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Second Generation State Takeover Legislation: Maryland Takes a New Tack

In *Edgar v. MITE Corp.*, the Supreme Court held unconstitutional the Illinois Business Take-Over Act, which regulated attempts to gain corporate control by means of a tender offer. A majority of the Court agreed only that the law violated the commerce clause. Three Justices also found that federal tender offer legislation preempted the Illinois Act under the supremacy clause of the Constitution. Although it set few clear standards, the *MITE* decision did not

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4. Chief Justice Burger and Justices Powell, Stevens and O'Connor joined Justice White's opinion of the Court holding that the Illinois statute placed impermissible indirect burdens on interstate commerce. Four Justices, Burger, White, Stevens and O'Connor, found that the Illinois Act was also invalid because it placed a direct burden on interstate commerce.
5. These Justices were Burger, White and Blackmun. The dissenting Justices, Brennan, Marshall and Rehnquist, did not reach the merits because they believed that the case was moot.
6. In pre-*MITE* decisions most lower federal courts invalidated state takeover laws on two grounds, holding both that the state laws were preempted by federal tender offer regulation and that the laws violated the commerce clause. See cases cited at note 44 infra. The commerce clause test applied by the Supreme Court in *MITE* called for balancing the burdens the Illinois statute placed on interstate commerce against the local benefits it produced. See notes 75-83 infra and accompanying text. This test provides few clear standards for evaluating the constitutionality of new and different forms of state takeover legislation. Had the court been able to agree on some version of preemption analysis, it might have quieted the controversy surrounding the constitutional status of state takeover regulation. Resolution of the preemption issue would have required definition of the policies behind federal tender offer regulation and an examination of the effect state regulation has on those policies. See Anderson, *The Meaning of Federalism: Interpreting the Securities Exchange Act of 1934*, 70 VA. L. REV. 813, 842-45 (1984). Such an
explicitly prohibit all state efforts in the tender offer area. Thus, certain state legislatures have responded with what might be termed a "second generation" of takeover legislation. Their objective is to avoid constitutional conflict while retaining a meaningful regulatory role for the states in the takeover process.

This Note examines the approach recently adopted by the Maryland legislature in special session one year after the Supreme Court's decision in MITE. Maryland has departed radically from the regulatory approach of first generation statutes; however, this Note argues that the statute has failed to escape the constitutional infirmities of its predecessors. Part I outlines the various mechanisms that regulate acquisition of corporate control: the federal tender offer regulatory mechanism known as the Williams Act, state takeover legislation such as the Illinois statute invalidated in MITE, and the new Maryland statute. Part II analyzes the debate concerning the constitutionality of state takeover legislation. Part III applies this analysis to the examination in MITE would have perhaps provided lower federal courts with more guidance in dealing with the new state takeover statutes.

7. The commerce clause balancing test leaves greater room for state efforts in the tender offer area than does preemption analysis. See Edgar v. MITE Corp., 457 U.S. at 646 (Powell, J., concurring in part) ("I join . . . [the view that the balancing test invalidates the statute] because . . . [this] Commerce Clause reasoning leaves some room for state regulation of tender offers.").

8. While most states simply amended or repealed those aspects of their takeover laws the Supreme Court found objectionable in Edgar v. MITE Corp., a number of states developed new methods for regulating takeovers. Most of the new state statutes follow one of three models: the Ohio approach, the Maryland approach, or the Pennsylvania approach.

Under the Ohio statute, Ohio Rev. Code Ann. §§ 1701.01, .11, .37, .48, .831, .832, 1707.01, .042, .23, .26, .29, .99 (Baldwin Supp. 1983), the acquisition of controlling blocks of target shares requires an affirmative vote of target shareholders approving the acquisition. The Maryland legislation, Md. Corps. & Assns. Code Ann. §§ 3-601 to 3-603 (Supp. 1984), imposes supermajority voting requirements and fair price provisions on business combinations such as mergers. The Pennsylvania statute, 15 Pa. Cons. Stat. Ann. §§ 1408(B), 1409.1(C) (1)-(3), 1910 (Purdon 1984-85 Supp.), restricts the voting rights of "interested shareholders" in certain corporate transactions such as mergers and provides disinterested shareholders a right of re-deemption for their shares if a person or group acquires 30% of the corporation's stock.

Because the statutes are recent, they have yet to generate much law review commentary. However, a few articles by attorneys practicing in states with the new statutes have appeared. See Krieder, Fortress Without A Foundation? Ohio Takeover Act II, 52 U. CIN. L. REV. 108 (1983); Newlin & Gilmer, The Pennsylvania Shareholder Protection Act, 40 BUS. LAW. 111 (1984); Scriggins & Clarke, Takeovers and the 1983 Maryland Fair Price Legislation, 43 MD. L. REV. 266 (1984); see also Profusek & Gompf, State Takeover Legislation After MITE: Standing Pat, Blue Sky, or Corporation Law Concepts?, 7 CORP. L. REV. 3 (1984).


10. First generation statutes focus on the tender offer for a controlling interest in the target corporation. The Maryland statute is aimed at regulating what the tender offeror may do (e.g., attempt to force a merger) after it has gained working control. The Maryland approach does, however, affect certain types of tender offers known as "two-tiered" or "two-step bids." See notes 48-49 infra.

11. For an article on the Maryland statute that takes a contrary position, see Scriggins & Clarke, supra note 8.

Maryland approach. It argues that while a court may find that the Maryland approach fails the commerce clause balancing test employed in MITE, the Maryland approach is most clearly subject to attack on the ground that it is incompatible with congressional objectives embodied in the Williams Act. Thus, the Maryland statute will force the courts to readdress the preemption issue left unresolved in MITE.13

I. THE REGULATORY MECHANISMS

A. The Williams Act

It is important to see how first generation statutes, such as the Illinois Business Take-Over Act, built on the Williams Act. Originally, one of the greatest attractions of the cash tender offer device14 was the speed and secrecy with which an offeror could gain control of the target corporation.15 This benefit to tender offerors worked to the disadvantage of target shareholders who were forced to make important investment decisions in a short period of time.16 The Williams Act is designed to protect investors. It attempts to give investors the time and information necessary to evaluate critically the terms of a tender offer by imposing disclosure and substantive requirements on tender

13. See note 6 supra.

14. Depending on the type of consideration offered, a tender offer may be described as an exchange offer or a cash offer. In an exchange offer, tendering shareholders receive securities in exchange for their shares. In a cash tender offer, tendering shareholders give up their equity for cash.

Cash tender offers have proven to be more popular than exchange offers in the hostile takeover bid setting. Exchange offers are subject to more cumbersome registration requirements than cash offers. See note 15 infra. The greater speed and surprise of the cash offer device benefits tender offerors by minimizing the time for target management to set up a defense or for other offerors to make a competing bid. See Troubh, Purchased Affection: a Primer on Cash Tender Offers, HARV. Bus. REV., July-Aug. 1976, at 79, 80.


16. See S. REP. No. 550, supra note 15, at 2; H.R. REP. No. 1711 at 2, reprinted in 1968 U.S. CODE Cong. & Ad. News at 2812, supra note 15 ("[B]y using a cash tender offer the person seeking control can operate in almost complete secrecy. . . . [T]he investor is severely limited in obtaining all of the facts on which to base a decision whether to accept or reject the tender offer.").
The Williams Act provides that a person who acquires beneficial ownership of more than five percent of the shares of a publicly held corporation registered under section 12 of the Securities Exchange Act must disclose detailed information concerning its identity, background and plans for the target. Disclosure must be made on the date of the commencement of the tender offer. Target management is also subject to the disclosure requirements of the Williams Act.

Senator Williams, the chief sponsor of the Act, explained the purpose of the bill before Congress: "This legislation will close a significant gap in investor protection under the Federal Securities laws by requiring the disclosure of pertinent information to stockholders when persons seek to obtain control of a corporation by a cash tender offer . . . ." 113 CONG. REC. 854 (1967). See also Piper v. Chris-Craft Indus., 430 U.S. 1, 24-37 (1977) (discussing the legislative history of the Williams Act).


The 5% figure represents congressional intent to insure disclosure of securities accumulations that have the potential for affecting corporate control and hence the market value of the security. The Williams Act originally mandated disclosure upon 10% acquisition. Congress lowered the figure to 5% as part of the 1970 amendments to the Williams Act in order to provide public disclosure at a more meaningful level. See Brown, The Scope of the Williams Act and Its 1970 Amendments, 26 BUS. LAW. 1637 (1971).

Section 12 applies to issuers engaged in or affecting interstate commerce whose securities are either listed on a national securities exchange or are held on record by at least 500 persons if the issuer has total assets exceeding $1 million. The $1 million figure has recently been increased to $3 million by the SEC under its rulemaking authority in order to account for inflation. Sec. Ex. Act of 1934 Release No. 18,647, 25 SEC Dock. (CCH) 49 (1982).

A significant number of corporations that are quoted over the counter and do not meet the alternate section 12 requirements are therefore exempt from section 14(d) of the Williams Act. Instead, as states limit the reach of their takeover statutes to tender offers for exempt corporations they may successfully avoid a constitutional challenge on preemption grounds. This Note focuses on the application of state takeover statutes to tender offers that are covered by section 12 of the 1934 Act and section 14(d) of the Williams Act.

The acquirer must fill out a Schedule 13(D) (for private negotiations or open market purchases), 15 U.S.C. § 78m(d)(1) (1982), or a Schedule 14(D) (for tender offers) § 78n(d) (1982). The information required in each is substantially the same. The acquirer must disclose its background and identity, the source and amount of funds to be used in making the purchases, and its purpose in making the purchases (e.g., to gain control of the target in order to merge it with another corporation or to sell the target's assets). The SEC is authorized to require additional information in order to protect investors. 15 U.S.C. § 78n(d)(1) (1982). The required additional information is set out in SEC Rule 14d-6, 17 C.F.R. § 240.14d-6 (1984). For a general discussion of the disclosure requirements of the Williams Act, see Schmults & Kelly, Disclosure In Connection With Cash Takeover Bids: The New Regulations, 24 BUS. LAW. 19 (1968).


23. Section 14(d)(4) of the Williams Act requires that anyone who recommends to target shareholders to accept or reject a tender offer must comply with SEC rules and regulations.
Despite the pro-management bias of the earlier versions of the Act, the final version attempts to equalize offerors' and target management's opportunity to appeal to the stockholders.

The Williams Act also contains three substantive provisions regulating public tender offers. The object of these provisions is to protect investors by alleviating some of the pressure inherent in deciding when or indeed whether to tender their shares. These provisions regulate the withdrawal rights of tendering shareholders, the tender offeror's duties to purchase shares when an offer is oversubscribed, and the

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SEC Rule 14e-2 requires the target company to address its stockholders on the question of how they should respond to the offer. The target company must publish a statement within 10 business days of the tender offer indicating that management: (1) Recommends acceptance or rejection of the offer, (2) Expresses no opinion and is remaining neutral toward the offer, or (3) Is unable to take a position with respect to the offer and explains the reasons for this inability. 17 C.F.R. § 240.14e-2 (1984).

24. Fears that management and investors had to be protected from corporate "raiders" provided the initial impetus behind federal tender offer regulation. See 111 Cong. Rec. 28,257 (1965) (Remarks of Sen. Williams) ("[T]he Federal Securities laws remain inadequate in one notable respect. They fail to take proper cognizance of the activities of corporate raiders."); see also Piper v. Chris-Craft Indus., 430 U.S. 1, 30 (1977).

25. According to the Senate Committee:

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

S. REP. No. 550, supra note 15, at 3. The shift away from the antitakeover stance of the original Williams Bill is an important indicator of congressional intent in tender offer regulation. The legislative history of the final version of the Act suggests Congress determined to leave tender offer markets relatively unfettered in recognition that tender offers may benefit target investors and the national economy. See notes 87-111 infra and accompanying text.

26. The Act provides for withdrawal rights within the first seven days of the offer and 60 days after the offer becomes effective. 15 U.S.C. § 78n(d)(5) (1982). The object of this provision is to give tendering shareholders an opportunity to reconsider their offer of stock for tender if, for instance, target management sheds new light on the desirability of the offer or if there is a competing offer. See 113 Cong. Rec. 856 (1967) (remarls of Sen. Williams). Section 14(d)(5) empowers the SEC to extend the withdrawal period if necessary to protect investors. The SEC has extended the period to 15 business days from the commencement of the offer. 17 C.F.R. § 240.14d-7(a)(1) (1984).

27. In the situation where a tender offer is made for less than all of the total outstanding shares of the target (a partial offer), the offer may be oversubscribed. The Act requires the tender offeror to take up tendered shares pro rata according to the number of securities tendered by each stockholder in the first 10 days of the offer. If the consideration for target shares is increased, a new pro rata period is applicable for 10 days after the increase. 15 U.S.C. § 78n(d)(6) (1982).

