1-1-1987

Round Two: Illinois' Second Generation Takeover Legislation, 36 DePaul L. Rev. 361 (1987)

Diane S. Kaplan
John Marshall Law School, 7kaplan@jmls.edu

ROUND TWO: ILLINOIS' SECOND GENERATION TAKEOVER LEGISLATION

*Diane S. Kaplan**

INTRODUCTION

The Illinois General Assembly has twice enacted legislation designed to alleviate the inequities resulting from corporate takeover attempts. The Illinois Business Take-Over Act of 1978 (1978 Act)[1] regulated the tender offer stage of the acquisition process and, like its thirty-six companion state statutes,[2] was intended to provide state sanctioned defense tactics to domestic corporations under the siege of a hostile takeover attempt. The United States Supreme Court held the 1978 Act unconstitutional under the commerce clause in *Edgar v. MITE Corp.*, (*MITE*).[3] With the demise of the 1978 Act, the remaining state takeover statutes fell like dominoes.[4]

In August 1985, the Illinois General Assembly enacted[5] its second gener-

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* Associate Professor, The John Marshall Law School. B.A., 1971, University of California at Berkeley; J.D., 1975, Yale Law School. The author wishes to express gratitude to The John Marshall Law School, Associate Dean Helen M. Thatcher, its secretarial staff, and research assistants Craig S. Donahue and Joseph P. Sorce for their insights, assistance, and encouragement.

1. Illinois Business Take-Over Act, ILL. REV. STAT. ch. 121 1/2, paras. 137.51-137.70 (1979) (repealed 1983).

2. *See* Sargent, *On the Validity of State Takeover Regulation: State Responses to* MITE *and* Kidwell, 42 OHIO ST. L.J. 689, 690 n.7 (1981).

3. 457 U.S. 624 (1982).

4. Federal and state appellate courts applying *MITE* throughout the country have held first generation state takeover statutes unconstitutional as applied to tender offers. *See, e.g.,* Mesa Petroleum Co. v. Cities Serv. Co., 715 F.2d 1425 (10th Cir. 1983) (Oklahoma act); Martin-Marietta Corp. v. Bendix Corp., 690 F.2d 558 (6th Cir. 1982) (Michigan act); National City Lines, Inc. v. LLC Corp., 687 F.2d 1122 (8th Cir. 1982) (Missouri act); Empire, Inc. v. Ashcroft, 524 F. Supp. 898 (W.D. Mo. 1981) (Missouri act). The courts have also found takeover statutes unconstitutional as applied to open market purchases. *See, e.g.,* Telvest, Inc. v. Bradshaw, 697 F.2d 576 (4th Cir. 1983) (Virginia act); Esmark, Inc. v. Strode, 639 S.W.2d 768 (Ky. 1982) (Kentucky act); Sharon Steel Corp. v. Whaland, 124 N.H. 1, 466 A.2d 919 (1983) (New Hampshire act).

5. On February 28, 1985, the late Senator Prescott Bloom introduced Senate Bill 0259 entitled, "Illinois Shareholder Protection Law." In general terms, S.B. 0259 provided certain rights to minority shareholders in a takeover attempt and authorized the officers and directors of the target company to consider the effects of any takeover on the employees, suppliers, customers, and community of the company. Apparently, S.B. 0259 was intended to follow Maryland's fair price legislation (MD. CORPS. & ASS'NS CODE ANN. §§ 3-601 to -603 (Supp. 1984)) which was heavily favored by those looking for a strong departure from the *Edgar v. MITE* type takeover statute. Shortly thereafter, on April 12, 1985, House Representative Robert

ation of takeover legislation[6] in the form of two amendments to the Business

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Churchill introduced House Bill 2138, designed to create the "Illinois Corporate Take-Over Act." In practical terms, H.B. 2138 was a thinly disguised attempt to reintroduce many of the provisions of the original 1978 Business Take-Over Act such as the regulation of takeovers by the Secretary of State and pre-takeover notification and hearing requirements. Hence, in the spring of 1985, two separate takeover statutes were pending in the General Assembly.

Eventually, a consensus developed in favor of S.B. 0259 and, on May 22, 1985, the bill was permanently sent to the House Judiciary Committee for interim study. With the focus now clearly on S.B. 0259, two Amendments to the Business Corporation Act of 1983 were proposed and accepted by the House Judiciary Committee. On June 30, 1985 the Senate concurred in the House Amendments and on August 23, 1985 Governor Thompson signed the Amendments as Public Act 82-204. For a discussion of the legislative history, see Interviews with Joan Coogan, Legislative Assistant to the Chicago Bar Association (Feb. 1986 and Aug. 11, 1986). *See also Session Illinois General Assembly — Final Legislative Synopsis and Digest* 163 (1985) (summarizing legislative development of Amendments).

