to adopt uniform 19c4-type rules" and stated " 'There's always been a wide degree of consensus [among the exchanges and the NASD] that there should be voting rights rules [and] I hope that staring into the vacuum, they will respond' ").

369. *See generally* L. TRIBE, *supra* note 169, § 6-35, at 539-40. Many misconceive the question posed by *CTS* as one comparing federal regulation with state regulation. *See, e.g.*, Davis, *supra* note 52, at 503.

statutes.[370] It pursues the comparison along the traditional federalism lines of inquiry, which coincidentally largely parallel the analytical frameworks of the free-marketers, the public-choice theorists, and the reformists.

A. *Incorporation-based Efficiency: The Adequacy of Constraints in the Market for Antitakeover Statutes*

Federal regulation of the market for antitakeover statutes can be justified if such statutes produce externalities. As we have seen, both the reformists and many free-marketers essentially claim that antitakeover statutes have characteristics of public goods consumed by managers (and perhaps non-shareholder stakeholders) who do not fully internalize the costs shifted by the statutes to shareholders—the statutes are suboptimal.[371] Others, in particular Professor Coffee, argue that antitakeover statutes control opportunism by shareholders and bidders, whose control transactions do not internalize the costs borne by managers when their expectations in a "long-term promise" with the firm are taken without compensation—the statutes are optimal.[372] Although the debate can be pursued in the abstract,[373] it is relatively meaningless as a critique of *CTS* or the current antitakeover regime. Instead, the appropriate debate—framed as one of federalism—begins with whether forces that optimally balance the competing interests constrain the market for

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370. To keep the problem tractable, I do not pursue a fuller inquiry into the wisdom of *CTS* corporate federalism, as applied beyond antitakeover statutes.

371. Reformists argue that antitakeover statutes differ little from, and perhaps are worse than, generic corporate codes. *See, e.g.*, Garfield, *supra* note 116, at 571. Free-marketers attempt to place the statutes in a different category. *See, e.g.*, Butler & Ribstein, *The Contract Clause*, *supra* note 207 (arguing that antitakeover statutes, and other state law intrusions by judges and politicians without the same incentives as the private parties, interfere with efficient private ordering; suggesting that the contract impairment clause safeguard against government interference in this private ordering); Fischel, *From* MITE *to* CTS, *supra* note 3.

372. Coffee, *Strain in the Web*, *supra* note 34, at 91. Coffee argues that antitakeover statutes and defenses serve as cost-saving alternatives to formalizing implicit promises to managers and other constituents of stability. Reasonable expectations in these promises, according to Coffee, are usurped without compensation and redistributed to shareholders, in a takeover.

373. Coffee's redistribution theory suffers from a number of defects. As Professor Oesterle argues, modern contract doctrines, including that of good faith, could enforce Coffee's "long-term promises" (if true); severance pay clauses could serve the purpose; and the theory is overbroad, ceding to managers greater power to behave opportunistically than is denied to shareholders. *See* Oesterle, *Delaware's Takeover Statute*, *supra* note 2, at 943; Oesterle, *The Rise and Fall*, *supra* note 95, at 242. Empirical evidence also undercuts the theory. Stakeholders fare no better, and may fare worse, in management takeovers (LBOs and recapitalizations) compared to hostile takeovers. *See supra* note 80 (describes effect of takeovers on workers).

antitakeover statutes, and then compares this constrained market to a likely federal product.

To date, analysis of the constraints on the antitakeover regime has been far too narrow, perhaps because corporate reformists and free-marketers generally agree. For the reformists, the antitakeover regime spawned by *CTS* confirms the fears of a "race to the bottom." Delaware's decision to enact antitakeover legislation, despite the absence of a local shareholding or employment constituency, also confirms their fears. For the free-marketers, the antitakeover statutes present a market paradox, correctable only by federal intervention. The free-marketers' assumption that states will not purposefully offer managers, nor will managers choose, a significantly suboptimal set of corporate rules depends on the interaction of a number of markets, most significantly a healthy market for corporate control. But antitakeover devices are specifically designed to weaken that market's disciplining effects.[374] While extolling the chartering market, the free-marketers deplore the dysfunctional market for antitakeover statutes.

Neither camp sees the existence of much constraint. Nonetheless, Professor Romano correctly (and virtually alone) identifies the legacy of *CTS* corporate federalism as political. The wisdom of the current state-based antitakeover regime is not merely a question of efficiency, but whether state political forces produce a better takeover regime than would the federal political process. The account of these political forces, however, is incomplete. The market for antitakeover statutes seems to operate under far more constraints, many of them political, than has been recognized. That *CTS* and its third generation of antitakeover statutes has not squelched takeover activity nor abated the call by some management groups for greater federal tender offer regulation suggests that the legislature-in-the-pocket explanation for the state antitakeover regime may be incomplete.[375]

374. The paradox that a healthy chartering market depends on a healthy control market, but a weak control market is likely if the chartering market is not healthy, also holds true for the chartering market, though in diluted form. If certain incorporation statutes suboptimally offer managers excessive flexibility to opt out of the control market, managers will not be disciplined for their suboptimal choice, particularly in the case of mature businesses in which equity capital needs may not be great and the risk of bankruptcy is minor. *See* Davis, *supra* note 52, at 510-11.