This provision was designed to reduce the pressure on a target shareholder to sell his or her shares quickly. Originally, tender offerors purchased securities on a "first come, first served" basis. The pro rata provision insures acceptance of at least a portion of a shareholder's shares submitted within the appropriate time period. Safe in this knowledge, the shareholder may take the time necessary to assess the offer instead of feeling compelled to tender immediately for fear of the offer being oversubscribed. See 113 Cong. Rec. 856 (1967) (remarks of Sen. Williams); Hearings on H.R. 14473 and S. 510 Before the Subcomm. on Commerce and Finance of the Comm. on Interstate and Foreign Commerce, 90th Cong., 2d Sess. 11 (1968) (remarks of Manuel F. Cohen, Chairman, SEC).

A recent rule promulgated by the SEC has extended the pro-rata period to include the entire offer period. 17 C.F.R. § 240.14d-8 (1984). The SEC expressed the view that the 10-day period
consideration paid to tendering shareholders. In addition to these three substantive provisions, the Williams Act contains an anti-fraud provision. This provision makes it unlawful to make any untrue statement or material omission or to engage in any fraudulent, deceptive or manipulative practices in connection with any tender offer.

B. First Generation State Takeover Legislation

After Congress passed the Williams Act, state legislatures began to develop tender offer regulation of their own in order to correct perceived weaknesses in the federal regulatory scheme. While state efforts in this area are hardly uniform, first generation statutes often contain certain core provisions. Some of these provisions are simply more stringent cousins of the disclosure and substantive provisions of the Williams Act. However, provisions for notification of state authorities and target management before commencement of a tender offer, administrative hearings and fairness determinations concerning the terms of a tender offer, and "friendly" offer exemptions are unique.

28. If a tender offeror increases the consideration offered to nontendering shareholders, that increase must be paid to all tendering shareholders, whether the shares were tendered before or after the increase. 15 U.S.C. § 78n(d)(7) (1982). The purpose of this provision is to insure equal treatment of all tendering shareholders. See H.R. REP. No. 1711 at 11, reprinted in 1968 U.S. CODE CONG. & AD. NEWS at 2821, supra note 15.

29. 15 U.S.C. § 78n(e) (1982). This provision applies to the statements and omissions of anyone who attempts to influence the decision of investors faced with a tender offer. Thus, it applies to target management as well as to the tender offeror.

30. Most state takeover statutes require tender offerors to disclose more information than is required by the Williams Act. See, e.g., GA. CODE ANN. § 22-1902(b) (Supp. 1984); HAWAII REV. STAT. § 417E-3(c) (Supp. 1982); Wis. STAT. § 552.05(2)(c) (1981); see also Note, A Failed Experiment: State Takeover Regulation After Edgar v. MITE Corp., 1983 U. ILL. L. REV. 456, 463 (discussing the disclosure provision of the Illinois Act).


31. The notification period varies among the states. See, e.g., N.Y. BUS. CORP. LAW § 1602 (McKinney Supp. 1984-85) (no extra period); ARK. STAT. ANN. § 67-1264.25 (1980) (10-day period); Illinois Business Take-Over Act § 4, ILL. REV. STAT. ch. 121-1/2, § 137.54(E) (1981) (repealed 1983) (20 days); N.C. GEN. STAT. § 78B-4(a) (1981) (30-day period); HAWAII REV. STAT. § 417E-3(f) (1976) (60 days). By contrast, the Williams Act requires only that the tender offeror file its disclosure statement on the day of the commencement of the offer. See note 22 supra and accompanying text.

32. Many state takeover statutes provide for mandatory or discretionary administrative review of materials disclosed by the tender offeror in order to insure compliance with statutory
to state statutes.

The professed intent behind these provisions is to give investors more time to consider the merits of a tender offer. Proponents of state takeover legislation suggest that such an intent is consonant with congressional design. But, the effect of most first generation statutes is to delay the effectiveness of a tender offer. Opponents of state takeover legislation argue that the delay produced by state statutes impermissibly upsets the Williams Act's neutral balance between tender offerors and target management by making it easier for target management to defeat a tender offer. If the state statutes undermine requirements. See, e.g., MASS. GEN. LAWS ANN. ch. 110C, § 2 (Michie/Law. Co-op. 1984); N.Y. BUS. CORP. LAW § 1604 (McKinney Supp. 1984-85). In the case of the Illinois Act invalidated in MITE, a hearing could be called for the purpose of determining the substantive fairness of the offer. Illinois Business Take-Over Act § 7, ILL. REV. STAT. ch. 121-1/2 § 137.57E (1981) (repealed 1983). Substituting administrative judgments concerning fairness for market controls has been heavily criticized. See Sargent, supra note 2, at 719; Note, supra note 30, at 463-64.

33. Many state takeover statutes exempt from coverage those tender offers that are approved by target management and are subject to shareholder vote. See, e.g., ALASKA STAT. § 45.57.110(2)(E) (1980); MICH. COMP. LAWS ANN. § 451.904(2)(d) (West Supp. 1984-85) (enforcement of statute enjoined as a probable burden on interstate commerce in Martin-Marietta Corp. v. Bendix Corp., 690 F.2d 558 (6th Cir. 1982)). The friendly offer exemptions arguably benefit investors by inducing tender offerors to negotiate with their fiduciaries, target management; however, these exemptions have been construed as primarily benefiting management. See note 38 infra.

34. The stated purpose of most state statutes has been to provide increased investor protection. Some states, however, clearly wanted to protect in-state management from the threat of a takeover. Compare Illinois Business Take-Over Act § 1.1, ILL. REV. STAT. ch. 121-1/2, § 137.51-1 (1981) (repealed 1983) (investor protection), with 1976 KY. ACTS 534 (codified at KY. REV. STAT. §§ 292.560-630 (1981)) (prevention of takeover bids). Moreover, despite the declared statutory goal of investor protection, many commentators believe that many statutes were designed to attract corporate domiciliaries or to remove in-state corporations' incentive to reincorporate in a state with a more favorable statute. If such a parochial intent may beattributed to the state statutes, they are subject to a strong commerce clause and preemption attack. See Langevoort, State Tender-Offer Legislation: Interests, Effects and Political Competency, 62 CORNELL L. REV. 213, 241-53 (1977); Wilner & Landy, The Tender Trap: State Takeover Statutes and Their Constitutionality, 45 FORDHAM L. REV. 1, 18 (1976); Note, Commerce Clause Limitations Upon State Regulation of Tender Offers, 47 S. CAL. L. REV. 1133, 1159 (1974). But cf. Note, Response to Great Western, supra note 3, at 895-905 (questioning why state statute's proffered purpose should be rejected).

35. Pre-commencement notification and administrative hearing provisions can slow down the tender offer process. Such provisions make it easier to insure full disclosure and help to reduce the pressure atmosphere surrounding a tender offer. See Sargent, supra note 2, at 716-19; Note, Response to Great Western, supra note 3, at 916; Note, Securities Law and the Constitution: State Tender Offer Statutes Reconsidered, 88 YALE L.J. 510, 524 (1979).

36. See Sargent, supra note 2, at 717; Note, supra note 35, at 524; Note, Response to Great Western, supra note 3, at 916.

37. Both proponents and opponents of state takeover statutes agree that the statutes introduce delay into the takeover process. Sargent, supra note 2, at 717 (proponent); Wilner & Landy, supra note 34, at 9 (opponents). The constitutional issue is whether by introducing this delay the states have overstepped the bounds of permissible regulation.

38. See E. ARANOW, H. EINHORN & G. BERLSTEIN, DEVELOPMENTS IN TENDER OFFERS FOR CORPORATE CONTROL 225-29 (1977) [hereinafter cited as DEVELOPMENTS]; Langevoort, supra note 34, at 249; Moylan, State Regulation of Tender Offers, 58 MARQ. L. REV. 687, 700 (1975); Wilner & Landy, supra note 34, at 25-29. Delay may benefit target management for a number of reasons. Management gains time to implement defensive tactics such as amending the
the federal policy embodied in the Williams Act then they are subject to attack under the preemption doctrine. 39

Delay of the effectiveness of a tender offer may also impermissibly burden interstate commerce. 40 However, even more constitutionally suspect under the commerce clause are the jurisdictional provisions of many first generation state statutes. 41 Under these state statutes a state could regulate tender offers for targets incorporated and doing business in other states if a required percentage of target shareholders reside in the forum state. 42 The extraterritorial reach of state takeover legislation may subject tender offerors to the difficult task of complying with the varying requirements of different state statutes. 43 This possibility, when coupled with state statutory provisions that tend to delay the tender offer process or otherwise aid target management, has led courts to strike down first generation state takeover legislation on commerce clause grounds, preemption grounds, or both. 44

corporate charter, searching for a friendly corporation or "white knight" to make a competing bid, or having the target buy up its own stock. On defensive tactics see generally DEVELOPMEN TS, supra, at 193-202; TENDER OFFERS, supra note 3, at 219-76.

Even if target management abstains from employing defensive tactics, delay will permit market forces to work to management's advantage:

A target's most effective defensive tactic is to stall for time, allowing market forces to make it undesirable for shareholders to relinquish their securities. A public announcement of a tender offer will stimulate open-market purchase of the target's securities by present shareholders or speculators expecting to realize a quick profit on their short term investment. Active trading will raise the price of the target's securities, and, as the market price draws closer to the tender offer price, the economic incentive for shareholders to sell their stock will fade.

Wilner & Landy, supra note 34, at 10 (footnotes omitted).

Friendly offer exemptions do not create delay, but have been criticized as pro-management devices inconsistent with the regulatory neutrality of the Williams Act. See Great Western United Corp. v. Kidwell, 577 F.2d 1256 (5th Cir. 1978), revd. on other grounds sub nom. Leroy v. Great Western United Corp., 443 U.S. 173 (1979); Sargent, supra note 2, at 698; Shipman, Some Thoughts About the Role of State Takeover Legislation: The Ohio Takeover Act, 21 CASE W. RES. L. REv. 722, 767 (1970).

39. See notes 84-85 infra and accompanying text.
40. See notes 76-77 infra and accompanying text.
41. See note 69 infra.

42. For example, the Illinois Act at issue in Edgar v. MITE Corp., 457 U.S. 624 (1982), applied to a tender offeror acquiring at least 5% of the outstanding shares of a target corporation. The statute defined a target as a corporation in which Illinois shareholders owned 10% of the class of securities subject to the tender offer or for which any two of the following conditions were met: (1) the corporation had its principal executive office in Illinois; (2) it was organized under Illinois law; (3) it had at least 10% of its stated capital and paid-in surplus represented within the state. Illinois Business Take-Over Act § 2.10, ILL. REV. STAT. ch. 121-2, § 137.52-10 (1981) (repealed 1983).

43. See MITE Corp. v. Dixon, 633 F.2d 486, 502 (7th Cir. 1980) ("[T]he disruptive effects of the Illinois Act could be duplicated by other states seeking simultaneously to assert jurisdiction over a tender offer."); affd. sub nom. Edgar v. MITE Corp., 457 U.S. 624 (1982). However, this criticism is "somewhat muted" with respect to the Illinois Act, which permitted, under its comity provision, the state administrator to defer to other jurisdictions in appropriate circumstances. MITE Corp. v. Dixon, 633 F.2d at 502 n.31.

44. For some pre-Edgar v. MITE decisions, see, e.g., Kennecott Corp. v. Smith, 637 F.2d 181 (3d Cir. 1980) (granting preliminary injunctive relief against the New Jersey takeover statute on the ground that the statute was likely to be declared preempted by the Williams Act); MITE
C. Maryland Statute

In 1976 the Maryland General Assembly enacted the Maryland Corporate Takeover Law.45 This statute, like most first generation state takeover legislation, regulated the tender offer as a means of gaining corporate control. In September, 1982, a federal district court ruled Maryland's 1976 Act unconstitutional on preemption and commerce clause grounds.46 In a June, 1983, special session, the Maryland General Assembly passed a bill that adopts a new approach to the problems of corporate takeovers and state protection of stockholders' interests.47 The Maryland statute regulates what is often called the second "step" or "tier" of a takeover process.48 Instead of regulating the tender offer process itself, the new statute regulates what course of

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45. 1976 Md. Laws 1712 (codified at MD. CORPS. & ASSNS. CODE ANN. §§ 11-901 to 11-908 (Supp. 1984)).


47. The emergency bill, simply named House Bill No. 1, repealed and reenacted with amendments MD. CORPS. & ASSNS. CODE ANN. §§ 3-202, 8-301(12) & 8-301(13). New sections, MD. CORPS. & ASSNS. CODE ANN. §§ 8-301 through 8-303 inclusive and §§ 8-301(14) were added.