6. Second generation takeover statutes are so named because they proceeded after *MITE,* while first generation statutes preceded *MITE.* The first generation statutes basically attempted to regulate the tender offer stage of the acquisition by tracking the provisions of the federal tender offer rules under the Williams Act, 15 U.S.C. §§ 78m(d)-(e), 78n(d)-(f) (1982). Second generation statutes generally attempt to regulate the second stage of the takeover in which the corporation undergoes a fundamental corporate change. Such statutes fall into two broad categories: (i) "control share acquisition" statutes which require advance board or shareholder approval before a bidder can vote certain levels of stock acquired in the target; and (ii) "fair price/business combination" statutes which require the bidder to comply either with certain pricing procedures or with certain shareholder.supermajority voting requirements before causing the corporation to enter into a fundamental corporate change.

The following states have adopted "control share acquisition" statutes. *See* HAWAII REV. STAT. §§ 416-171 to -172 (Supp. 1985); IND. CODE ANN. §§ 23-1-42 to -42-11 (Burns Supp. 1986); ME. REV. STAT. ANN. tit. 13-A, § 901 (West 1981); MINN. STAT. ANN. § 80B.01-.13 (West Supp. 1986); MO. ANN. STAT. §§ 351.015, 351.407 (Vernon Supp. 1986); OHIO REV. CODE ANN. §§ 1701.01-1701.831 (Page Supp. 1983); UTAH CODE ANN. § 16-10-76.5 (Supp. 1986). The following states have enacted "fair price/business combination" statutes. *See* CONN. GEN. STAT. ANN. § 33.374(a)-(c) (West 1986); GA. CODE ANN. §§ 14-2-232 to -234 (1986); ILL. REV. STAT. ch. 121 1/2, paras. 137.51-137.70 (1986); IND. CODE ANN. §§ 23-1-43-1 to -1-43-24 (Burns 1986); KY. REV. STAT. ANN. § 271A.396-.398 (Baldwin 1986); LA. REV. STAT. ANN. §§ 12:132-134 (West 1986); MD. CORPS. & ASS'NS CODE ANN. §§ 3-601 to -603 (1985); MICH. STAT. ANN. §§ 21.200 (775)-(784) (Callaghan 1985); MISS. CODE ANN. § 79-25-1 to -25-7 (Supp. 1985); N.Y. BUS. CORP. LAW § 912 (McKinney 1986); PA. STAT. ANN. tit. 15, § 1409.1 (Purdon Supp. 1986) (repealed 1986); VA. CODE ANN. § 13.1-725 to -728 (1985); WASH. REV. CODE ANN. § 23A.08.425 (Supp. 1986); WIS. STAT. ANN. § 180.725 (West 1986). Second generation legislation is pending in California and New Jersey.

For decisions concerning "control share acquisition" statutes, see Fleet Aerospace Corp. v. Holderman, 796 F.2d 135 (6th Cir. 1986), *prob. juris. denied,* 107 S. Ct. 1623 (1987) (holding Ohio's statute unconstitutional under both the supremacy and commerce clauses); Dynamics Corp. of Am. v. CTS Corp., 794 F.2d 250 (7th Cir. 1986), *rev'd,* 107 S. Ct. 1637 (1987) (Court reversed Seventh Circuit holding that Indiana statute was unconstitutional under both the supremacy and commerce clauses); APL Ltd. Partnership v. Van Dusen Air, Inc., 622 F. Supp. 1216 (D. Minn. 1985), *appeal dismissed,* Nos. 85-5285/5286-MN (8th Cir. Jan. 7, 1986) (holding the Minnesota Control Share Acquisition Act unconstitutional under the commerce clause); Icahn v. Blunt, 612 F. Supp. 1400 (W.D. Mo. 1985) (holding the Missouri Control Share Acquisition Act unconstitutional, as applied to foreign corporations, under both the commerce clause and

Corporation Act of 1983 (Business Corporation Act).[7] Unlike the 1978 Act, which explicitly regulated tender offers, sections 7.85[8] and 8.85[9] (Amendments) purport to regulate only the internal affairs of "domestic corporations"[10] by defining the rights and duties between minority and majority shareholders in the second stage of the front-end-loaded takeover.[11] Section 7.85 requires a successful tender offeror who has become an "Interested Shareholder"[12] to comply with either "supermajority" voting requirements or "price and procedure" requirements before securing control over the target.[13] Section 8.85 permits target management to consider as within the "best interests of the corporation" the effects of "any action" upon the corporation's employees, suppliers, customers, and community.[14] Together, sections 7.85 and 8.85 provide incumbent management of domestic corporations with two potent lines of defense against the modern hostile takeover. While section 7.85 fortifies the board's defense posture against the offeror by escalating the risks and expenses of undertaking an unfriendly acquisition, section 8.85 thwarts shareholder challenges to the board's defense strategy.