375. Romano, *Future of Hostile Takeovers*, *supra* note 51, at 465 & n.20 (reporting that even after the Delaware antitakeover statute the National Association of Manufacturers continued to lobby Congress for amendments to the Williams Act that would increase beyond 20 days the tender offer waiting period and require additional disclosure about bidder's intentions and financing).

Before turning to these constraints, it is important to keep our bearings. Speaking of an "optimal" or "better" federalism means making important value judgments. An efficiency comparison of a state-based regime and federal intervention may be empty, for even if it is possible to gauge the constraints under which each operates, the comparison cannot work without making assumptions that essentially presuppose the result. The comparison forces the choice of a referent by which to measure the results. Should corporate federalism maximize shareholder wealth; minimize externalities on non-shareholder constituencies; legitimize managerial prerogatives; or take into account the human costs of economic dislocation? A full efficiency analysis thus requires resolving the empirical questions of where takeover premiums originate and how antitakeover statutes reallocate the premiums, as well as the distributive question of which sources matter to us.[376]

For present purposes, I pursue a much less ambitious task, identifying the constraints on the market for antitakeover statutes from the perspective of shareholders.

1. Market constraints

That a market in antitakeover statutes exists seems clear enough. Many states enacted third-generation statutes in response to Delaware's adoption of its business combination statute, which in turn had been prompted by concerns that firms would reincorporate outside Delaware if the state did not act. Pennsylvania's recent disgorgement statute is the latest competitive entry.

From the shareholders' perspective, a number of market forces constrain managers in choosing a statutory antitakeover regime. Antitakeover statutes come in an integrated package, which unlike the provisions of a model form contract cannot be plucked and adopted piecemeal. As state corporate law now stands—its incorporation-based nature entrenched by the internal affairs doctrine—an incorporated firm can use only the package offered by its chartering state, even though other states may offer more desirable pieces. Because of this, managers may be reluctant to reincorporate simply because of the perceived advantages of another state's antitakeover regime.[377] For example, firms must balance a

376. *See, e.g.*, Johnson & Millon, *Missing the Point*, *supra* note 34, at 847-48 (arguing that shareholder wealth maximization should not be the exclusive measure for antitakeover statutes, whose purposes are much more encompassing).

377. *See, e.g.*, Bernstein, *How to Keep Raiders at Bay—On the Cheap*, BUS. WEEK, Jan. 29,

Delaware-incorporated firm's decision to take advantage of Pennsylvania's new antitakeover package with the additional costs of Pennsylvania incorporation, including a less-developed body of caselaw, a more partisan judiciary, a potentially more fickle legislature, and a less experienced and sophisticated corporate bar than Delaware's. By the same token, firms must balance the decision to reincorporate in Delaware against the loss of local political responsiveness.

The managers' need to raise capital also contrains the market for antitakeover statutes. Even if such antitakeover statutes dampen the discipline flowing from the control market, managers' desire for the prestige and the predictably higher compensation that come with overseeing a larger business may constrain the choice of which antitakeover regime managers opt into.[378] The recent experience in Pennsylvania illustrates the operation of these constraints.

Further, the possibility of a takeover (even if by proxy fight) is not completely foreclosed—and, indeed, could not be if the Williams Act and proxy regulation under the Exchange Act are understood to place some bounds on state interference with control rights. The increasing receptiveness of institutional shareholders to proxy fights and their increasing success suggests that managers may find that faith in the invulnerability of a state's antitakeover regime—and lax performance—only invites exposure in the control market.[379] The history of takeover defenses shows that those seeking control find ways around them.

2. *Wings effects of threatened federal intervention*

In addition to these market constraints, the threat of federal intervention always looms in the wings, producing a regulating effect.[380] States that go too far in abdicating to manager opportunism risk federalization in the form of federal preemption or occupation. The reformists and

1990, at 59 (reporting that some executives who are impressed with the possibilities under the Delaware antitakeover statute view reincorporating in Delaware as not "worth the hassle").

378. The Indiana Chamber of Commerce made a similar argument in *CTS*, which said that if a statute allows manager opportunism, firms incorporated in the state will have difficulty attracting equity investors. Managers of such disadvantaged firms will find that their own value fall in the executive labor market. Ind. Chamber of Comm. Brief, *supra* note 68, at 20.

379. *See* Conard, *Beyond Managerialism: Investor Capitalism?*, 22 U. MICH. J. L. REF. 117, 131-51 (1988) (describing increased institutional investor activism on takeover issues).

380. The academic literature rarely mentions the federal wings effects, but it is a prevalent theme of the popular takeover literature. *See, e.g.*, B. BURROUGHS & J. HELYAR, *supra* note 359, at 267, 390-91, 513; Sontag, *supra* note 363.

free-marketers, focusing almost exclusively on the competition among chartering states,[381] disregard this important force. Because it carries the risk of true regulation, it may be far more potent than state competition.