48. In the first tier or step of a "two-tier" takeover bid the offeror gains control of the target through open market purchases of target shares, privately negotiated purchases or a tender offer. In the second step, the purchaser or tender offeror uses its control to obtain complete ownership of the target usually by merging the target corporation into itself. See Toms, Compensating Shareholders Frozen Out in Two-Step Mergers, 78 COLUM. L. REV. 548, 548 (1978); Comment, Front-End Loaded Tender Offers: The Application of Federal and State Law to an Innovative Corporate Acquisition Technique, 131 U. PA. L. REV. 389, 389-92 (1982).
action a tender offeror may take after it has succeeded in gaining a controlling interest in the target.\textsuperscript{49}

The Maryland statute responds to concerns over the vulnerability of minority target shareholders after a successful tender offeror assumes control.\textsuperscript{50} By virtue of its controlling interest, the tender offeror may be able to make fundamental changes in the target's corporate structure against the will of the remaining target shareholders.\textsuperscript{51} The Maryland General Assembly found most objectionable the tender offeror's ability to "freezeout"\textsuperscript{52} minority shareholders at a price lower

\textsuperscript{49} The Maryland statute does, however, regulate "front-end loaded two-tier tender offers." That is, instead of making an offer for 100% of the target shares at one price the two-tier tender offeror may announce that it will make an offer for less than 100% of the target's shares at one price and, if successful, will use its controlling interest to "freezeout," see note 52 infra, the remaining shareholders at a lower price. This is a powerful acquisition technique because it pressures target shareholders to tender in the first step or risk being frozen out at the lower price in the second step. See Brudney & Chirelstein, Fair Shares in Corporate Mergers and Takeovers, 88 HARV. L. REV. 297, 337 (1974) [hereinafter cited as Fair Shares]; Brudney & Chirelstein, A Restatement of Corporate Freeouts, 87 YALE L.J. 1354, 1361-62 (1978) [hereinafter cited as Restatement]; Greene & Junewicz, A Reappraisal of Current Regulation of Mergers and Acquisitions, 132 U. PA. L. REV. 647, 676-93 (1984); Comment, supra note 48, at 403-13. The Maryland statute prohibits a lower second step price, effectively eliminating the front-end loaded tender offer. See note 141 infra and accompanying text.

\textsuperscript{50} DEPARTMENT OF LEGISLATIVE REFERENCE, STAFF REPORT TO THE GENERAL ASSEMBLY OF MARYLAND, Extraordinary Session, June 1983, at 14 (1983) (intent of Maryland statute is to protect target shareholders in the second step of a takeover) [hereinafter cited as STAFF REPORT].

\textsuperscript{51} Fundamental changes in corporate structure, such as mergers or sales of corporate assets, must ordinarily be approved by both the target's board of directors and its shareholders. See, e.g., DEL. CODE ANN. tit. 8, § 251 (1983) (requiring majority vote of shareholders); N.Y. BUS. CORP. LAW § 903 (McKinney Supp. 1984) (requiring 2/3 vote of shareholders). However, if the ownership of the rest of the corporate stock is scattered or isolated a tender offeror may be able to control corporate affairs with significantly less than a majority interest and thus affect the merger or sale of assets.

In the rare case where a tender offeror acquires 90% to 95% of the target's stock, it may utilize the short-form merger procedure available in many states to effect a merger without shareholder approval. See, e.g., DEL. CODE ANN. tit. 8, § 253 (1983) (requiring 90% control of the corporation's shares); N.Y. BUS. CORP. LAW § 905 (McKinney Supp. 1984) (requiring 90%). Short form merger statutes are designed to give force to the will of a dominant majority of shareholders in the face of a recalcitrant or hostile minority. See Note, The Short Merger Statute, 32 U. CHI. L. REV. 596, 598 (1965).

\textsuperscript{52} In its strictest sense, a freezeout involves action taken by the controlling shareholders of a corporation solely for the purpose of terminating minority shareholders' equity interest in the enterprise. See Vorenberg, Exclusiveness of the Dissenting Stockholder's Appraisal Right, 77 HARV. L. REV. 1189, 1192-93 (1964); see also Singer v. Magnavox Co., 380 A.2d 969 (Del. 1977) (holding that a cause of action by minority shareholders exists in the event of a freezeout even if the majority's actions meet the letter of the law); but see also Weinerberger v. UOP, Inc., 457 A.2d 701, 715 (Del. 1983) (severely limiting the scope and effect of Singer).

In the traditional case of a merger approved by the board of directors and at least a majority of the shareholders of two independent corporations dealing at arm's length, the controlling and minority shareholders receive identical treatment. The terms of the merger, approved by a majority of stockholders of each corporation, apply equally to all. Freezeout mergers differ in that the acquiring corporation is also the controlling shareholder of the target. The acquiring corporation can cause the target to be merged into it and "freezeout" the remaining target shareholders by providing in the merger plan that each target share be traded for cash. The acquiring corporation can then use its controlling interest in the target to carry out the merger plan. For a concise description of the difference between arm's length mergers and freezeout mergers, see
than the premium price initially offered by the tender offeror in order to gain its controlling interest.53

The Maryland statute attempts to protect minority target shareholders by changing state corporate law voting requirements for certain major corporate transactions and by adding provisions governing the rights of objecting stockholders. Any business combination54 must be recommended by the target company's Board of Directors and approved by at least eighty percent of the outstanding shares eligible to vote and at least two-thirds of the voting shares not owned by the interested stockholder55 or its affiliates.56 This means that a business combination such as a merger must be approved by a "supermajority" of the target company's shareholders.

The stated purpose of Maryland's supermajority voting requirement is to give weight to minority interests in the governance of major corporate affairs.57 However, in order to prevent a tyranny of the minority, the Maryland law provides for an exemption to the supermajority requirement commonly called a fair price provision. A supermajority vote does not apply if the cash or other consideration (e.g., securities) received by minority shareholders in a business combination is at least equal in value to the highest figure yielded by a complicated statutory formula.58 Thus, a tender offeror may freezeout the minority if it is willing to abide by the fair price provision. In this way, the Maryland approach seeks to balance the interests of controlling and dissenting shareholders after a successful tender offer.

The voting restrictions and fair price provision of the new Maryland statute are similar to those found in recent shareholder-adopted


Some commentators would use the term freezeout even when target shareholders are not forced to give up their equity if the consideration they receive is inadequate. The emphasis is placed not on the cashing out of the target shareholders, but on the controlling shareholder's ability to set the merger terms to its advantage. See Greene, supra, at 489 n.8; Toms, supra note 48, at 548, n.2.

53. STAFF REPORT, supra note 50, at 9.
54. "Business Combination" is defined broadly in the Maryland statute. See MD. CORPS. & ASSNS. CODE ANN. § 3-601(e) (Supp. 1984).
55. Section 3-601(j) of the Maryland statute provides:

"Interested Stockholder" means any person (other than the corporation or any subsidiary) that:

(i) Is the beneficial owner, directly or indirectly, of 10 percent or more of the voting power of the outstanding voting stock of the corporation; or
(ii) Is an affiliate of the corporation and at any time within the 2 year period immediately prior to the date in question was the beneficial owner, directly or indirectly, of 10 percent or more of the voting power of the then outstanding voting stock of the corporation.

57. STAFF REPORT, supra note 50, at 15.
58. Section 3-603(b) of the Maryland statute entitles holders of common stock of the target to the highest of the following figures:
corporate charter amendments. As shareholder-adopted corporate charter amendments, these provisions may be permissible. The essential issue is whether a state can constitutionally impose these "shark-repellent amendments" on all corporate domiciliaries in the name of investor protection.

In addition to providing protection against hostile takeover bids, the Maryland statute grants the Board of Directors of a target company wide discretion to define various combinations it wishes to exclude from coverage under the new law. This "friendly offer" exemption was necessary to gain support for the statute from the business community. But, the exemption, supermajority, and fair price provisions of the Maryland statute present problems similar to those found in first generation statutes. The Maryland approach may impermissibly burden interstate commerce and interfere with the principles of investor autonomy and neutrality in the Williams Act.

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<th>Formula</th>
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<tr>
<td>(1)</td>
<td>Highest price per share (including brokerage commissions and transfer taxes) paid by the interested shareholder for any target shares acquired by it for the two year period prior to the first general public announcement of the proposed business combination.</td>
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<tr>
<td>(2)</td>
<td>Highest price per share paid by the interested stockholder in the transaction in which it became an interested stockholder.</td>
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<tr>
<td>(3)</td>
<td>Market value of target shares on the day of the first general public announcement of the proposed business combination.</td>
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<td>(4)</td>
<td>Market value of target shares on the day on which the interested stockholder first became an interested stockholder.</td>
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<td>(5)</td>
<td>The figure arrived at through formula (3) multiplied by the fraction of the highest price per share paid by the interested stockholder for target shares for the period two years before the first general public announcement of the proposed business combination over the market value of target shares on the first day in that two year period that the interested stockholder acquired target shares.</td>
</tr>
<tr>
<td>(6)</td>
<td>The figure arrived at through formula (4) multiplied by the fraction described in formula (5).</td>
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Note that in formulas (5) & (6) the fraction will be greater than one unless the highest price paid for target shares is equal to first day price.

See Md. CORPS. & ASSNS. CODE ANN. § 3-603(b) (Supp. 1984).


60. The charter amendments are permissible under state enabling laws. See, e.g., DEL. CODE ANN. tit. 8, § 102(b)(4) (1983); N.Y. BUS. CORP. LAW § 616(a)(2) (McKinney 1963). But see notes 184-85 infra and accompanying text.


61. See notes 183-91 infra and accompanying text.


63. See note 181 infra. Another statutory exemption deserves special attention. Business combinations involving targets that, prior to July 1, 1983, already had a shareholder with a 10% or greater beneficial interest in the company are exempted. Md. CORPS. & ASSNS. CODE ANN. § 3-603(d)(1) (Supp. 1984).
II. THE CONSTITUTIONALITY OF FIRST GENERATION STATE TAKEOVER LEGISLATION

The constitutionality of first generation state takeover statutes has been challenged on two grounds. Opponents of the statutes claim that such regulation violates the commerce clause and that the Williams Act preempts state regulation of nationwide tender offers under the supremacy clause.64

This Part examines the validity of these constitutional objections. First, this Part delineates the commerce clause analysis of first generation state takeover statutes that provided the basis for the opinion of the Court in Edgar v. MITE Corp. Next, this Part reviews the arguments for and against preemption, and suggests guidelines for determining when state tender offer legislation defeats congressional purposes and should therefore be preempted. This Part concludes that state regulation is not always inconsistent with congressional objectives in the Williams Act but that the states may play only a limited regulatory role.

A. Commerce Clause

The commerce clause provides that "Congress shall have Power . . . [i]o regulate Commerce . . . among the several States."65 The individual states, however, are not altogether excluded from exercising regulatory power that has an effect on interstate commerce.66 Under the Pike test,67 "[a] state statute must be upheld if it 'regulates evenhandedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental . . . unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits.' "68 In MITE, Justice White, writing for a plurality, found that the Illinois Act violated this test for two reasons. First, the

64. See, e.g., Langevoort, supra note 34; Moylan, supra note 38; Wilner & Landy, supra note 34; Note, supra note 34. But see, e.g., Boehm, State Interests and Interstate Commerce: A Look at the Theoretical Underpinnings of Takeover Legislation, 36 WASH. & LEE L. REV. 733 (1979); Sargent, supra note 2; Shipman, supra note 38; Note, Response to Great Western, supra note 3; Note, supra note 35.

65. U.S. CONST. art. I, § 8, cl. 3.


68. Edgar v. MITE Corp., 457 U.S. at 640 (quoting Pike v. Bruce Church, Inc., 397 U.S. 137, 142 (1970)). "Evenhandedness" here means that a state's regulatory scheme must not further residents' interests at the expense of the interests of residents in other states. If the statute is characterized as investor protection legislation, it would appear that the statutes regulate evenhandedly since they pertain equally to transactions involving both resident and nonresident shareholders. See Sargent, supra note 2, at 721. If state takeover legislation is viewed as an attempt to shield target management for the purpose of keeping corporations within the state, its constitutionality under the commerce clause is open to greater challenge. See Shipman, supra note 38, at 745-46; Note, supra note 35, at 528. But see Edgar v. MITE, Corp., 457 U.S. at 646-47 (Powell, J., concurring) (suggesting that states may have a legitimate interest in protecting in-state corporations from takeover).
Illinois Act produced direct rather than incidental restraints on interstate commerce. Second, the burden the Illinois Act imposed on interstate commerce was excessive in light of the local interests the Act purported to further.

1. Direct Restraints on Interstate Commerce

The extraterritorial reach of state takeover legislation has proven to be a fatal constitutional defect. Unlike blue sky laws, which regulate securities transactions occurring within a particular state and only incidentally affect interstate commerce, most first generation state takeover legislation directly regulates securities transactions that take place across state lines. Such direct regulation is prohibited by the commerce clause.