Section I of this Article sets forth preliminary historical information placing Illinois' second generation takeover legislation in its legal context. Section II summarizes, explains, and demonstrates pertinent provisions of the Amendments. Section III assesses the constitutional implications of the Amendments under the supremacy and commerce clauses of the federal Constitution. Section IV concludes that the Amendments have failed to negotiate successfully the obstacles posed by *Edgar v. MITE* and, hence, must fall under either the supremacy clause, the commerce clause, or both.

I. BACKGROUND

The Amendments represent the General Assembly's response to two developments: the Supreme Court's majority holding in *Edgar v. MITE* that

supremacy clause); Terry v. Yamashita, [1986-87] Fed. Sec. L. Rep. (CCH) ¶¶ 94,111 and 94,112-14 (1986) (holding Hawaii's statute unconstitutional under the commerce clause). To date, there are no reported decisions on the constitutionality of the "fair price/business combination" statutes.

7. Business Corporation Act of 1983, ILL. REV. STAT. ch. 32, paras. 1.01-17.05 (Supp. 1985). The takeover amendments were added by Public Act 84-204, effective Aug. 23, 1985.

8. Business Corporation Act of 1983 § 7.85.

9. *Id.* § 8.85.

10. The Business Corporation Act of 1983 section 1.80 defines "domestic corporation" as all corporations subject to the BCA's provisions, except foreign corporations. *See infra* notes 123-28 and accompanying text.

11. *See infra* notes 40-46 and accompanying text. *See also* Scriggins & Clark, Takeovers and The 1983 Maryland Fair Price Legislation, 43 MD. L. REV. 266, 267-70 (1984) (historical background of front-end-loaded takeover strategy).

12. Business Corporation Act of 1983 § 7.85.C(2).

13. *Id.* § 7.85.

14. *Id.* § 8.85.

the 1978 Act violated the commerce clause of the Constitution[15] and the development of the two tiered front-end-loaded takeover.[16]

A. *Edgar v. MITE*

The 1978 Act regulated the tender offer stage of the takeover by imposing procedural and substantive requirements on the tender offeror.[17] According to its proponents, the 1978 Act's primary purpose was to protect resident shareholders of Illinois corporations from the coercive effects of a tender offer.[18] The 1978 Act's requirements, however, extended to all tender offers, not just those of a purely domestic nature.[19] For example, the 1978 Act defined "target" as any corporation owned by at least ten percent of Illinois residents or for which any two of the following three conditions were met: (i) the corporation's headquarters were located in Illinois, (ii) the corporation was incorporated under Illinois law, (iii) at least ten percent of the corporation's stated capital and paid-in surplus were represented within Illinois.[20]

The 1978 Act also contained a precommencement notification provision requiring the offeror to file a registration statement with the Secretary of State and the target twenty days prior to the tender offer's commencement.[21] The 1978 Act prohibited the offeror from communicating with the target's shareholders during this period although the target was not similarly restricted.[22] The twenty day registration period could be extended indefinitely if either the Secretary or the target requested a hearing for the protection

15. *MITE*, 457 U.S. 624.

16. *See, e.g.*, Martin Marietta Corp. v. Bendix Corp., 549 F. Supp. 623 (D. Md. 1982) and *infra* note 41. Bendix attempted a front-end-loaded takeover of Martin Marietta by tender offering 70% of Marietta's stock at $48.00 per share. Bendix then intended to merge the two companies by offering the remaining Marietta shareholders $0.82 of Bendix stock for each share of Marietta. *Id.* at 625. Bendix did not guarantee any minimum amount of consideration in the share exchange. *Id.* at 625 n.2. Marietta countered with its own "pac-man" strategy whereby it tender offered for $75.00 per Bendix share with the intention of merging out the remaining shareholders by an exchange offering of 1 2/3 shares of Marietta per each Bendix share. *Id.* Into this fray leapt United Technologies Corporation with a $75.00, soon increased to $85.00, tender offer for Bendix. *Id.* Not surprisingly, everyone went to court. Bendix sued to enjoin the Maryland Corporate Takeover Law; Marietta sued Bendix for misrepresentations and omissions in its disclosure materials; Bendix counterclaimed that Marietta's countertender was illegal; United Technologies sued to enjoin Bendix from amending its charter to frustrate tenders for Bendix; Bendix countered United Technologies arguing that its tender offer violated antitrust laws. *See* Martin Marietta Corp. v. Bendix Corp., 547 F. Supp. 533, 534 n.5 (D. Md. 1982).