The evidence of a wings effect is compelling. At an obvious level, the states' circumspection in the second-generation antitakeover statutes indicated their awareness of *MITE*'s federalization. The relative restraint, particularly in Delaware, in the third generation indicates at the least caution toward *CTS*. The base-level transfer/control rights apparently federalized in *CTS* and the possibility of intervention against blatant protectionism affected the course of the Pennsylvania statute. A state law that allowed managers to withdraw from the control market, that blatantly protected the local employment or tax base, or that was not incorporation-based would face federal intervention.

CTS is not the only floor. Calls for federal intervention gained the attention of the third-generation drafters, with apparent effect. Moreover, federal disclosure laws may embarrass managers into not reincorporating opportunistically.

The control market is sensitive, perhaps hypersensitive, to this wings effect. In October 1987, the proposed House Ways and Means tax bill that would have limited the deductibility of interest incurred to finance takeovers, leveraged buyouts, and recapitalizations sent shudders through the control market.[382] The investment community pointed to the tax bill as the fundamental cause of the dramatic ten percent decline

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381. *See* Romano, *Law as Product*, *supra* note 28, at 227-32 (summarizing state competition literature). A few, however, have recognized a federal wings effect, though without elaboration. *See* Garfield, *supra* note 116, at 592 (concluding that Delaware's "restraint [in its business combination statute] is probably best explained by Delaware's concern with a federal preemptive response").

382. H.R. 3545, Budget Reconciliation Act of 1987, 100th Cong., 1st Sess. §§ 10138-40, 10142-44 (1987). The bill sought to discourage both friendly and hostile takeovers, though treating them slightly differently. For friendly deals, it would have eliminated deductions for interest expenses exceeding $5 million a year on debt incurred to acquire more than 50% of another firm's stock or of a firm's own stock in a recapitalization. For hostile takeovers, it would have made nondeductible all interest on debt used to finance the acquisition of more than 20% of a targets's stock or assets. The House Ways and Means Committee's purposes were clear:

> The Committee believes that corporate acquisitions that lack the consent of the acquired corporation are detrimental to the general economy as well as to the welfare of the acquired corporation's employees and community. The committee therefore believes it is appropriate not only to remove tax incentives for corporate acquisitions, but to create tax disincentives for such acquisitions.

H.R. REP. NO. 391, 100th Cong., 1st Sess. 1086 (1987). *See also* Mitchell & Netter, *Triggering the 1987 Stock Market Crash: Antitakeover Provisions in the Proposed House Ways and Means Tax Bill*, 24 J. FIN. ECON. 37, 39 (1989); Solomon & Dicker, *The Crash of 1987: A Legal and Public Policy Analysis*, 57 FORDHAM L. REV. 191, 225-26 (1988).

of October 14-16, which precipitated the October 19 freefall. Event studies comparing stock price changes to events related to the bill seem to confirm these suspicions.[383]

Evidence of the wings effects exists in the congressional takeover forum in which the securities industry, shareholder groups, bidders, and management groups have participated. One must wonder why Congress continues to hold regular hearings on takeovers, and why members of Congress continue to introduce takeover bills, whose provisions would both increase regulation of tender offers and limit takeover defenses. The hearings and bills, experience makes clear, go nowhere. But they are portentous messages to drafters of state antitakeover statutes: "If the states don't watch out, the feds might."

3. *State populism*

The legitimacy of antitakeover statutes has depended on creating the appearance that the interests of shareholders and other constituents are being served. This quells popular antipathy toward special-interest politics, as well as satisfying legal restrictions at the state level on private legislation.[384] The rhetoric and politics of populism constrains the form,

383. The bill's antitakeover provisions were introduced in the late afternoon of October 13, 1987, and were approved by the House Ways and Means Committee in the late afternoon of October 15. On October 14 and 16 (the two trading days immediately following announcement of the bill's introduction and approval), the Standard & Poors 500 index fell 2.9% and 5.2%. On October 28, when committee Chairman Rostenkowski suggested there might be changes to the antitakeover provisions, the index rose 4.9%, and on October 29 when he formally indicated the statute would be modified, it rose 2.9%. During the next month Rostenkowski indicated his willingness to modify the provisions, which were finally dropped in a House-Senate conference on December 15. The next day, stock prices rose 2.2%. *See* Mitchell & Netter, *supra* note 382, at 43-44 (tables 1 and 2).

Mitchell and Netter found these stock price changes statistically significant for general stock prices and for a portfolio of firms that were takeover targets. *Id.* at 44, 50 (tables 2 and 3). In addition, trading by arbitrageurs, who bear the risk of regulatory restraints on the control market, confirms that takeover investment was linked to the tax bill. *Id.* at 53 (table 4). Although the authors found some evidence marginally linking the October 14 decline to the announcement of a higher than expected trade deficit, no other significant contemporaneous events occured on the other four event dates associated with the bill. *Id.* at 59-62.