The Illinois statute at issue in MITE reached transactions occurring wholly outside of the state. Analogizing the limits of state legislative power to the jurisdictional limits of state courts, Justice White wrote that a state's direct assertion of "extraterritorial jurisdiction over persons or property would offend sister States and exceed the inherent limits of the State's power."
2. *Indirect Restraint on Interstate Commerce*

When a state statute regulates interstate commerce indirectly, the question under the *Pike* test is whether the burden imposed on that commerce is excessive in relation to the local interests served by the statute.\(^{75}\) The most obvious burden first generation state takeover statutes place on interstate commerce arises from their ability to prevent and delay tender offers anywhere in the country.\(^{76}\) Allowing a state to block a nationwide tender offer could have detrimental effects on investors' interests and the efficiency of markets for corporate acquisition.\(^{77}\) Other aspects of commerce clause analysis that point toward finding first generation statutes unconstitutional include the possibility of exposing tender offerors to conflicting state regulatory schemes, the availability of alternate means of protecting investors that impose fewer burdens on interstate commerce, and the need for uniform regulation.\(^{78}\) On the other hand, proponents of first generation state takeover statutes argue that the statutes further two legitimate local interests: protection of target security holders and regulation of the internal affairs of companies incorporated under state

\(\text{Shipman, supra note 38, at 749.}\)


\(\text{76. See Edgar v. MITE Corp., 457 U.S. at 643; note 37 supra.}\)

\(\text{77. According to the MITE Court these effects include: depriving shareholders of the oppor­}

\(\text{tunity to sell their shares at a premium, inhibiting economic efficiency by hindering the realloca­}

\(\text{tion of economic resources to their highest valued use, and reducing incumbent management's}

\(\text{incentive to perform well. Edgar v. MITE Corp., 457 U.S. at 643.}\)

\(\text{On the economic effects of chilling tender offers, compare Easterbrook & Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 Harv. L. Rev. 1161 (1981);}

\(\text{Easterbrook & Jarrell, *Do Targets Gain from Defeating Tender Offers?*, 59 N.Y.U. L. Rev. 277 (}

\(\text{1984); Fischel, *Efficient Capital Market Theory, the Market for Corporate Control, and the Regu­}

\(\text{lation of Cash Tender Offers*, 57 Tex. L. Rev. 1 (1978) (arguing that tender offers benefit target}

\(\text{shareholders and that target management should generally not be permitted to take defensive}

\(\text{action), with Lipton, *Takeover Bids in the Target's Boardroom*, 35 Bus. Law. 101 (1979); Lipt­}

\(\text{ton, *Takeover Bids in the Target's Boardroom: A Response to Professors Easterbrook and Fischel*,}

\(\text{55 N.Y.U. L. Rev. 1231 (1980) (arguing that the beneficial effects of tender offers are overstated}

\(\text{and that target management should be allowed to exercise its business judgment in deciding}

\(\text{whether to oppose a takeover). For a discussion of the empirical data on the economic effects of}

\(\text{tender offers, see Lowenstein, *Pruning Deadwood in Hostile Takeovers: A Proposal for Legisla­}

\(\text{tion*, 83 Colum. L. Rev. 249 (1983).}\)

\(\text{78. See Note, supra note 34, at 1160-61. Opponents of state statutes argue that the prospect}

\(\text{of having to comply with the requirements of several state statutes will discourage tender offerors}

\(\text{from making offers and that a uniform system of tender offer regulation must be maintained in}

\(\text{order to minimize disruption of national securities markets. See, e.g., DEVELOPMENTS, supra}

\(\text{note 38, at 232-33. But see Sargent, supra note 2, at 728; Note, supra note 35, at 529-30 (sug­}

\(\text{gesting that the burden of compliance with a number of state statutes is not severe given their}

\(\text{similarities).}\)
law.\textsuperscript{79}

The \textit{MITE} Court analyzed the Illinois statute from the perspective of both of these local interests and found that they failed to outweigh the burdens imposed on interstate commerce. Looking at the statute as a form of securities regulation, Justice White wrote that "[w]hile protecting local investors is plainly a legitimate state objective, the State has no legitimate interest in protecting nonresident shareholders."\textsuperscript{80}  
The low percentage of resident shareholders necessary to trigger the jurisdictional provisions of most first generation statutes severely undermines the securities regulation rationale of these statutes.

The Supreme Court was similarly unimpressed with the internal corporate affairs rationale for the Illinois statute. Proponents of state takeover statutes argue that because tender offers are related to internal corporate affairs, such as proxy solicitations, which are traditionally regulated under the law of the state of incorporation, tender offers, too, should be subject to state regulation.\textsuperscript{81}  
The Supreme Court flatly rejected this view, stating that "[t]ender offers contemplate transfers of stock by stockholders to a third party and do not themselves implicate the internal affairs of the target company."\textsuperscript{82}  
Five justices agreed that the Illinois statute failed the \textit{Pike} test\textsuperscript{83} and thus violated the com-

\textsuperscript{79} See, e.g., Shipman, supra note 38, at 740-46 (regulation of internal corporate affairs); Note, supra note 35, at 529 (protection of shareholders); see also Edgar v. MITE Corp., 457 U.S. at 646 & n.* (Powell, J., concurring) (states have a legitimate interest in keeping corporate headquarters within the state); Boehm, supra note 64, at 741-46 (state takeover legislation furthers additional state interests in regulating foreign corporations doing business within the state and in preventing precipitous shifts in the location of headquarters of in-state corporations).

\textsuperscript{80} Edgar v. MITE Corp., 457 U.S. at 644; see also Note, supra note 35, at 528. Insofar as the Illinois Act attempted to protect resident investors, the Supreme Court agreed with the court of appeals that the Illinois disclosure, withdrawal and pro rata provisions afforded only a marginal increase in protection over the Williams Act and current SEC rules. Edgar v. MITE Corp., 457 U.S. at 645 (agreeing with MITE Corp. v. Dixon, 633 F.2d 486, 500 (7th Cir. 1980)). See also Great Western United Corp. v. Kidwell, 577 F.2d 1256, 1280 (5th Cir. 1978), revd. on other grounds sub nom. Leroy v. Great Western United Corp., 443 U.S. 173 (1979) (increased disclosure may confuse investors). The \textit{MITE} courts also believed that any increase in investor protection afforded by the Illinois Act was offset by the risk that the delay created by the provisions would deter lucrative tender offers. Edgar v. MITE Corp., 457 U.S. at 645 (citing MITE Corp. v. Dixon, 633 F.2d at 500).

\textsuperscript{81} See Shipman, supra note 38, at 741-45; see also Sargent, supra note 2, at 724-26 (discussing arguments on both sides of this issue). This argument is significant in that it offers a justification for the extraterritorial reach of first generation state takeover statutes: the state of incorporation has historically regulated corporate matters despite the fact that this may entail regulation of transactions occurring outside the state. See Boehm, supra note 64, at 743; Shipman, supra note 38, at 742-43. Furthermore, state corporation law is entitled to full faith and credit in other states. Order of United Commercial Travelers of Am. v. Wolfe, 331 U.S. 586 (1947). \textit{See generally} Reese & Kaufman, \textit{The Law Governing Corporate Affairs: Choice of Law and the Impact of Full Faith and Credit}, 58 \textit{COLUM. L. REV.} 1118 (1958). Full faith and credit would mitigate the critique that tender offerors will be subject to conflicting state statutes. Courts could apply the takeover law of the state in which the target was incorporated.

\textsuperscript{82} Edgar v. MITE Corp., 457 U.S. at 645; see also Wilner & Landy, supra note 34, at 16-17; Note, supra note 34, at 1153-55 (suggesting that a tender offer does not implicate corporate internal affairs but is merely the aggregate of numerous individual sales of securities).

\textsuperscript{83} Justice Powell joined this part of the opinion of the court because its reasoning "leaves
merce clause.

B. Preemption

States are preempted from regulating areas in which Congress is competent to legislate if any one of four tests is met. The preemption debate surrounding state takeover regulation has focused on the question of whether state regulation frustrates congressional objectives in the Williams Act in some substantial way. Under this test, courts and commentators have attempted to define Congress' intent in passing the Williams Act. There is general agreement that Congress was concerned with protecting investors. What is not clear, however, is the meaning of investor protection.

1. The Argument for Preemption: The Market Approach to Investor Protection

According to the Fifth Circuit in Great Western United Corp. v. some room for state regulation of tender offers.” Edgar v. MITE Corp., 457 U.S. at 646 (Powell, J., concurring). Thus, while Justice Powell agreed that the balance of burdens on interstate commerce and local benefits indicated that the Illinois statute violated the commerce clause, he would not necessarily bar less offensive state regulation.


Most courts and commentators agree that in passing the Williams Act, Congress did not explicitly or implicitly prohibit states from regulating tender offers. See Edgar v. MITE Corp., 457 U.S. 624, 631 (1982); see also Sargent, supra note 2, at 704-06; Shipman, supra note 38, at 756-58; Note, supra note 35, at 519-20. But see Wilner & Landy, supra note 34, at 25; Note, supra note 34, at 1164-66.

In most cases it is possible for an offeror to comply with both state and federal tender offer regulation. However, the SEC has attempted to provoke a direct conflict between federal regulations and state precommencement notification provisions by adopting Rule 14d-2(b) requiring that a tender offeror make its offer effective within five days of publicly announcing the material terms of the offer. 17 C.F.R. § 240.14d-2(b) (1984). The SEC, in acknowledging this "direct and substantial" conflict, explained that Rule 14d-2(b) was "necessary for the protection of investors and to achieve the purpose of the Williams Act." Tender Offers [1979-1980 Transfer Binder] Fed. Sec. Rep. (CCH) ¶ 82,373, at 82,584 (Dec. 19, 1979). The commission believed that "the state takeover statutes . . . frustrate[d] the operation and purposes of the Williams Act." Id. For a discussion of the conflict between state precommencement notification provisions and Rule 14d-2(b) and a look at state attempts to avoid preemption, see Sargent, supra note 2, at 707-12.

Congress, in the Williams Act, "relied on a 'market approach' to investor protection." The court stated that Congress recognized that tender offers often benefit individual investors and thus Congress advocated a narrow regulatory role in the tender offer area. Congress realized, however, that laissez-faire is inconsistent with investors' interests. To counteract the speed and secrecy of the unregulated tender offer, the Williams Act attempts to insure that investors are provided with enough time and information to decide whether to tender their shares, while at the same time leaving investors the opportunity to receive attractive tender offers. Individual investors, not a governmental "benevolent bureaucracy," or a fiduciary target management, should decide whether a tender offer succeeds or fails. However, in order to protect the investor's decision-making ability from bias, Congress had to avoid giving an advantage to either the tender offeror or to target management. Neutrality between offerors and management thus becomes the essence of investor protection.

State takeover regulation presents two related obstacles to the Williams Act's market approach to investment protection. First, state regulation may rely on a benevolent bureaucracy or target management's fiduciary duties to protect investors. The Williams Act emphasizes investor autonomy. Second, state regulation may disrupt the neutral balance the Williams Act established between tender offerors and target management. By putting tender offerors and target management on equal footing, Congress intended to leave investors free to make informed, unbiased decisions regarding takeover bids. The preemption test used by those courts that view the Williams Act as adopting a market approach is whether the state regulation upsets that neutral balance.

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88. 577 F.2d at 1276.
89. 577 F.2d at 1277.
90. See notes 15-17 supra and accompanying text.
92. The Fifth Circuit described the "fiduciary approach" of state takeover statutes as "[reliance] upon the business judgment of corporate directors with a fiduciary duty to their shareholders" to protect investors instead of letting investors bargain for themselves. 577 F.2d at 1276. "[T]he market approach to investor protection adopted by Congress and the fiduciary approach . . . are incompatible." 577 F.2d at 1279.
93. See Edgar v. MITE Corp, 457 U.S. 624, 633 (1982) ("[A] major aspect of the effort to protect the investor was to avoid favoring either management or the takeover bidder."); see also note 25 supra.
94. Kidwell, 577 F.2d at 1279-80 ("Idaho disrupted the neutrality indispensable for the proper operation of the federal market approach to tender offer regulation. The . . . statute
2. The Argument Against Preemption: Investor Protection Through Additional Regulation

Those who support state takeover regulation, like those who oppose it, emphasize the investor protection goals of the Williams Act. They reject, however, the proposition that Congress intended to adopt a particular method to achieve this goal. Under this view, the "market approach's" neutral balance between tender offerors and target management does not represent a congressional objective, but is merely an incident of the Williams Act's disclosure policies. In support of this view, proponents of state takeover legislation cite the legislative hearings on the Williams Act and the Supreme Court's discussion of the Act's legislative history in _Piper v. Chris-Craft Industries_.

95. "[B]y providing the target company with additional time within which to take steps to combat the offer, the precommencement notification provisions furnish incumbent management with a powerful tool to combat tender offers, perhaps to the detriment of the stockholders. . . ." _MITE_, 457 U.S. at 635.

96. "The potential for delay provided by the hearing procedures upset the balance struck by Congress by favoring management at the expense of stockholders." 457 U.S. at 639.

97. "[T]he state thus offers investor protection at the expense of investor autonomy — an approach quite in conflict with that adopted by Congress." 457 U.S. at 640 (quoting 633 F.2d at 494).

98. See _Boehm_, _supra_ note 64, at 750; _Sargent_, _supra_ note 2, at 714-15; _Shipman_, _supra_ note 38, at 759.

99. In the words of one student commentator, "Any balance that emerged from the Williams Act was neither a 'purpose' nor an 'objective' of its draftsmen, but rather a byproduct of the congressional desire to 'require full and fair disclosure.'" _Note_, _supra_ note 35, at 522; see also _Boehm_, _supra_ note 64, at 747.