17. Illinois Business Take-Over Act §§ 137.54-137.57.

18. *MITE*, 457 U.S. at 644-46.

19. *Id.* at 641-43.

20. Illinois Business Take-Over Act § 137.52-10(a)-(c).

21. *Id.* § 137.54.E.

22. *Id.* § 137.59.G.

of the offerees. If the Secretary determined at the hearing that the terms of the offer were unfair or illegal, the tender offer could be denied registration.[23]

The 1978 Act was challenged in January of 1979 by MITE, a Delaware corporation headquartered in Connecticut. MITE simultaneously made a cash tender offer for all outstanding shares of Chicago Rivet and Machine Company (Chicago Rivet), an Illinois corporation doing business primarily in Pennsylvania, and filed suit in federal district court seeking declaratory and injunctive relief from the 1978 Act on the grounds that it violated the supremacy and commerce clauses.[24] Three days later, Chicago Rivet filed a declaratory and injunctive action in Pennsylvania alleging that MITE's Illinois tender offer violated the Pennsylvania Takeover Disclosure Law.[25] After an unsuccessful skirmish in the Pennsylvania courts, Chicago Rivet turned its attention to the Illinois Act and, under its protection, self-tendered for forty percent of its own outstanding stock.[26] Within days, the district court permanently enjoined enforcement of the 1978 Act on the grounds that it violated both the supremacy and commerce clauses.[27] Shortly after entry of the final judgment, both MITE and Chicago Rivet withdrew their tender offers.[28] On appeal by the Secretary of State, the district court's rulings were affirmed by the Seventh Circuit[29] and affirmed in part by the Supreme Court.[30]

The Court articulated several objections to the 1978 Act. As a threshold matter, the Court rejected the applicability of the internal affairs doctrine in the tender offer context:

> The internal affairs doctrine is a conflict of laws principle which recognizes that only one State should have the authority to regulate a corporation's internal affairs — matters peculiar to the relationships among or between the corporation and its current officers, directors, and shareholders — because otherwise a corporation could be faced with conflicting demands . . . . That doctrine is of little use to the State in this context. Tender offers contemplate transfers of stock by stockholders to a third party and do not themselves implicate the internal affairs of the target company.[31]

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23. *Id.* § 137.57.A.

24. *MITE,* 457 U.S. at 627-28.

25. *Id.* The Pennsylvania Securities Commission chose not to invoke the takeover protections provided in PA. STAT. ANN. tit. 70, §§ 71-79 (Purdon 1986). Chicago Rivet then moved for a temporary restraining order which was denied by the U.S. District Court, Western District of Pennsylvania. *MITE,* 457 U.S. at 628 n.3.

26. *MITE,* 457 U.S. at 629. Section 137.52-9(4) of the Illinois Business Take-Over Act exempted from regulation a company's offer for its own shares.

27. *MITE,* 457 U.S. at 629.

28. *Id.*

29. MITE Corp. v. Dixon, 633 F.2d 486 (7th Cir. 1980), *aff'd sub nom.* Edgar v. MITE Corp., 457 U.S. 624 (1983).

30. *MITE,* 457 U.S. at 624.

31. *Id.* at 645 (citing RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 302 comment b (1971)).

The Court's commerce clause analysis questioned as both over- and underinclusive the 1978 Act's purported purpose of protecting resident shareholders.[32] The Court found the 1978 Act to be overinclusive in that its broad definition of target[33] allowed Illinois to regulate acquisitional activities of foreign corporations "even if not a single . . . shareholder were a resident of Illinois,"[34] and thus, imposed extraterritorial burdens on interstate commerce which exceeded the local interests it purported to protect.[35] The Court found the 1978 Act to be underinclusive in that its time and informational requirements[36] already were provided by the Williams Act, thus failing to protect "substantially" even resident shareholders.[37] The Court also noted that the pro-management bias inherent in the notice, hearing, and fairness provisions discriminated against the offeror in violation of the Williams Act's requirement of neutrality between incumbent management and the takeover bidder.[38] For these reasons, a majority of the Court struck down the 1978 Act as violative of the commerce clause and three justices opined that the 1978 Act violated the supremacy clause as well.[39]

B. The Front-End-Loaded Takeover

The front-end-loaded takeover is an acquisitional strategy whereby the acquiror typically makes a cash tender offer for a percentage of the target's

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32. *MITE,* 457 U.S. at 644.