Although the tax bill seems to have triggered the initial decline, institutional and structural factors such as index arbitrage and portfolio insurance inherent in the equities (cash), futures, and options markets were largely responsible for the October 19 freefall. REPORT OF THE PRESIDENT'S TASK FORCE ON MARKET MECHANISMS (Jan. 1988); DIVISION OF MARKET REGULATION, SECURITIES AND EXCHANGE COMM'N, THE OCTOBER 1987 MARKET BREAK, REPORT (Feb. 1988). *See also* Solomon & Dicker, *supra* note 382 (concluding that the decline was triggered by fundamental factors, but exacerbated by index arbitrage and the buying of portfolio insurance).

384. In some states, state constitutional prohibitions against special-interest legislation mandate this political populism. *See* Macey, *Promoting Public-Regarding Legislation Through Statutory In-*

if not substance, of antitakeover statutes. Other political actors, besides management, have a presence in the legislative process of antitakeover statutes.[385]

Over time, the forces of populism predictably will work with the politics of generic corporate law to limit manager opportunism in antitakeover statutes. As the corporate bar becomes involved in revising antitakeover statutes as part of its periodic review of generic corporate codes, its preference for rules that invite uncertainty and litigation—or, stated more graciously, rules that balance the competing interests in a takeover—will tend to produce more moderate versions of antitakeover statutes than those drafted and enacted in the desperate heat of a takeover battle.[386] As this happens, the political currency of new takeover targets to tighten these moderated statutes will begin to wane. Populism can only stomach so much special-interest politics.

B. A Political Comparison: A Preferable, but Paralyzed, Congress

The Coase Theorem predicts that with few exceptions an efficient result will follow regardless of the existing legal rules whenever competing interests are represented in a negotiated solution, provided transaction costs are not too high.[387] The Theorem, though not a theory of political philosophy, is reflected in the prevalent assumption that federal takeover legislation will reflect "rational economic thought,"[388] because interests, besides those of managers—including shareholders, bidders, stakeholders—will be better represented at the federal level than they are currently at the state level.[389] A political perspective thus avoids choosing an efficiency referent. A fully represented negotiated solution would decide the

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terpretation: An Interest Group Model, 86 COLUM. L. REV. 223, 232-33 (1986); Romano, *Future of Hostile Takeovers*, *supra* note 51, at 469.

385. *See* Coffee, *Corporate Federalism*, *supra* note 51; Johnson, *supra* note 9, at 868-69, 923 (concluding that the legal community "screen[s] and translate[s] widely held social norms into legal doctrine").

386. *See supra* note 318 (revisions of extraterritorial statutes); *supra* notes 328-34 and accompanying text (legislative history of Pennsylvania's recent disgorgement statute).

387. *Coase, The Nature of the Firm*, 4 ECONOMICA 386, 390-94 (1937), *reprinted in* READINGS IN PRICE THEORY 331, 336-39 (G. Stigler & K. Boulding eds. 1952). Professor Schwab suggests that because the Theorem purports only to predict the result of bargaining under low transaction costs, it is more accurately described as a Prediction. Schwab, *Coase Defends Coase: Why Lawyers Listen and Economists Do Not*, 87 MICH. L. REV. 1171, 1176 (1989).

388. *See, e.g.*, Langevoort, *A Comment on* CTS, *supra* note 2, at 123.

389. *See, e.g.*, Davis, *supra* note 52, at 501 (concluding shareholder groups better represented at the federal level).

distributive question of whose interests matter.[390]

1. Is representation likely to be fuller at the federal level?

Managers, consumers in the chartering market, are better represented at the state level than are shareholders. Even though states, through state employee pension funds, are often the largest single shareholder in any given state, shareholders never took part in the politics of the second-generation statutes and remain on the periphery in the third generation.[391] Neither institutional shareholders, individual shareholders, nor bidders form a cohesive group at the state level.[392] Because to be effective they would have to conduct effective lobbying at the state level on numerous fronts, free-riding predictably discourages any one shareholder or bidder from making the effort, particularly against the odds of cohesive management opposition.[393]

Based on her assessment of federal legislative activity before *CTS*, Professor Romano entertained little hope for a broad-based federal takeover response, concluding that shareholders are as diffuse and unorganized at the federal level as at the state level and that any federal takeover response would mirror that of the states.[394] Romano found, as might be expected, that bills introduced in Congress during the period between *MITE* and *CTS* looked much like state second-generation statutes. Assuming that any federal legislation would be based on some extant proposal, Romano imagined a mandatory regime that increased the difficulty

390. In the same vein, some have argued that such questions as the desirability of control markets, the problems of bidder overpayment, industrial policy and resource allocation can only be addressed comprehensively in Congress. *See* Davis, *supra* note 52, at 513-14; Macey, *State Legislation*, *supra* note 3, at 488.