100. In an often quoted remark, SEC Chairman Cohen stated, "The principal point is that we are not concerned with assisting or hurting either side. We are concerned with the investor who today is just a pawn in a form of industrial warfare. . . . The investor is lost somewhere in the shuffle. This is our concern and our only concern." _Full Disclosure of Corp. Equity Ownership and in Corporate Takeover Bids: Hearings on S. 510 Before the Subcommittee on Securities of the Senate Committee on Banking and Currency, 90th Cong., 1st Sess. 178 (1967), quoted in _Piper v. Chris-Craft Indus._, 430 U.S. 1, 27-28 (1977) (emphasis supplied by the court).

101. 430 U.S. 1 (1977). The _Piper_ Court stated, "Neutrality is . . . but one characteristic of legislation directed toward a different purpose—the protection of investors." 430 U.S. at 29.

The proponents' reliance on _Piper_ is to some extent misplaced. The issue before the court in that case was whether the Williams Act confers a private right of action upon defeated tender offerors. The Court held that Congress intended to protect investors, not tender offerors, in the Williams Act. The Court did not discuss whether the Williams Act embodies a neutral regulatory approach to tender offers with which the states could not interfere. See _Crane Co. v. Lam_, [1981 Transfer Binder] _Fed. Sec. L. Rep._ (CCH) ¶ 97,896 (E.D. Pa. Feb. 12, 1981) (holding a Pennsylvania law preempted by the Williams Act because it gave target management advantages not contemplated by Congress).
The proponents of state takeover regulation further contend that state statutory provisions such as those for pre-commencement notification are consistent with the goal of investor protection because they reduce the pressure on shareholders to tender immediately and mitigate the panic atmosphere surrounding a tender offer. Indeed some commentators argue that state statutes realize the goals that the Williams Act was designed, but failed, to achieve. The fact that state regulation may also create delay, which may help target management defeat a tender offer, does not in their view create a basis for preemption. Proponents of state regulatory efforts argue that Congress wanted to protect investors; it did not intend to confer upon tender offerors a right to make an unfettered offer.

3. A Suggested View of the Williams Act

This subsection argues that the correct view of the Williams Act lies close to the “market approach” view. The “market approach” view recognizes the interrelatedness of neutrality and the Williams Act’s concept of investor protection. The legislative history of the Act indicates that Congress believed that a neutral balance between tender offerors and target management would benefit investors by preserving their opportunity to receive attractive tender offers and by providing a check on inefficient management. Thus, contrary to the opinion of some proponents of state takeover legislation, neutrality and investor protection are integrated principles.

There is, however, a tendency under the “market approach” view to overemphasize the purposefulness with which Congress adopted a neutral regulatory stance in the Williams Act. The legislative history reveals that Congress adopted a neutral stance not simply because

102. See, e.g., Sargent, supra note 2, at 716-20; Note, Response to Great Western, supra note 3, at 913, 915; Note, supra note 35, at 524.
103. See Sargent, supra note 2, at 719; Note, Response to Great Western, supra note 3, at 915.
104. See Sargent, supra note 2, at 715-16; Note, supra note 35, at 524-25.
105. The following exchange between Senator Javits and Senator Williams, the sponsor of the Williams Act, illustrates congressional concern over tender offer regulation:

Mr. JAVITS. One other question I should like to ask the Senator: There is no intention in the measure... to in any way condemn the practice of making tenders, is there?

Mr. WILLIAMS of New Jersey. There is no intention in any way to prohibit tender offers. As a matter of fact, I think it [the Williams Act] might encourage them.

113 CONG. REC. 24,665 (1967). See also 113 CONG. REC. 854 (1967) (In his remarks before the Senate, Senator Williams stated that “[the Williams Act] is not aimed at obstructing legitimate takeover bids. In some instances, a change in management will prove a welcome boon for shareholder and employee...”).

106. Congress recognized that the pro-management bias of the early versions of the Williams Act was detrimental to investors’ interests in receiving lucrative tender offers. See Piper, 430 U.S. at 30. Thus, to a large extent, Congress perceived neutrality and investor protection as integrated principles. See MITE Corp. v. Dixon, 633 F.2d 486, 496 (7th Cir. 1980), affd. sub nom. Edgar v. MITE Corp., 457 U.S. 624 (1982) (“[A]n equitable balance between the contending sides is perceived as a principal means of investor protection.”).
neutrality preserves investors' opportunities to receive tender offers, but in part because it was unsure of what type and degree of regulation would best serve investors' interests. Given this uncertainty, it is incorrect to speak of the Williams Act as establishing an immutable congressional balance.

Although the argument against the "market approach" is useful in that it questions the purposefulness of the neutral balance in the Williams Act, the argument often goes too far. The Williams Act does affirmatively recognize neutrality as an element of investor protection. This is made explicit in the congressional debates and is implicit in the reformulation of the pro-management bias of the original version of the Williams Act. Furthermore, discussion of the Williams Act in Congress subsequent to its passage suggests that Congress has embraced the courts' "market approach" interpretation of the Act. Thus, even if Congress initially adopted a neutral stance for

107. The legislative history reveals that there was great disagreement over the desirability of facilitating or hindering the tender offer process. While some tender offers proved lucrative to investors and the national economy, others provided a vehicle with which self-interested outsiders could "raid" a target. In view of this lack of consensus on tender offer policy, Congress determined to "avoid tipping the balance of regulation." See S. REP. NO. 550, supra note 15, at 3; H.R. REP. NO. 1711 at 4, reprinted in 1968 U.S. CODE CONG. & AD. NEWS, at 2813, supra note 15; 113 CONG. REC. 24,664 (1967). This language, often used to support the market approach view of the act, see note 25 supra, may in fact be interpreted to support the opposite view. The passive tone of "avoid tipping" may suggest that Congress did not intend to establish a neutral balance between tender offerors and target management, but rather opted for neutrality due to an inability to reconcile incompatible economic philosophies on how best to protect investors in the tender offer context. See Boehm, supra note 64, at 749-50; Note, supra note 35, at 522 n.81.

108. Proponents of state takeover legislation emphasize Congress' uncertainty about the proper role and strength of federal regulation. See Boehm, supra note 64, at 749-50; Shipman, supra note 38, at 759-60. When such uncertainty exists it is appropriate to allow states to perform their Brandeisian laboratory functions. See Shipman, supra note 38, at 760. States should therefore be left free to experiment in order to find the best method for protecting investors. One commentator has suggested: "If a scheme of state regulation does not eliminate 'the basic capability of offerors to make successful tender offers' and if the scheme is in fact designed to protect investors . . . then there would seem to be little basis for objection." Sargent, supra note 2, at 715 (quoting MITE Corp. v. Dixon, 633 F.2d 486, 496 (7th Cir. 1980), affd. sub nom. Edgar v. MITE Corp., 457 U.S. 624 (1982)). However, even if one accepts that Congress did not establish an immutable balance in the Williams Act, one may still reject the states' role in altering the balance. See Great Western United Corp. v. Kidwell, 577 F.2d at 1280 n.52 ("Changing economic conditions may have disrupted the balance that Congress struck in the Williams Act. But, it is for Congress — not Idaho — to determine if adjustments in the federal balance are necessary, and if so, what adjustments should be made.")., red. on other grounds sub nom. Leroy v. Great Western United Corp., 443 U.S. 173 (1979). The national market for corporate acquisition may not be an appropriate area for individual states to perform their Brandeisian laboratory functions.

109. A commentator sympathetic to state efforts in the takeover area stated that "[i]t is difficult to describe the Williams Act's policy of investor protection through full and fair disclosure without reference to regulatory neutrality, and the Piper language, when considered in context, does not support a contrary view." Sargent, supra note 2, at 714.

110. See note 107 supra.

111. During consideration of the Hart-Scott-Rodino Antitrust Improvements Act of 1976, 15 U.S.C. § 18a (1976), Congress specifically addressed the ten-day proration period of the Wil-
mixed reasons, the theory that Congress adopted neutrality because it promotes investors' interests now predominates. Congressional acquiescence in this judicially accepted view of the Williams Act merits recognition.

Accepting the importance of neutrality in federal tender offer legislation means that the states may play only a narrow regulatory role. While the Williams Act does not reflect an immutable balance between tender offerors and target management it does suggest that the balance is an important aspect of the Act's goal of investor protection. In short, states may, to a limited extent, depart from the neutral regulatory balance of the Williams Act in search of better ways of protecting investors' interests; however, states may not depart in a manner that is likely to decrease significantly investors' opportunities to receive tender offers for their shares. This is the preemption standard against which the Maryland legislation should be judged.

III. THE CONSTITUTIONALITY OF THE MARYLAND APPROACH

This Part analyzes the Maryland statute in terms of the commerce clause and preemption challenges that led to the invalidation of first generation statutes. While states have a legitimate interest in protecting investors in potential freezeout situations, state regulation must be consistent with congressional objectives in federal tender offer legislation and must not overburden interstate markets for corporate acquisition.

The Maryland statute, like first generation legislation, is subject to commerce clause attack; however, the case for invalidation on commerce clause grounds is less compelling here than in the context of first generation statutes. By concentrating on the second step of the takeover process and limiting jurisdiction to corporate domiciliaries, the Maryland legislation cuts back on the extraterritorial reach that

liams Act. The House Report and comments by Congressman Rodino reaffirm the importance of neutrality in the federal regulatory scheme.

The House Report stated:

[It] is clear that this short waiting period was founded on congressional concern that a longer delay might unduly favor the target firm's incumbent management, and permit them to frustrate many pro-competitive cash tenders. This ten day waiting period thus underscores the basic purpose of the Williams Act — to maintain a neutral policy towards cash tender offers, by avoiding lengthy delays that might discourage their chances for success.


Congressman Rodino explained to the House:

Lengthier delays will give the target firm plenty of time to defeat the offer . . . . And the longer the waiting period, the more the target's stock may be bid up in the market, making the offer more costly and less successful. Should this happen, it will mean that shareholders of the target firm will be effectively deprived of the choice that cash tender offers give to them . . . . Generally, the courts have construed the Williams Act so as to maintain . . . options for the target company's shareholders, and the House conference contemplate that the courts will continue to do so.

122 CONG. REC. 30,877 (1976) (emphasis added).
proved fatal to first generation statutes. But even if the Maryland statute is not clearly invalid under the commerce clause it fails on the preemption grounds left open in MITE. The regulation is likely to upset the balance between tender offerors and target management in a manner that threatens to decrease significantly investors' opportunities to receive tender offers. It therefore interferes with congressional objectives in the Williams Act.

A. Commerce Clause

The Maryland statute successfully avoids placing impermissible direct restraints on interstate commerce. It does not put conditions on tender offers communicated across state lines, but focuses primarily on the internal corporate affairs of companies incorporated within the state. Consequently, the Maryland statute's effect on interstate commerce is less direct than that typical of first generation statutes, particularly of the statute at issue in Edgar v. MITE Corp. Furthermore, because the Maryland statute is part of the state corporation law, it will receive full faith and credit from other states. The Maryland approach thus avoids the problem of exposing tender offerors to conflicting state statutes.

However, even if the statute avoids direct restraints on interstate commerce, it may impose indirect restraints that outweigh the local interests served by the statute. Moreover, to the extent that a court views Maryland's professed rationale for its statute as a veil for promoting parochial state interests, the legitimacy of the statute will be undercut. Finally, even if the Maryland statute furthers legitimate state interests, the statute may be struck down on the ground that those interests may be adequately served by alternate means that impose fewer burdens on interstate commerce.

In shifting the regulatory focus on takeovers from the first step (tender offers) to the second step (business combinations) the Maryland legislature intended to avoid characterization of the statute as a species of securities regulation and to improve the statute's chances of passing the Pike test for indirect restraints on commerce. Unlike first generation statutes that place explicit conditions on transfers of

112. See notes 69-74 supra and accompanying text.

113. It is true that the Maryland approach affects business combinations of large, publicly held corporations, which generate interstate transactions. Nevertheless, by focusing on the internal affairs of these corporations, the Maryland statute avoids the problems of extraterritorial reach which troubled the Court in MITE. See notes 73-74 supra and accompanying text; see also Staff Report, supra note 50, at 69.

114. See Shipman, supra note 38, at 742 n.124; note 81 supra.

115. To the extent that a state statute is a form of securities regulation, it is clear that the state interest in regulation is limited to protection of resident investors. Edgar v. MITE Corp., 457 U.S. 624, 644 (1982). The Maryland statute applies to corporate domiciliaries regardless of the number of resident shareholders. Hence the statute has little to commend it as a valid form of securities regulation. See note 80 supra and accompanying text.
stock by target shareholders to the tender offeror, the Maryland statute "implicate[s] the internal affairs of a target company," and so is related to traditional forms of state corporation law.