33. *See supra* notes 17-20 and accompanying text for the 1978 Act's definition of target.

34. *MITE,* 457 U.S. at 642.

35. *Id.* at 644-45.

36. *See supra* notes 21-24 and accompanying text for the 1978 Act's time and informational requirements.

37. *MITE,* 457 U.S. at 644-45.

38. The Williams Act Amendments, 15 U.S.C. §§ 78m(d)-(e), 78n(d)-(f) (1982), sought to ensure that "public shareholders who are confronted by a cash tender offer for their stock will not be required to respond without adequate information regarding the qualifications and intentions of the offering party." Rondeau v. Mosinee Paper Corp., 422 U.S. 49, 58 (1975) (citing S. REP. No. 550, 90th Cong., 1st Sess. 2 (1967)) [hereinafter Senate Report]. The Senate Report recognized that "takeover bids should not be discouraged because they serve a useful purpose in providing a check on entrenched but inefficient management." Senate Report, *supra,* at 3. The result was an attempt to enact a law furthering the federal "policy of neutrality in contests for control." Piper v. Chris-Craft Indus., Inc., 430 U.S. 1, 29 (1977). As recognized in *Rondeau,* the drafters of the Williams Act emphasized that they had taken extreme care "to avoid tipping the scales either in favor of management or in favor of the person making the takeover" bid and that the bill was "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." 422 U.S. at 58 (citing S. REP. No. 550, 90th Cong., 1st Sess. 3, 4 (1967); *See* H.R. REP. No. 1711, 90th Cong., 2d Sess. 4 (1968); Junewicz, *infra* note 95, at 143-45.

39. *MITE,* 457 U.S. at 646. Justices Powell, Stevens, and O'Connor held the law violated only the commerce clause. *Id.* at 630-40. Chief Justice Burger and Justices White and Blackmun concurred that the law violated the supremacy clause as well. *Id.* at 646-54. Justices Rehnquist, Marshall, and Brennan held the appeal was moot. *Id.* at 655, 664. *See* Sargent, *The Rise and Fall of First Generation State Takeover Statutes,* in A.L.I.-A.B.A. COURSE OF STUDY: NEW DIRECTIONS IN STATE TAKEOVER REGULATION: THE SECOND GENERATION STATUTES 192-95 (1986) (*MITE* reflected disagreement on whether the states could regulate tender offers).

shares sufficient to obtain voting control over the target,[40] and then, assuming the success of the tender offer, secures control over the target by merging it with or consolidating it into the acquiror or one of its affiliates.[41] Pursuant to this second transaction, the remaining shareholders are offered either cash for their stock or an exchange of their stock for the equity or debt of the acquiror. The value of the cash-out or exchange offer, however, is usually substantially less than either the cash paid for identical stock in the tender offer[42] or the market value of the stock before the tender offer.[43] Because of the coercive nature of this takeover strategy, the target's shareholders rush to tender in the first stage of the acquisition to avoid being forced out at an inadequate price in the second stage.[44] The front-end-loaded takeover has met with considerable success and criticism[45] because it frequently enables the acquiror to purchase the assets of the target "for a combined price that is less than their real value."[46]

II. THE AMENDMENTS

A. Definitions

Section 7.85.A defines "target" as any "domestic corporation,"[47] not otherwise exempted,[48] which has at least one class of equity securities reg-

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40. *See, e.g., Bendix*, 549 F. Supp. at 625. At this point, the shareholder faces the difficult choices of retaining his shares and risking devaluation should the tender offer succeed, immediately tendering his shares to secure the full price for all shares, waiting out the current offer in the hope that the market will force the offeror to increase the offering price, waiting for a competing bidder to offer a better price, or selling his stock on the open market where often the mere announcement of a tender offer will raise the value of the target's stock.

41. *See* Scriggins & Clark, *supra* note 11, at 266 (state corporation laws generally permit merger upon approval by simple majority).

42. Dynamics Corp. of Am. v. CTS Corp., 794 F.2d 250, 252 (7th Cir. 1986), *rev'd*, 107 S. Ct. 1637 (1987); Martin Marietta Corp. v. Bendix Corp., 549 F. Supp. 623 (D. Md. 1982); Esmark, Inc. v. Strode, 639 S.W.2d (Ky. 1982). *See also* Scriggins & Clark, *supra* note 11, at 267 (remaining shareholders in tender offer will suffer loss).