391. *See, e.g.*, *Hearings: Tender Reform (Part I)*, *supra* note 295, at 447 (statement of Roland M. Machold, director, Division of Investments for the State of New Jersey) (stating that "corporate influence at the State level is very powerful and . . . investor interests are dispersed and very weak"). *See also* Davis, *supra* note 52, at 502 (describing passivity of Wisconsin pension fund during enactment of Wisconsin's antitakeover statute); Oesterle, *Delaware's Takeover Statute*, *supra* note 2, at 889 n.51 (describing similar passivity by Delaware's Board of Pension Trustees).

392. *See, e.g.*, *Hearings: Tender Offer Reform (Part II)*, *supra* note 297, at 22 (statement of Joseph I. Lieberman, Attorney General of Connecticut) (supporting the result in *CTS* even though Dynamics is domiciled in Connecticut). *See also* Romano, *Future of Hostile Takeovers*, *supra* note 51, at 468.

393. Macey & Miller, *supra* note 28.

394. Romano, *State Competition Debate*, *supra* note 60, at 712-13 (suggesting that there is no reason to think that "diffuse and unorganized" shareholders would be any more capable of communicating their views to Congress than to state legislatures). *See also* Garfield, *supra* note 116, at 597 & n.312.

of takeovers or an opt-out federal antitakeover statute modeled on a state version, different only from the state counterparts in that it would have a national scope.

But *CTS* reversed the direction of the federalism winds, and Romano's prediction seems flawed at two levels. First, the antitakeover spirit of the pre-*CTS* bills was more likely caused by *MITE* itself, which placed the constitutionality of a state response in serious and universal doubt, than any intrinsic congressional antipathy to takeovers. Before and after *CTS*, Congress provided a forum for those who had been denied an effective remedy elsewhere. The pre-*CTS* bills generally reflected antitakeover interests; many post-*CTS* bills have contained proposals for federal preemption of state antitakeover legislation.

Second, continuing congressional paralysis and the spectrum of groups that have spoken on the takeover issue in congressional hearings, particularly following *CTS*, contradicts a theory of federal legislative capture. Institutional shareholders, the securities industry, and recently, noninstitutional shareholders have been well represented in Congress, collectively perhaps better than management interests.[395] Although free-riding may pose a problem, for many institutional investors, the expense of lobbying at the federal level may be relatively small, at least no more an impediment than it is for management groups.[396] For example, after the October 1987 stock market crash, Wall Street immediately and successfully sought to kill the House Ways and Means antitakeover provisions.[397] In addition, the SEC, traditionally a significant voice in Congress, has a securities industry and shareholder bias, if not a mandate.

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395. *Institutional* shareholders can and have organized before Congress. *See* Romano, *Future of Hostile Takeovers, supra* note 51, at 503 & n.112. In the takeover context their interests will generally overlap with individual shareholders.

In other contexts, individual shareholders appear to have been far more poorly represented. For example, under the Investment Company Act of 1940—the federal regulation of mutual funds, the poor woman's stock portfolio—statutory protection against investment advisor self-dealing is tolerated under a deferential waste standard. Inv. Co. Act § 36(b) (codified at 15 U.S.C §§ 80a-1-80-b-21 (1988)). *See, e.g.*, Meyer v. Oppenheimer Management Corp., 895 F.2d 861, 866 (2d Cir. 1990) (upholding fees paid by fund for sales and distribution pursuant to Rule 12b-1 plan, since they "were not so disproportionately large that it bears no reasonable relationship to the services rendered and could not have been the product of arm's-length bargaining") (quoting Gartenberg v. Merrill Lynch Asset Management, Inc., 694 F.2d 923, 928 (2d Cir. 1982), *cert. denied*, 461 U.S. 906 (1983)).

396. In the post-*CTS* hearings, the College Retirement Equities Fund sent a representative to testify before Congress. *See Hearings: Regulating Corporate Takeovers, supra* note 293, at 354 (statement of James S. Martin, executive vice president of CREF).

397. Langley, *Wall Street Interests, Aided by Reagan, Seek to Kill Anti-takeover Tax Rules*, Wall St. J., Oct. 30, 1987, at 16, col. 1.

If anything, congressional response to takeovers has historically evinced a remarkably pro-Wall Street attitude. As noted before, significant lobbying by the securities industry prompted Congress to moderate the Williams Act, which as originally proposed was decidedly antitakeover.[398] Today, the interests of the securities industry and shareholder groups on the question of state antitakeover powers have coalesced, and the latter appear to be better represented than in the past. Despite significant pre-*CTS* pressure on Congress to do something, nothing happened.