The Maryland statute's status as state corporation law offers support against commerce clause attack. The law of the state of incorporation has historically regulated corporate internal affairs despite the fact that this may mean regulation of transactions occurring outside the state. The state of incorporation also plays a legitimate role in protecting resident and nonresident corporate shareholders under state fiduciary doctrines. Arguably, the Maryland statute protects investors by insuring them a fair freezeout price. This may appear to be a more tangible benefit than the extra time and disclosure benefits of first generation statutes.

But Maryland's interest in regulating corporate internal affairs and protecting investors may not offset the burdens its statute places on interstate commerce. Unlike first generation statutes, the Maryland legislation does not obstruct interstate commerce by blocking nationwide tender offers. However, it burdens commerce by increasing the costs of corporate takeovers. Corporate takeovers may be desirable from the standpoint of interstate commerce because they serve as a discipline on inefficient management. Business combinations after a takeover may improve resource allocation and produce economies of scale. The MITE Court emphasized that these salutary effects are negated by anti-takeover legislation.

Another burden produced by the Maryland statute concerns its potential interference with the accuracy of markets for corporate acquisition. It may increase takeover costs for reasons irrelevant to the target company's value by artificially tying freezeout price to tender offer price whatever the vicissitudes of the market. The value of a target, as reflected in its share and asset value, may drop in the time

116. See note 82 supra and accompanying text. But see notes 143-49 infra and accompanying text (Maryland statute reaches arm's length transactions more akin to tender offers than corporate internal affairs).

117. See Boehm, supra note 64, at 743; see also Shipman, supra note 38, at 742-43.

118. Boehm, supra note 68, at 743. However, it is not clear that state fiduciary doctrines are applicable in all corporate takeover contexts. The two-tier offer (tender offer and freezeout merger in a short period of time) may be regarded as an arm's length transaction between the tender offeror and target shareholders. The shareholders may not need the protection of state fiduciary law. See notes 146-48 infra and accompanying text. Indeed, the application of state fiduciary law in the context of two-tier tender offers may conflict with the market approach of the Williams Act. See note 182 infra.

119. But see Toms, supra note 48, at 571 (After a successful tender offer, minority shareholders may be harmed by a rule tying freezeout price to tender offer price.).

120. See id. at 571-75 (discussing the effect of an equal consideration rule in two-step transactions on corporate acquisition markets). See also notes 175-77 infra and accompanying text.

121. See Toms, supra note 48, at 572 n.83.

122. See Edgar v. MITE Corp., 457 U.S. at 643.

123. See Toms, supra note 48, at 571.
period between a first step tender offer and a planned second step freezeout. In this situation, under the Maryland fair price provision the tender offeror will be forced to choose between foregoing the freezeout or paying a freezeout price that is artificially high relative to the target's value.\textsuperscript{124} "The public interest in an accurate market will be harmed to the extent that the [target] company's assets are being less accurately valued. . . ."\textsuperscript{125}

The Maryland approach may also have a chilling effect on tender offers. Often the object of obtaining control of a target through a tender offer is to force a business combination. If this objective becomes more expensive as a result of supermajority and fair price provisions, it is reasonable to assume that some people will be deterred from making tender offers.\textsuperscript{126} The Maryland approach is then subject to the criticism levied at first generation statutes — that shareholders may be deprived of the opportunity to sell their shares at a premium.\textsuperscript{127}

In addition, if the true purpose of the statute is to insulate in-state corporations at the expense of national markets for corporate acquisition, the commerce clause prohibits the advancement of such parochial interests.\textsuperscript{128} A number of commentators have suggested that first generation statutes are designed to promote economic protectionism.\textsuperscript{129} The Maryland approach may have a substantial anti-takeover effect and may be subject to the same economic protectionism claim.

Courts may be reluctant to question a state statute's asserted rationale, but even assuming that the Maryland statute promotes legitimate state interests, the statute may still be declared invalid if there exist less burdensome means of achieving the desired statutory result.\textsuperscript{130} If the goal is to protect shareholders from the coercive effects of two-tier tender offers and freezeout mergers, alternative measures, such as a new type of appraisal statute, could provide target shareholders with benefits similar to those accorded by the Maryland approach with less disruption of markets for corporate acquisition.\textsuperscript{131}

Ultimately, the question of the validity of the Maryland approach

\textsuperscript{124} This assumes that the tender offeror did not obtain a "friendly offer exemption" under the Maryland statute, see notes 62-63 supra and accompanying text, and that the tender offeror is unable to command a supermajority vote on a lower freezeout price.

\textsuperscript{125} Toms, supra note 48, at 573 n.89.

\textsuperscript{126} Id. at 572; see also notes 167-68 & 175-77 supra and accompanying text.

\textsuperscript{127} See Edgar v. MITE Corp., 457 U.S. at 633 n.9, 643.

\textsuperscript{128} See Note, supra note 34, at 1158-59.

\textsuperscript{129} See note 34 supra.

\textsuperscript{130} See Note, supra note 34, at 1160-61.

\textsuperscript{131} Some legal commentators have urged that investors' interests may best be served by limiting frozen-out shareholders to an appraisal remedy. These commentators add, however, that to protect investors adequately, appraisal techniques should be revised to take into account elements of value arising from the accomplishment or expectation of the freezeout merge. See Toms, supra note 48, at 575-83; Comment, supra note 48, at 418-21. This approach was endorsed by the Delaware Supreme Court in Weinberger v. UOP, Inc., 457 A.2d 701, 713 (Del. 1983).
under the commerce clause is less clear than it is for first generation statutes. Because the new Maryland statute is more closely related to traditional forms of internal corporate affairs regulation than the Illinois statute struck down in *MITE*, Maryland may have a stronger state interest in its statute under the *Pike* test than the Supreme Court was willing to accord to the Illinois statute. However, the outcome of the balancing test is difficult to predict. This lack of clarity on the commerce clause question is likely to lead a court to reexamine the issue of when state takeover legislation is preempted by the Williams Act.

B. *Preemption*

Preemption analysis of the Maryland statute must focus on whether its provisions frustrate congressional objectives in the Williams Act. This analysis is more difficult than preemption analysis of first generation statutes for two reasons. First, the Maryland statute, unlike first generation state statutes, has a different focus from that of the Williams Act: it regulates the second step of the takeover process. Second, because the Maryland statute more closely resembles traditional state corporation law than do first generation statutes, it would seem to implicate established principles of state fiduciary law which should not lightly be declared preempted. These factors, however, should not prevent a court from holding that the Williams Act preempts the Maryland statute. This Note argues that the supermajority, fair price and friendly offer exemption provisions of the Maryland statute are inconsistent with the concept of investor protection embodied in the Williams Act and are unconstitutional under the supremacy clause.

1. *Federal Regulation of Two-Tier Offers*

The Maryland statute focuses on business combinations, the second step of the takeover process; the Williams Act concentrates on tender offers, the first stage. However, both statutes affect the operation of both stages of a takeover and hence present a possible conflict of federal and state regulatory objectives.

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132. The Supreme Court in *MITE* noted that the Illinois statute did not qualify as a legitimate form of state securities regulation or as state regulation of internal corporate affairs. *Edgar v. MITE Corp.*, 457 U.S. 624, 643-44 (1982).

133. See *STAFF REPORT*, supra note 50, at 70 (letter of Maryland Attorney General Sachs to Maryland Governor Hughes).

134. For the various preemption tests, see note 84 supra and accompanying text. There is no indication in the Williams Act that Congress explicitly or implicitly intended to preempt state takeover legislation patterned after Maryland law. It is also clear that there is no direct conflict between the Williams Act and the Maryland General Corporation Law.

135. See notes 137-42 infra and accompanying text.

136. See note 144 infra and accompanying text.
The Williams Act and SEC rules appear to contemplate and attempt to regulate indirectly two-tier tender offers. Two recent federal court decisions have upheld the use of "front-end loaded two-tier offers."137 In *Radol v. Thomas*138 the court noted that SEC Rule 13e-3139 "by negative implication, acknowledges that such transactions occur and purports to regulate the second step of such two-tier transactions."140

Not only does federal regulation extend to the second tier, but it is clear that the Maryland statute touches upon the heavily federally regulated first tier. The Maryland approach will greatly affect the tender offeror's decision on how to structure the first step of a two-tier bid. Indeed, the new legislation effectively eliminates the possibility of making a hostile front-end loaded two-tier bid.141 Most importantly, by imposing strict conditions on the second step of a takeover, the Maryland statute may deter potential acquirers from attempting the first step tender offer.142 The interrelatedness of the two steps in a takeover process suggests that while the federal regulatory scheme and the Maryland approach are hardly congruent, they overlap to a sufficient extent to present the preemption question of whether the Maryland approach stands as an obstacle to the effectuation of congressional objectives in the tender offer area.

2. Preemption of State Corporation Law

In *Edgar v. MITE Corp.*, the Supreme Court indicated that first

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140. *Radol*, 534 F. Supp. at 1312. Rule 13e-3 requires companies to disclose certain information prior to freezing out minority shareholders. The rule exempts from disclosure certain types of freezeouts that present less opportunity for majority overreaching. Two-tier transactions (tender offer-merger) are exempted from disclosure if the tender offeror completes the second step merger within one year of the tender offer and pays frozen-out shareholders the same price offered during the tender offer. 17 C.F.R. § 240.13e-3(g)(1) (1984). Thus, a front-end loaded bid (in which tender offer price is higher than merger price) would not be exempted and would have to comply with the Rule's disclosure requirements. Ironically, it may benefit a tender offeror not to qualify for the above exemption. If it discloses that the tender offer price will be greater than merger price, the tender offeror may pressure shareholders to tender their shares in the first step. See note 149 infra. However, if the offeror avoids disclosure and qualifies for the exemption by offering identical tender offer and freezeout price, shareholders will have little incentive to tender in the first step and the offeror may fail to gain sufficient control to complete the second step. See Note, Freezeout Merger Regulation: An SEC Rule Joins State Efforts, 37 WASH. & LEE L. REV. 964, 980 n.161 (1980). On Rule 13e-3 generally, see 1 M. LIPTON & E. STEINBERGER, TAKEOVERS & FREEZEOUTS § 9.04[1] (1984).

141. The supermajority and fair price provisions in the Maryland statute insure that in a business combination opposed by target management target shareholders will not receive less than tender offer price.

142. See notes 167-68 infra and accompanying text.
generation state takeover statutes such as the Illinois Act could not be upheld on the ground that they promote a legitimate state interest in regulating the internal affairs of corporate domiciliaries. The court did not accept the premise that tender offers are related to internal affairs transactions. The new Maryland legislation, however, purports to concentrate on the second step of the takeover process, often a freezeout merger. Mergers are classic examples of internal affairs transactions traditionally regulated under state law. In a freezeout merger, for example, the actions of the controlling shareholder of a corporation and their effect on the remaining shareholders may be policed under principles of state fiduciary law. Thus, even if there is tension between federal regulation and the Maryland approach, a court might be hesitant to declare the Maryland statute preempted by the Williams Act.

This argument for the Maryland approach fails to appreciate that fiduciary obligations running from the controlling shareholder to the remaining shareholders vary with the nature of the internal affairs transaction. Certain types of freezeouts present less opportunity for controlling shareholders to overreach than do others and hence in these situations there is less need to defer to state fiduciary law. In


144. See Santa Fe Indus. v. Green, 430 U.S. 462, 478-79 (1977) (Freezeout of minority shareholders does not provide a cause of action under § 10(b) of the 1934 Act or SEC Rule 10b-5). Santa Fe involved a freezeout under Delaware's "short-form merger" statute. A parent corporation owning 95% of the stock of its subsidiary took advantage of the statute in freezing out the remaining 5% in a merger. The Supreme Court ruled that such corporate conduct is traditionally left to state regulation. 430 U.S. at 465, 478-79.

145. Cf. Santa Fe Indus. v. Green, 430 U.S. 462, 478 (1977) (a factor in determining congressional intent to create a cause of action is whether the cause of action is traditionally relegated to the states); Cort v. Ash, 422 U.S. 66, 78, 82-85 (1975) (Absent a clear expression of congressional intent, courts will be reluctant to imply a private cause of action for stockholders from federal regulation where established state policies of corporate regulation would be overridden.).

146. See Restatement, supra note 49, at 1359-65; Fair Shares, supra note 49, at 336-40; Greene, supra note 52, at 491-96. These authors contend that freezeouts should be classified according to their potential for majority overreaching. They would recognize three distinct categories: (1) Two-step (tender offer-merger) transactions between previously unaffiliated corporations, (2) Mergers of long-held affiliates, and (3) Pure going-private transactions.

In the two-step transaction between two unaffiliated corporations, the acquiring corporation should owe no fiduciary duty to target shareholders if it discloses its plan for the target at the time of the tender offer and effects those plans soon after assuming control. See Restatement, supra note 49, at 1361. The transaction is viewed as the result of arm's length bargaining between the acquiring corporation and the target shareholders. Shareholders are able to protect their own interests with little state intervention. Id. But see note 159 infra.