43. *See generally* L. LOSS, FUNDAMENTALS OF SECURITIES REGULATION 570 (1983) (tender offers are often followed by a second offer for less value, a freeze-out merger, or both).

44. *See* Radol v. Thomas, 534 F. Supp. 1302, 1312 (S.D. Ohio 1982) (tender offers coerce sales to the offeror because the fear of a squeeze-out compels the shareholders to sell or risk loss in the value of their investment).

45. *See* Dynamics Corp. of Am. v. CTS Corp., 794 F.2d at 252 (7th Cir. 1986), *rev'd*, 107 S. Ct. 1637 (1987); *Bendix*, 549 F. Supp. at 630. *See generally* Scriggins & Clark, *supra* note 11, at 271 n.23 (illustrating the breadth of articles written on anti-takeover legislation).

46. *See* Scriggins & Clark, *supra* note 11, at 267.

47. Business Corporation Act of 1983 § 1.80(a).

48. *Id.* § 7.85.A. This section exempts domestic corporations which do not have securities registered under the Securities Exchange Act of 1934 and which neither have adopted nor amended their articles to include section 7.85. *Id.* A domestic corporation may "opt out" of section 7.85 provided it amends, repeals, or adopts provisions inconsistent with section 7.85 by the affirmative vote of (i) 80% of the total outstanding voting shares and (ii) a majority of the

istered under the Securities Exchange Act of 1934 or which has adopted or amended its articles to include section 7.85.[49] Sections 1.80(a) and (b) of the Business Corporation Act[50] limit the definition of "domestic corporation" to any corporation which is subject to its provisions and which is not incorporated under the laws of any other state.

An "Interested Shareholder"[51] is any acquiror who, as determined by a majority of the "Disinterested Directors,"[52] has obtained either ten percent of the combined voting power of the target's outstanding shares[53] or which, as an affiliate or associate of the target, has acquired beneficial ownership of ten percent of the combined voting power of the target's outstanding stock two years prior to "the date in question."[54] A "Disinterested Director" is any member of the target's board who acquired his directorship free of the Interested Shareholder's influence and includes any person who was either a member of the target's board prior to the time the Interested Shareholder became an Interested Shareholder or who was recommended to

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total voting shares held by Disinterested Shareholders. *Id.* Section 1.80 excludes from the definition of "domestic corporation" any "foreign corporation," which is defined as "a corporation for profit organized under laws other than the laws of this state, but shall not include a foreign banking corporation organized under the laws of a country other than the United States . . . ." *Id.* § 1.80(b).

Compare Illinois' exemption provisions *with* CONN. GEN. STAT. ANN. § 33.374(a)-(c) (West 1985) (exempts corporations not required to file reports pursuant to sections 13 or 15(d) of the Securities Exchange Act of 1934, as amended, 15 U.S.C. § 78a-kk (1982)); GA. CODE ANN. §§ 14-2-231 to -235 (1985) (Georgia's supermajority/formula price provisions will not apply to a corporation that has not amended or adopted its bylaws to specifically include these provisions. Once adopted, the bylaw can only be repealed by a vote of two-thirds of the continuing directors and a majority of votes represented by disinterested shareholders or such higher vote as is required by the articles or bylaws. Moreover, such repeal is irrevocable); KY. REV. STAT. § 271A.397 (Baldwin 1986) (exempts corporations having fewer than 500 shareholders, investment companies registered under the Investment Company Act of 1940, bank or holding companies registered under the Bank Holding Company Act of 1956, savings and loan companies as defined in the Savings and Loan Holding Company Amendments of 1967, and domestic insurers as defined under certain provisions of Kentucky's corporate law); MD. CORPS. & ASS'NS CODE ANN. §§ 3-601 to -603, 8-301(14) (Supp. 1984) (exempts corporations having fewer than 100 shareholders). *See generally* Voran & Ponns-Townley, *An Overview of State Takeover Regulation,* in A.L.I.-A.B.A. COURSE OF STUDY, NEW DIRECTIONS IN STATE TAKEOVER REGULATION: THE SECOND GENERATION STATUTES 45-46 (1986).

49. Business Corporation Act of 1983 § 1.80(a), (b).

50. *Id.* § 7.85.

51. *Id.* § 7.85.C(2). Hereinafter, the term "Interested Shareholder" shall include any affiliate or associate thereof as defined by Rule 126-2 of the General Rules and Regulations of the Securities Exchange Act of 1934. *Id.* § 7.85.C(5).

52. *Id.* § 7.85.C(9).

53. *Id.* § 7.85.C(2)(a).