Why is this so? One answer may be that members of Congress answer to a different set of political expectations than do state legislators. At the state level, local issues and protectionism are significant components of state politics; state legislators perceive corporate law, rightly or wrongly, as a significant element in the package that leads a business to migrate to or from the state.[399] The scorecard for state legislators' re-election revolves around the electorate's perceptions on local issues, such as how well the legislator serviced constituents and how well state government fostered local employment.[400]

At the federal level, incumbency depends to a greater extent on the electorate's perceptions about the national economy and the effectiveness of national government, for which members of Congress are held accountable.[401] Preventing the country from an economic downturn motivates members of Congress, which helps explain why for the last decade protectionism has been an unpopular issue in Congress. For example, a

398. *See supra* note 85 and accompanying text. *See also* Piper v. Chris-Craft Indus., Inc., 430 U.S. 1, 22 (1977) (commenting that the original Williams Act proposal, which was "avowedly pro-management," evolved in response to "positions expressed by the SEC and other interested parties from private industry and the New York Stock Exchange") (quoting 113 CONG. REC. 854 (Jan. 18, 1967) (remarks of Sen. Williams)). The Williams Act compromise may have reflected little more than a division of spoils between the securities industry, interested in transactional fees, and corporate management. Empirical studies suggest that the Act extracts a price from bidders without increasing the price to shareholders. *See supra* note 159. The interests of the securities industry and of shareholders may not always coincide.

399. *See* Garfield, *supra* note 116, at 560-62 (reporting efforts by state and local chambers of commerce to attract business).

400. M. JEWELL, REPRESENTATION IN STATE LEGISLATURES 48 (1982).

401. As Professor Romano points out, few members of Congress are affected by any one takeover. Romano, *Future of Hostile Takeovers*, *supra* note 51, at 477. Although in any significant takeover a handful of senators and representatives can be expected to want to protect their constituents, there will predictably be a lack of general consensus on any given takeover. In fact, if takeovers are efficient, the rational course for a federal legislator would be to introduce a specific bill, garnering local support for the effort, and hope that it goes nowhere. That certainly has been the pattern. *Id.* (citing bills introduced by members of Congress on behalf of particular takeover targets in their states or districts, though the bills make no progress).

recurring theme of the post-*CTS* congressional hearings was the effect takeovers have on United States competitiveness, and whether the conversion of debt into equity in leveraged buyouts heightens the risk of a recession. Neither subject has proved relevant in the politics of state antitakeover statutes. By contrast, witness Congress' quick retreat from the antitakeover provisions of the House Ways and Means bill.

The current congressional paralysis reflects that Congress more than the states integrates the competing views on takeovers.[402] The congressional hearings are replete with statements by members of Congress of the importance of a "level playing field."[403] The absence of a national consensus and, in some instances, the inability of takeover actors to identify their own interests reduces the pressure for a federal response. For example, it is still unclear whether on balance leveraged takeovers help or hurt the federal budget, which at the same time create enormous capital gains and transform equity into deductible debt. As Professor Romano reports, voters generally oppose takeovers; but takeovers confuse them, and ultimately they become indifferent.[404] And so the irony: Congress is more representative, but because of this less likely to act.

Public-choice theory also predicts this outcome. The conditions for federal legislative deference to state law exist for takeover regulation. States, particularly Delaware, have made significant investments in their antitakeover regimes; states offer a wide and growing variety of antitakeover options; and in an area in which no national consensus exists, states stand to take the blame for takeover regulation's failure.[405] From a managers' perspective, state corporate law, with a constitutionalized internal affairs doctrine, represents a desirable substitute for federal legislation.

402. *See* Macey, *Public Choice: The Theory of the Firm and the Theory of Market Exchange*, 74 CORNELL L. REV. 43, 46 (1988) (concluding that Congress tries to alienate as few interest groups as possible).

403. For example, Senator Metzenbaum stated: "Despite the abuses, some takeovers do improve management and help achieve a company's potential. Congress should not tilt the takeover playing field one way or the other. It should only ensure that it is level and that it is fair." *Hearings: Corporate Takeovers, supra* note 295, at 2.

404. Romano, *Future of Hostile Takeovers*, *supra* note 51, at 490-95 (reporting "constancy" in polls, but "confusion in public perceptions" about takeovers and a preference for state regulation).

405. Macey, *Federal Deference to Local Regulators and the Economic Theory of Regulation: Toward a Public—Choice Explanation of Federalism*, 76 VA. L. REV. 265, 274-76 (1990). This also explains why Congress has had less difficulty regulating national capital markets. No state had, or in the 1930s could constitutionally have had, a dominant blue-sky regime; local diversity of securities regulation was antithetical to predictable, uniform standards which capital markets crave; and the Depression left Congress with no one to blame.

Only one (pliant) legislature need be lobbied; state legislatures and courts (particularly Delaware's) are as capable as Congress and the federal judiciary; federal paralysis assures state law's preeminence. Indeed, managers will find state corporate law better than federal law because an incorporation-based regime allows exit, which could well be unavailable under a federal scheme. Theory matches reality: Congress is stalemated.

As desirable as a federal solution might be—such as one requiring that antitakeover statutes be offered only on an opt-in basis[406]—the possibility may not be realistic. The Supreme Court, whose wings presence may be more strongly felt than any other market or regulatory force, has an important continuing gatekeeping role.