In the case of mergers of long-held affiliates there are fiduciary duties running from the parent to the subsidiary. Contrary to the two-step acquisition in which the parties deal at arm's length, here the parent has the ability to act on inside information or to time the freezeout to coincide with its own best interests. See Greene, supra note 52, at 493.

The "going private transaction" presents the greatest opportunity for abuse. Two separate on-going businesses are not involved. Rather, the controlling shareholders of a corporation simply create a new shell corporation and exchange their stock for stock in the shell corporation. They then proceed to merge the two corporations and freezeout minority stockholders. The shell corporation is thus created solely for the purpose of freezing out the minority and giving the
a merger of long-held affiliates there are important issues concerning the fiduciary obligations of directors and controlling shareholders, the business judgment rule and the fairness of the transaction. These issues have traditionally been resolved under state law. In contrast, the merger associated with the second step of a two-tier tender offer presents more of an arm's length situation.147

In the two-tier offer context, the merger is proposed by an outsider, the tender offeror, at the same time the tender offer is announced. As an outsider, the tender offeror owes little or no fiduciary obligation to target shareholders. Moreover, the tender offeror is required at the outset to disclose its intention to effect a second-step merger. This required disclosure insures that the second step is based on arm's length negotiations between the tender offeror and the target shareholders, not upon the tender offeror's use of control if the offer succeeds.148

controlling shareholders complete ownership. See Restatement, supra note 49, at 1365; Greene, supra note 52, at 495-96. For a compilation of recent law review commentary on freezeout and going-private techniques, see 1 M. LIPTON & E. STEINBERGER, supra note 140, at § 9.01 n.6.

147. Some courts, however, have held that fiduciary obligations exist even in the two-tier offer context. For example, the leading case dealing with minority freezeouts has been Singer v. Magnavox Co., 380 A.2d 969, 980 (Del. 1977), in which the Delaware Supreme Court held that a tender offeror could not cash out non-tendering target shareholders in a second step merger without showing that the merger is supported by a valid business purpose. Recently, the Delaware Supreme Court declared that the Singer business purpose test shall no longer have any effect. Weinberger v. UOP, Inc., 457 A.2d 701, 715 (Del. 1983). The Singer business purpose test had been criticized by commentators for two reasons. First, the test is based on the theory that a controlling shareholder owes a fiduciary duty to the minority not to cash them out without a valid business purpose. This theory was criticized for applying fiduciary principles to a tender offer that is really an arm's length transaction. See Restatement, supra note 49, at 1362-64; see also Comment, supra note 48, at 413-16. But see Goldman & Wolfe, In Response to A Restatement of Corporate Freezeouts, 36 WASH. & LEE L. REV. 683 (1979). If the tender offeror is unaffiliated with the target, discloses its intention to freezeout the minority, and effects the freezeout shortly after assuming control, it should not owe any fiduciary duty to target shareholders. See note 146 supra. Second, the business purpose test is unworkable. The distinction between a purpose designed to benefit the surviving corporation in the merger and one designed to benefit the controlling shareholder in the target (who is also going to be the owner of the surviving corporation) is "difficult to perceive." Goldman & Wolfe, supra, at 688; see also Greene, supra note 52, at 500-02; Greene & Junewicz, supra note 49, at 687. For general commentary on Singer, see McBride, Delaware Corporate Law: Judicial Scrutiny of Mergers, 33 BUS. LAW. 2231 (1978); Note, Singer v. Magnavox Co.: Delaware Imposes Restrictions on Freezeout Mergers, 66 CALIF. L. REV. 118 (1978); Note, Singer v. Magnavox and Cash Take-out Mergers, 64 VA. L. REV. 1101 (1978); see also Steinberg & Lindahl, The New Law of Squeeze-Out Mergers, 62 WASH. U. L.Q. 351 (1984) (tracing the development of Delaware law from Singer to Weinberger).

148. Additional insurance would be provided by requiring the tender offeror to complete the second step soon after the end of the offer itself. See Greene, supra note 52, at 509. As the period between the steps lengthens, the original adversarial nature of the relationship between the tender offeror and target shareholders is blunted. As the tender offeror uses its controlling interest to manage the target, the minority may, over time, justifiably come to rely on the tender offeror to protect its interests. Also, if there is a wide gap between the tender offer and the second step, there is increased opportunity for self-dealing on the part of the tender offeror-controlling shareholder. SEC rules recognize that a two-tier offer may be characterized as an arm's length transaction only if the second step is completed soon after the tender offer. See 17 C.F.R. § 240.13e-3(g)(1) (1984) (exempting two-tier offers from the disclosure provisions of the going-private regu-
In sum, while state law remains important in regulating most corporate internal affairs transactions, the need for state regulation is weakest in the context of business combinations associated with two-tier tender offers. To the extent that the Maryland approach attempts to regulate such offers, the internal affairs rationale offers little protection against preemption attack. If indeed two-tier offers represent arm’s length transactions, the disclosure and substantive provisions of the Williams Act can provide the appropriate means of protecting investors. Additional state regulation, such as the Maryland statute, may unnecessarily upset the Williams Act’s balance between tender offerors and target management and therefore should be preempted.

3. The Preemption Standard Applied

According to the market approach view of the Williams Act, preemption analysis of state takeover legislation must focus on the extent to which state legislation upsets the federal regulations’ neutral balance between tender offerors and target management, and the concomitant effect on investors’ opportunities to receive tender offers. SEC Rule 14d-8, which has effects similar to those of the fair price provision of the Maryland statute, has been strongly criticized for upsetting this neutral balance. An even stronger case may be made that the supermajority, fair price and friendly offer exemption provisions of the Maryland law will significantly favor target management in the takeover contest. While many states allow shareholders to amend corporate charters to include similar supermajority provisions, Maryland has imposed these provisions on shareholders of in-state corporations

149. Professors Brudney and Chirelstein argue that while front-end loaded two-tier offers are arm’s length transactions, target shareholders are unable to protect themselves fully. They assert:

Given the inability of [a target’s] dispersed stockholders to communicate with one another during the tender, the act of offering a higher price on tender than would be paid on merger would have a “whipsaw” effect on [the] stockholders. Individual stockholders would find it difficult or impossible to refuse a tender price of $40 when they are also made aware that if the tender succeeds, the remaining shares will be merged out at $30. In effect, an announced disparity between the tender and the merger figure would deprive stockholders of their ability to make unforced, independent judgment on whether an average of $35 is an acceptable overall price for the assets of the firm. Fair Shares, supra note 49, at 337.

Brudney & Chirelstein contend that principles of fairness and investor protection dictate that freezeout price in a two-tier offer be set at the equivalent of tender offer price. They do not address, however, the preemption and commerce clause questions involved if a state were to enact their proposals. One student commentator has suggested that the Brudney & Chirelstein equal-consideration proposal is inconsistent with the federal approach to regulation of two-tier offers. See Comment, supra note 48, at 404-05, 422.

150. See notes 105-11 supra and accompanying text.
152. See note 60 supra.
and thus may be said to have violated the principle of investor autonomy in the Williams Act.

a. The controversy surrounding SEC Rule 14d-8: implications for the Maryland approach. The recently promulgated SEC Rule 14d-8\textsuperscript{153} extends the ten-day proration period provided in the Williams Act.\textsuperscript{154} The Williams Act pro rata provision is designed to alleviate some of the pressure placed on shareholders through the threat of an oversubscribed partial tender offer, by insuring that all shareholders who wish to receive the tender offer premium can have at least a percentage of their shares accepted.\textsuperscript{155} However, there is still substantial pressure on target shareholders when the tender offeror announces that its partial offer is only the first step of a plan to gain complete control and that the second-step freezeout price will be lower than the partial offer price.\textsuperscript{156} Under the Williams Act, if a target shareholder failed to tender within ten days and if the tender offer were ultimately successful, he might have all of his shares frozen out at the lower second-step price.

The SEC, through its rule-making power, recently extended the proration period of the Williams Act to include the entire time the tender offer remains open: a minimum of twenty business days. According to the SEC, the extended proration period is necessary to protect investors faced with partial and two-tier tender offers.\textsuperscript{157} The SEC has been severely criticized for overstepping its authority in promulgating this rule.\textsuperscript{158} Critics argue that the extension of the proration period is contrary to the explicit ten-day limitation in the Wil-

\footnotesize

\begin{itemize}
  \item \textsuperscript{153} 17 C.F.R. § 240.14d-8 (1984).
  \item \textsuperscript{154} See note 27 supra.
  \item \textsuperscript{155} See note 27 supra.
  \item \textsuperscript{156} In a partial offer with no mention of a second-step freezeout, a target shareholder may welcome the possible change of corporate control and thus wish to hold on to his or her shares. If the tender offeror announces its intention to cash out remaining target shareholders in a second step, nontendering shareholders may not be able to benefit from the change in control and the incentive to tender is increased. \textit{But see} Green & Junewicz, supra note 49, at 676 (noting that there may be a great incentive to tender in a partial offer without mention of a second step if shareholders feel that the tender offeror will in control the corporation to its own and not the shareholders' benefit).
\end{itemize}
Iiams Act and upsets its intended neutral balance between tender offerors and target management by creating delay that will benefit target management. 159

The controversy over the neutrality principle of the Williams Act and the SEC's authority to alter the balance established by the Act has important ramifications for the validity of the Maryland statute. By requiring that second-step price be at least equal to tender-offer price, the Maryland approach may upset the balance between target management and tender offeror even more radically than an extended proration period. Any incentive to tender early is almost completely eroded because whether they tender or not, target shareholders receive the same treatment; they may not be frozen out at lower than tender offer price. Indeed, the Maryland approach reduces the need for any proration period in a two-tier offer context. 160

The Williams Act pro rata provision and Rule 14d-8 attempt to insure that all shareholders have an equal opportunity to participate in the first step of a two-tier bid. 161 The Maryland approach goes beyond this to give shareholders equal treatment in both stages of a two-step transaction. 162 If Rule 14d-8 conflicts with the provisions of the Williams Act, then a fortiori the Maryland statute poses an impermissible conflict.

b. Neutrality violations: supermajority voting, fair price provisions and friendly offer exemptions. Supermajority provisions make it difficult and expensive to consummate a two-step takeover. 163 Were it not

159. See, e.g., Note, supra note 158, at 936-38; Recent Developments, supra note 158 at 1345-47. A longer period creates delay because target shareholders have less incentive to tender early. See note 111 supra.

160. The need for a proration period is not completely eliminated because there is still some risk in not tendering. If for some reason the tender offeror does not complete a second-step and the market value of the target's share declines, the shareholder will have lost the opportunity to get a premium for his or her shares. See Toms, supra note 48, at 571. This risk might induce shareholders to tender in the first step. If this risk were great, enough shareholders might tender to oversubscribe the offer and trigger the pro rata provision.

161. See Comment, supra note 48, at 404 (1982); see also SEC Advisory Committee on Tender Offers, Report of Recommendations 24 (July 8, 1983), reprinted in Special Edition, Fed. Sec. L. Rep. (CCH) 1028 (July 15, 1983) [hereinafter cited as ADVISORY REPORT] ("There is substantial sentiment on the Committee that, so long as there is equal opportunity for all shareholders to participate in all phases of each bid, the laws should not distinguish among various types of bids.").

162. One student commentator has stated, "Equal treatment of shares is a policy restricted in application to the tendering portion of a two-step acquisition." Comment, supra note 48, at 404 (emphasis in original). The Williams Act's "best price" provision, § 14(d)(7), 15 U.S.C. § 78n(d)(7) (1982) insures that the highest tender offer price is paid to all tendering shareholders, even those who tendered before the consideration offered was increased. See note 28 supra.