54. *Id.* § 7.85.C(2)(b). Although the phrase "date in question" is not defined, it is assumed to refer either to the date on which the business combination is proposed or the date on which compliance is achieved, or both, if such events occur simultaneously.

succeed a Disinterested Director by a majority of the Disinterested Directors then in office.[55]

B. Section 7.85

1. The Supermajority Voting Requirement

Unlike the 1978 Act, which directly regulated the tender offer stage of the acquisition, section 7.85 is triggered only after the successful completion of the tender offer but before the commencement of the second stage of the takeover. Section 7.85.A specifies five categories of control transactions, entitled "business combinations," which tend to derogate the rights of minority shareholders in the forced second stage of the front-end-loaded takeover. Section 7.85 prohibits the consummation of any such business combination unless it is approved first by an eighty percent supermajority of all shares entitled to vote, including the shares of the Interested Shareholder, and second, by a simple majority of all shares entitled to vote, excluding those of the Interested Shareholder.[56]

The first two categories of business combinations include any merger, consolidation, or share exchange with the target,[57] or any sale, lease, exchange, mortgage, pledge, transfer or other disposition of at least ten percent of the target's consolidated net worth.[58] These two categories of transactions were included within the protected class of business combinations to prevent the Interested Shareholder from disposing of the target's assets in a manner which effectively forces out the minority.[59]

The third category of business combination is the issuance or transfer of any of the target's securities to an Interested Shareholder.[60] This provision serves several protective functions. First, it prevents those in control of the target from selling control to an Interested Shareholder without regard for the interests of the minority.[61] Second, it prevents a successful tender offeror which has become an Interested Shareholder from acquiring sufficient stock to "greenmail"[62] the corporation or from issuing to itself or to an ally an

55. *Id.* § 7.85.C(7)(b).

56. *Id.* § 7.85.A. *Compare* MD. CORP. & ASS'NS CODE ANN. § 3-602(2) (1985) (requires affirmative vote of two-thirds of disinterested shareholdings) *with* MICH. STAT. ANN. §§ 21.2000(775)-(784) (Callaghan 1985) (requires issuance of "advisory statement" by board in addition to approval by shareholders).

57. Business Corporation Act of 1983 § 7.85.A(1)(a). Hereinafter, the term "target" shall include any subsidiary of the target.

58. *Id.* § 7.85.A(1)(b).

59. *See* Scriggins & Clark, *supra* note 11, at 275.

60. Business Corporation Act of 1983 § 7.85.A(1)(c).

61. *See* Scriggins & Clark, *supra* note 11, at 276.

62. "Greenmail" is frequently and pejoratively referred to as legalized blackmail of the securities markets. A greenmailer typically acquires a sufficient interest in the target to forewarn management of a possible takeover attempt. To ward off additional purchases and to preserve incumbent management's control, the target reacquires the greenmailer's shares at a substantial premium. *See generally* Nathan & Sobel, *Corporate Stock Repurchases in the Context of Unsolicited Takeover Bids,* 35 BUS. LAW. 1545 (1980) (discussing problems associated with issuer stock repurchases as a takeover response).

amount of stock sufficient to meet the supermajority voting requirements of section 7.85.A.[63]

The fourth category of business combination is any plan for the liquidation or dissolution of the target which either is proposed by the Interested Shareholder or in which the Interested Shareholder will receive anything other than cash.[64] The purpose of this provision is to prevent the Interested Shareholder from looting, liquidating or otherwise squandering the assets of the target. The last category of business combination includes securities transactions such as stock reclassifications, recapitalizations, mergers, consolidations and share exchanges[65] which have the effect of increasing the percentage of the Interested Shareholder's control over the target.[66]

2. *The Price and Procedure Requirements*

Section 7.85.B waives the supermajority voting requirement for approval of business combinations in favor of the more lenient voting requirements of the Business Corporation Act[67] if the Interested Shareholder complies with either of two alternative procedures. The first alternative, set forth in section 7.85.B(1), exempts from the supermajority voting requirement any business combination receiving approval of two-thirds of the Disinterested Directors. The purpose of this provision is to encourage negotiated takeovers.[68] The second alternative, set forth in section 7.85.B(2), waives the supermajority voting requirement if the Interested Shareholder complies with certain price and procedure conditions that are intended to compensate the second stage shareholders on a parity with the highest price paid by the acquiror to the tendering shareholders during the tender offer stage of the

63. *See* Scriggins & Clark, *supra* note 11, at 276. *Cf.* N.Y. BUS. CORP. LAW § 513(e) (McKinney 1986) (New York's anti-greenmail provision which prohibits a resident corporation from purchasing more than ten percent of its own stock from a stockholder for more than market value unless the purchase is approved by the board of directors and a majority of all outstanding shares, including those of the Interested Shareholder).