2. *Is the federal government likely to be more responsive?*

The federalism assumption that states can be more experimental, and hence more responsive to market demand, finds support in the corporate context. The history of corporate law reflects a self-correcting market.[407] The variety and growth of antitakeover statutes prove, if nothing else, that the state antitakeover regime is flexible and responsive. There has been significant product differentiation among the statutes, particularly when compared to generic corporate codes. The recent Pennsylvania disgorgement statute demonstrates the range of possibility at the state level; the spectacle of individual firms obtaining a legislative response in less than a week powerfully evidences states' willingness to please.[408]

Even a fully-represented, negotiated federal solution would predictably be less fluid or flexible than the current incorporation-based regime. By definition, no federal solution would be final; adjustment inevitably would be necessary. But Congress has become an ineffective institution in a climate of rapid change; mistakes would not be easily corrected; re-

406. Garfield, *supra* note 116 (recommending that federal legislation require opt-in statutes with disclosure requirements to overcome shareholder ignorance); Romano, *State Competition Debate*, *supra* note 60 (similar proposal).

407. *See* Butler, *Nineteenth-Century Jurisdictional Competition in the Granting of Corporate Privileges*, 14 J. LEGAL STUD. 129, 138-52 (1985) (describing monopolistic abuses under the special charter system which were corrected through general incorporation statutes).

408. *See supra* note 117 and accompanying text. Further evidence of this response to market demand is Delaware's court system, which can hear important takeover cases at the trial court level, handle an appeal and reach a final decision in less than 10 days. *See* Coffee, *The Mandatory/Enabling Balance in Corporate Law: An Essay on the Judicial Role*, 89 COLUM. L. REV. 1618, 1622 (1989) (concluding that Delaware's specialized courts are better than federal judiciary); Moore, *State Competition: Panel Response*, *supra* note 132, at 780 (describing process).

sponses to new market conditions would not be quick.[409] Even delegation to the SEC would suffer from the political illegitimacy of having far-reaching policy decisions made by a single, politically unaccountable administrative agency. Further, federal transaction costs arising from federal delay and indecision, as well as the mindset of state corporate law, might offset the advantage of full representation. Because of these transaction costs, the Coase Theorem predicts a suboptimal solution.

An expanded federal role could force on the federal judiciary heightened corporate law responsibilities to make adjustments and mediate conflicts unresolved by Congress.[410] An inkling of how the courts might perform that role arises from the story of *CTS*, in which the Supreme Court had to reverse itself after Congress failed to react to the enormous federalizing potential of *MITE*. To illustrate, Professor Kozyris has suggested that Congress should federalize "transferability" rights, preempting state law that encroaches on effective transferability, whether in the form of antitakeover statutes or a generic corporation rule that authorizes firm-specific defenses, such as poison pills.[411] Putting aside the question whether Congress has the political will to do this, the task of determining which statutes and defenses unduly "encroach" on control markets would essentially put the SEC or the courts in the position of deciding substantive economic policy.[412] The wisdom of *CTS* and corporate federalism is that such imponderables are left to a fluid, adjustable process.

Further, competing regulatory models would not constrain any unitary federal corporate regulation, except to the extent the failure of United States corporate policy eventually leads to business flight outside the United States. Firms could not easily migrate from bad federal law.[413] Neither a chartering market nor the wings effects of higher-level intervention would significantly constrain federal action.

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409. Romano, *Future of Hostile Takeovers*, *supra* note 51, at 477-78. State mistakes—for example, *Smith v. Van Gorkom* and *Singer*—are capable of relatively rapid adjustment.

410. Macey & Miller, *supra* note 28, at 501 (pointing out judicial activity will have little effect on inter-group activity if "legislature acts quickly to restore the terms of the original bargain by nullifying the court's decision through subsequent statutory enactment").

411. Kozyris, *Corporate Takeovers at the Jurisdictional Crossroads: Preserving State Authority Over Internal Affairs While Protecting the Transferability of Interstate Stock Through Federal Law*, 36 UCLA L. REV. 1109 (1989).

412. For example, more than three years after *CTS* commentators cannot agree whether the Indiana control-share statute helps or hurts shareholders. *Cf.* Booth, *State Takeover Statutes Revisited*, *supra* note 235; Butler, *Corporation-Specific Statutes*, *supra* note 3.

413. Coffee, *Corporate Federalism*, *supra* note 151, at 761.

But the states-as-laboratories argument is fundamentally flawed because antitakeover statutes create effects outside the enacting state. The statutes, though perhaps "novel social and economic experiments,"[414] produce effects that cannot be quarantined. They restrain freedom in capital markets, employment markets, supply markets, and corporate control markets throughout the country. A corporate law experiment gone awry has repercussions far beyond the state's political borders. As responsive as the state markets for charters and antitakeover statutes are, the ultimate question is to whom. If the captive-legislature view is correct, the social and economic cost of waiting for the process to run its course may not be worth the price. Again, the Supreme Court has an important role to play.