163. See Tender Offers, supra note 3, at 260-62; 1 A. Fleischer, supra note 59, at 26-30; 1 M. Lipton & E. Steinberger, supra note 140, at § 6.03[2][b]; see also Mullaney, Guarding Against Takeovers — Defensive Charter Provisions, 25 Bus. Law. 1441, 1453 (1970). Most state corporation laws permitting supermajority voting requirements were directed primarily at the charters of closely held corporations. The reasoning behind allowing such a requirement — preventing oppression of minority shareholders — does not necessarily apply with equal force in the context of publicly-held corporations. See Gilson, The Case Against Shark Repellent Amend-
for the existence of the fair price provision, Maryland’s supermajority requirement\(^{164}\) could virtually give management a veto power over business combinations.\(^{165}\) Such a pro-management bias runs counter to the investor protection goal of the neutral stance of the Williams Act.\(^{166}\)

The management-entrenching effect of the supermajority provision may have a collateral effect in deterring tender offers.\(^{167}\) Since the goal of a tender offer is often to gain sufficient control to complete a takeover, the increased difficulty of achieving this goal may act as a disincentive to tender offerors.\(^{168}\) This result may harm investors by denying them potential tender offers and the benefits of new management.\(^{169}\)

The fair price provision in the Maryland statute represents a means of avoiding the supermajority vote on a business combination.\(^{170}\) Although at first glance the fair price provision may seem to correct the disruption of the neutral balance caused by the supermajority voting requirement,\(^{171}\) the fair price provision itself is inconsistent with

\[^{164}\text{See notes 54-58 supra and accompanying text.}\]

\[^{165}\text{Maryland’s state-imposed supermajority provision would seem to have significant management-entrenchment tendencies because a business combination must be approved by a two-thirds disinterested shareholder majority. Target management may own enough shares to block the business combination even if the tender offeror acquires 80\% of the total outstanding target shares. See notes 54-56 supra and accompanying text; cf. Greene & Junewicz, supra note 49, at 703 n.278 (“The deterrent effect of a ‘supermajority’ provision is particularly high where management controls enough shares to block the supermajority vote even if the offeror tenders for all outstanding shares.”).}\]

\[^{166}\text{See note 105 supra and accompanying text.}\]

\[^{167}\text{Indeed, a main purpose of shark-repellent provisions is to deter tender offers: “The idea is to amend the target’s articles of incorporation to make it a less desirable or more difficult acquisition, and thereby to encourage the ‘shark’ to seek a more appetizing or more easily digested alternative.” Gilson, supra note 163, at 777.}\]

\[^{168}\text{Cf. Friedenberg, Jaws III: The Impropropriety of Shark-Repellent Amendments as a Takeover Defense, 7 DEL. J. CORP. L. 32, 43, 84, 88 (1982) (supermajority provisions prevent shareholders from accepting offers and also deter bidders); Gilson, supra note 163, at 796-800 (supermajority requirement raises the cost of offers but deterrent effect is attenuated by differing incentives to offeror and by costs to management of resistance).}\]

\[^{169}\text{See note 77 supra and accompanying text; Friedenberg, supra note 168, at 84, 88.}\]

\[^{170}\text{See notes 58-59 supra and accompanying text.}\]

\[^{171}\text{Unlike the supermajority requirement, the fair price provision offers little direct advantage to target management. The existence of the provision means that management cannot use its voting power to block a business combination. See Hochman & Folger, Deflecting Takeovers: Charter and By-Law Techniques, 34 BUS. LAW. 537, 553-54 (1979). However, requiring tender offerors to pay “fair price” in the second step may indirectly benefit incumbent management by increasing the cost of a takeover. See DEVELOPMENTS, supra note 38, at 196.}\]
the market approach. Under the market approach view, the Williams Act requires only that all target shareholders receive an equal opportunity to participate in a tender offer. Those who choose not to tender presumably make a conscious decision concerning the risks and advantages of holding onto their shares and should not be entitled to the same treatment as tendering shareholders. Yet the Maryland fair price provision insures that all target shareholders — tendering and nontendering — receive similar treatment in the takeover process.

The fair price provision of the Maryland statute conflicts with the principles of the Williams Act in other respects. First, the fair price provision eliminates the capacity of tender offerors to make front-end loaded two-tier bids, a technique implicitly recognized and permitted under federal regulations. Second, because target shareholders know that they cannot be frozen out at less than tender offer price, the pressure to respond to a tender offer is greatly reduced. As the criticism of SEC Rule 14d-8 has suggested, the reduced pressure on shareholders to respond to a partial or two-tier offer works to the advantage of target management. Management gains more time to block a tender offer while tender offerors are likely to have to incur greater expense to succeed. This is likely to cut down on the willingness of people to make tender offers, an effect inconsistent with the concept of investor protection in the Williams Act. Finally, the mechanics of Maryland's fair price provision are such that the tender offeror will have great difficulty ascertaining the cost of the second step of a takeover. This makes the first step, the tender offer, less attractive, again disrupting the balance of the federal statute.

The Maryland statute also disrupts the balance between tender offerors and target management by granting target management discretion to exclude certain business combinations from the coverage of the law. Many courts and commentators analyzing the friendly offer exemptions of first generation state takeover statutes have found that such exemptions tip the regulatory balance in favor of target management. The legislative history of the new Maryland statute suggests that its friendly offer exemption is designed to accommodate target

172. See note 161 supra and accompanying text.
173. See note 58 supra and accompanying text.
174. See notes 137-41 supra and accompanying text.
175. See DEVELOPMENTS, supra note 38, at 196; 1 A. FLEISCHER, supra note 59, at 32; Fischel, supra note 77, at 31 n.101; Hochman & Folger, supra note 171, at 554.
176. See notes 154-62 supra and accompanying text.
177. See M. LIPTON & E. STEINBERGER, supra note 140, § 6.03[2][c] at 6-34.
178. See note 58 supra; see also Hochman & Folger, supra note 171, at 554-55 (deterrent potential of fair price provision is derived in part from the offeror's loss of control over the ultimate takeover price).
179. See notes 62-63 supra and accompanying text.
180. See notes 33 & 38 supra.
management. Adoption of the exemption was necessary to gain support for the statute from the Maryland business community. The Maryland friendly offer exemption violates principles of neutrality and investor autonomy established by the Williams Act. It permits target management, rather than investors, to decide which takeover attempts should have the best opportunity for success.

c. Investor autonomy violations. The criticism that the friendly offer exemption reduces investor autonomy extends to the Maryland statute as a whole. The very adoption by the state of a law that deters takeover attempts reduces shareholder autonomy. Because its shark-repellent provisions are statutorily imposed instead of adopted through charter amendment, the Maryland approach in effect replaces investor autonomy with a benevolent bureaucracy. Some commentators and the SEC have expressed doubt about the validity of

181. Governor Hughes of Maryland vetoed the original version of the new Maryland statute because it was too broad. At a veto hearing, the executives of a number of Maryland corporations complained that the Bill would unnecessarily apply to friendly takeovers as well as corporate affairs that have no relationship to a takeover. These complaints figured prominently in the Governor's veto of the original bill. See STAFF REPORT, supra note 50, at 49-51; see also Allen, Maryland Bill On Takeovers Spurs a Fight, Wall St. J., May 26, 1983, at 33, col. 3.

182. Supporters of friendly offer exemptions argue that target stockholders are benefited by such exemptions because management gains increased bargaining power in negotiations with the tender offeror. See Smith, supra note 163, at 7. In granting target management the discretion to determine which transactions should be subject to the new Maryland law, the Maryland approach relies on management's business judgment and fiduciary duties to protect target shareholders' interests. But see note 92 supra (fiduciary approach is inconsistent with the market approach of the Williams Act); Hochman & Folger, supra note 171, at 552 (friendly offer exemption might be subject to attack on the ground that it improperly delegates to directors discretionary authority on matters reserved for stockholders).

183. The "benevolent bureaucracy" language has been used to criticize administrative review provisions in first generation state takeover statutes. See Sargent, supra note 2, at 697; see also note 32 supra. The term may be appropriate in the Maryland context as well, because the Maryland statute also curtails shareholder freedom to decide which takeover attempts should have the best opportunity for success.

184. The argument that shark-repellent provisions should be encouraged because they induce tender offerors to negotiate with target management implies that existing constraints on tender offers do not adequately protect the interests of target shareholders. There is no reason to believe that such an implication is valid. The Exchange Act imposes substantive restrictions on tender offers, requires extensive disclosure by the bidder, and contains an antifraud provision. Additional safeguards arguably conflict with the federal policy of neutrality which is embodied in the statute. Indeed, shark-repellent amendments are analogous to state antitakeover laws which delay, and sometimes prevent, the commencement of a tender offer. In part, the antitakeover statutes are undesirable because they superimpose a pro-management bias on the regulatory scheme created by Congress and the SEC. This criticism also applies to shark-repellents and provides another reason for opposing their adoption.

shark-repellent amendments even when adopted by shareholders. The case against supermajority voting requirements, fair price provisions and friendly offer exemptions is made even stronger when investors do not themselves adopt such measures.

The Maryland statute clearly does provide some benefits. It eliminates the coercion inherent in partial and two-tier offers by assuring nontendering shareholders a voice in the second step or, at least, treatment no worse than that received by tendering shareholders. These


Most commentators view shareholder approval of shark-repellent provisions as an important element of the provisions’ validity. See 1 A. FLEISCHER, supra note 59, at 12-14, 33-34; Friedenberg, supra note 168, at 49; see also Black & Smith, Antitakeover Charter Provisions: Defending Self-Help for Takeover Targets, 36 WASH. & LEE L. REV. 699, 730 (1979). In this regard, it is significant to note that under the new Maryland law shareholders of Maryland corporations can elect to be exempt from the Maryland law only if they pass a charter amendment in favor of exemption by a vote of 80% of the outstanding voting shares and a vote of two-thirds of the voting shares not owned by interested stockholders. MD. CORPS. & ASS'NS. CODE ANN. § 3-603(e)(1)(ii) (Supp. 1984).

187. The propriety of states statutorily imposing shark-repellent provisions on target shareholders has been questioned by commentators sympathetic to shareholder adopted shark-repellent amendments:

While it is interesting to speculate on the types of substantive corporate law changes that might be implemented to deal with the transfer of control, in the final analysis it may be that no such statutory changes are necessary. The real focus should be on the relationship between all of the stockholders and their willingness to surrender some of their present rights in favor of preventing one stockholder from gaining absolute control. In short, are stockholders willing to forgo a potentially profitable tender offer in order to minimize or eliminate the risk that they or their fellow stockholders may emerge as minority stockholders in a controlled enterprise? From this perspective, the relevant questions are for the stockholders to decide.

Black & Smith, supra note 186, at 730 (emphasis added).

Theoretically, investors are able to adopt shark-repellent provisions through corporate charter amendments. If this opportunity is open, it makes sense to let investors choose for themselves. The Maryland legislature may have believed, however, that self-help is unavailable in many cases. The Staff Report to the General Assembly of Maryland states:

It is generally agreed that a company-by-company approach does not solve the problem. It is unlikely that those companies having a large proportion of institutional investors would be unable [sic] to get a charter amendment, because it is the institutional investors who stand to profit most in a takeover.

STAFF REPORT, supra note 41, at 18.

Shark-repellent charter amendments conflict with the interests of institutional investors and institutional investors have usually voted against them. See TENDER OFFERS, supra note 3, at 259-60; Gilson, supra note 163, at 826-27. However, recent data indicates that shark-repellent proposals have enjoyed a great deal of success. See Fried, Frank, Harris, Shriver & Jacobson, Analysis of Shareholder Response to 1983 Shark Repellent Proposals (May 19, 1983), reprinted in 2 A. FLEISCHER, supra note 59, at 615-43.


189. Maryland’s response to the coerciveness of partial and two-tier offers is similar to the
benefits are provided, however, at the expense of tender offerors who are stripped of a useful acquisition technique and, more importantly, at the expense of those investors who desire to receive tender offers for their shares. The Maryland statute's potential anti-takeover effect cannot be reconciled with the concepts of neutrality and investor protection in the Williams Act. The statute is incompatible with congressional objectives in regulating tender offers and is therefore preempted.

CONCLUSION

In Edgar v. MITE Corp. the Supreme Court declared unconstitutional state legislation regulating the tender offer as a means of obtaining corporate control. The MITE decision did not rule out all forms of state regulation in this area and a number of states have developed a "second generation" of takeover legislation. The new Maryland statute merits special attention. Instead of regulating the tender offer for a controlling interest in a target corporation, the Maryland statute purports to protect investors by regulating what the tender offeror may do after gaining working control. The Maryland statute, through the use of "supermajority" voting requirements and a fair price provision, restricts the ability of the tender offeror to later "freezeout" minority shareholders.

While Maryland's new statute bears some resemblance to traditional forms of state regulation of the internal affairs of corporate domiciliaries, the statute's effect on tender offers and corporate acquisition markets suggests that it has not escaped the constitutional infirmities of predecessor statutes invalidated in MITE. The burdens the Maryland statute places on interstate commerce outweigh the local benefits it produces; thus the statute violates the commerce clause. Furthermore, the regulatory approach of the Maryland statute is inconsistent with the conception of investor protection in the federal proposals of Professors Brudney and Chirelstein who suggest that the freezeout price should be equal to the tender offer price. See Fair Shares, supra note 49, at 337; Restatement, supra note 49, at 1361.

190. See notes 105-11 supra and accompanying text. It may be urged that congressional methods of investor protection have not kept pace with innovative acquisition techniques such as front-end loaded two-tier offers. Nonetheless, it is for Congress, not the states, to determine what action, if any, should be taken. See Great Western United Corp. v. Kidwell, 577 F.2d 1256, 1280 n.52 (5th Cir. 1978), rev'd on other grounds sub nom. Leroy v. Great Western United Corp., 443 U.S. 173 (1979) ("Changing economic conditions may have disrupted the balance that Congress struck in the Williams Act. But, it is for Congress — not Idaho — to determine if adjustments in the federal balance are necessary . . . .").

191. "Courts have invalidated state tender offer statutes that interfere with the bidder's conduct of a tender offer under federal rules and burden tender offers in interstate commerce. Newly developed state statutes which, through regulation of target companies, have substantially similar effects on the ability to conduct a tender offer should not be permitted regardless of the form in which they are drafted." ADVISORY REPORT, supra note 161, at 34-35 (footnotes omitted).
tender offer regulatory mechanism, the Williams Act, and is therefore preempted under the supremacy clause.