C. *National Unity: The Empty Fear of Retaliation*

Although federalization has been justified to deflate the impetus for state retaliation,[415] state antitakeover statutes are immune from *state* retaliation by virtue of the constitutionalized internal affairs doctrine. For example, when the Indiana statute forced CTS shareholders to subsidize the desire of the firm's managers (and perhaps other non-shareholder constituents) for stability, out-of-state shareholders and bidders, including Connecticut-based Dynamics, felt the effect. But Connecticut or any other state, even if one were inclined to retaliate by enacting a protakeover statute, such as one requiring CTS managers to be passive, would be powerless directly to do so under *CTS*. Nor does it prove meaningful to do so indirectly by excluding CTS from conducting business in Connecticut. *CTS* leaves the Supreme Court as the only federalism player capable and suited to adjusting its antitakeover blueprint.

CONCLUSION

A federalism perspective of *CTS* offers a coherent explanation for the decision's blueprint for a state-based antitakeover regime. No other provides as useful or appropriate a framework.

The decision's effect can be summarized:

(1) *CTS* forbids antitakeover statutes from interfering with the Wil-

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414. *See* New State Ice Co. v. Liebmann, 285 U.S. 262, 311 (1932) (Brandeis, J., dissenting) ("It is one of the happy incidents of the federal system that a single courageous State may, if its citizens choose, serve as a laboratory; and try novel social and economic experiments without risk to the rest of the country.").

415. Regan, *The Dormant Commerce Clause*, *supra* note 169, at 1114.

liams Act bidding process (and implicitly the proxy process under the Exchange Act), forcing states to machinate statutes that operate by redefining shareholder voting, appraisal, and redemption rights.

(2) *CTS* weakly federalizes shareholder transfer/control rights. Shareholders must retain "voice" or "exit" rights—that is, the ability to oust management by either voting their shares or selling them to someone who can. For the Court to have done less would have risked setting into motion the demise of state-based corporate federalism.

(3) *CTS* constitutionalizes the internal affairs doctrine, but somewhat inconsistently refuses to place into the balance economic justifications for shareholder free-trading rights. Although *CTS* seems to withdraw meaningful review of the political motives of state chartering, a federalism understanding of the case suggests that the Court may implicitly have retained some supervisory authority.[416] Discriminatory protectionism, a theory undeveloped in the *CTS* record, is not sanctioned.

This *CTS* blueprint leaves takeovers subject to decentralized private markets, incorporation-based state facilitation, and a federal-state dialectic. No one corporate constituent is necessarily a winner or loser. The process catalyzed by *CTS* saves the federal judiciary (and for that matter each of the federalism players) from resolving definitively the empirical and policy takeover debate. From the Court's perspective, not only does this preserve federal judicial resources and credibility, it legitimizes the Court's role as federal/state gatekeeper. By restoring state corporate law to its traditional status after the *MITE* scare, the Court would seem to have nothing to lose and everything to gain.

The *CTS* gambit sets into motion a process, with which the Court need not (and predictably will not) interfere until it is clear how it is playing out. Nonetheless, because *CTS* may not have anticipated or taken into account the congressional takeover stalemate, the importance of the Court's gatekeeping role is heightened. *CTS* retains one, perhaps two, tools to perform this gatekeeping function. First, the federalizing reach of the Exchange Act or the Williams Act is available to ensure basal shareholder transfer/control rights; state products of the process can be subjected to minimal substantive standards. Second, although not an explicit part of the *CTS* blueprint, the commerce clause's broad prohibitions against protectionism can be revived to ensure transactional

416. Just as in the contract impairment cases, where the Court judges state legislation on the basis of whether it had a public or private impetus, such an analysis could well guide the commerce clause analysis.

justice; the Court did not foreswear reviewing the political economy of state antitakeover statutes.[417] Both tools can and should be used consistently with *CTS*'s commitment to a process in which no federalism player receives or must assume a definitive role. In particular, *CTS* wisely stanches the federalization implicit in *MITE* and that which would have become inevitable were the internal affairs doctrine not constitutionalized.

In the end, *CTS* situates the Supreme Court as a catalyst in the corporate federalism balance, neither a reagent, searching for the ideal balance, nor a reactant, participating actively in the results. It is a vital role. The takeover stakes are too great for the Court not to keep the game honest.

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417. *See*, DeBow & Lee, *Understanding (and Misunderstanding) Public Choice: A Response to Farber & Frickey*, 66 TEX. L. REV. 993, 1010 (summarizing the debate between those who advocate an expanded role for the courts in reviewing rent-bestowing governmental action under a rights-based theory and those who emphasize the constitutional limits to the judicial function and the limited judicial capacity for substantive evaluation of economic legislation). *Compare* Epstein, *Judicial Review: Reckoning on Two Kinds of Error*, 4 CATO J. 711, 715-16 (1985); Siegan, *Rehabilitating* Lochner, 22 SAN DIEGO L. REV. 453, 454 (1985), *with* Bork, *The Constitution, Original Intent, and Economic Rights*, 23 SAN DIEGO L. REV. 823, 830 (1986); Scalia, *Economic Affairs as Human Affairs*, 4 CATO J. 703, 705 (1985).