64. Business Corporation Act of 1983 § 7.85.A(1)(d).

65. *Id.* § 7.85.A(1)(e).

66. *See* Scriggins & Clark, *supra* note 11, at 276.

67. Business Corporation Act of 1983 § 7.85.B(1). *See infra* note 143.

68. Hanks, *State Takeover Laws: The Second Generation*, NAT'L L.J., Nov. 3, 1986, at 34. *Compare* Illinois' friendly offeror exemption *with* GA. CODE ANN. §§ 14-2-231 to 14-2-235 (Harrison 1985) (board may exempt a friendly takeover if it is unanimously approved by the board's continuing directors, provided that the continuing directors constitute at least three members of the board at the time of approval or that the transaction is recommended by at least two-thirds of the continuing directors and approved by a majority of the disinterested shareholders); KY. REV. STAT. ANN. § 271A.397 (Baldwin 1986) (permitting a majority of the disinterested members of a Kentucky board to approve a business combination at any time); MD. CORP. & ASS'NS CODE ANN. §§ 3-601 to -603, 8-301(14) (1985) (permitting a board to exempt a transaction prior to the time a bidder acquires enough shares to become an Interested Shareholder).

takeover.[69] The price conditions differ depending on the type of stock involved in the transaction.

When common stock is at issue, section 7.85.B(2)(a) requires the Interested Shareholder to pay the holders of common stock the highest price as between one of four formulas:

The higher of:	Illustration
FORMULA I: The highest price per common share paid by the Interested Shareholder in the two year period prior to the Announcement Date.[70]	25
OR	
FORMULA II: The highest price per common share paid by the Interested Shareholder in the transaction in which it became an Interested Shareholder.[71]	20
The higher of:	
FORMULA III: The fair market value[72] per common share on the first trading date after the Announcement Date.[73]	23
OR	

69. Business Corporation Act of 1983 § 7.85.B(2).

70. *Id.* § 7.85.B(2)(a)(1)(a). The "Announcement Date" is defined as the date of the first public announcement of the proposal of the business combination. *Id.*

71. *Id.* § 7.85.B(2)(a)(1)(b).

72. Section 7.85.C(8) of the Business Corporation Act defines "fair market value" as:

> (a) in the case of shares, the highest closing sale price during the 30-day period immediately preceding the date in question of a share on the New York Stock Exchange Composite Tape, or, if such shares are not quoted on the Composite Tape, on the New York Stock Exchange, or, if such shares are not listed on such Exchange, on the principle United States securities exchange registered under the Securities Exchange Act of 1934 on which such shares are listed, or, if such shares are not listed on any such exchange, the highest closing sale price or bid quotation with respect to a share during the 30-day period preceding the date in question on the National Association of Securities Dealers, Inc. Automated Quotations System or any system then in use, or if no such quotations are available, the fair market value on the date in question of a share as determined by a majority of the Disinterested Directors in good faith; and (b) in the case of property other than cash or shares, the fair market value of such property on the date in question as determined by a majority of the Disinterested Directors in good faith.

Id.

73. *Id.* § 7.85.B(2)(a)(2).

FORMULA IV: The fair market value per common share on the first trading date after the Determination Date.[74]	21

According to this illustration, the Interested Shareholder will have to pay the second stage shareholders $25.00, an amount greater than both the tender offer price or the stock's fair market value under Formulas III and IV.

Where stock other than common stock is at issue, section 7.85.B(2)(b) requires that all such shareholders receive in exchange for all such shares the higher of the following formulas:

The higher of:	Illustration
FORMULA V: The highest price per such share paid by the Interested Shareholder in the two year period prior to the Announcement Date.[75]	30
OR	
FORMULA VI: The highest price per such share paid by the Interested Shareholder in the transaction in which it became an Interested Shareholder.[76]	20
FORMULA VII: The highest preferential amount to which such shareholders are entitled upon liquidation, dissolution or winding up of the corporation.[77]	25
FORMULA VIII: The higher of the fair market value of such stock on the first trading date after the Announcement Date or on the Determination Date.[78]	25/22

74. *Id.* § 7.85.B(2)(a)(2). The "Determination Date" is defined as the first trading date after the first public announcement that the Interested Shareholder became an Interested Shareholder. *Id.*

75. *Id.* § 7.85.B(2)(b)(1)(a).

76. *Id.* § 7.85.B(2)(b)(1)(b).

77. *Id.* § 7.85.B(2)(b)(2).

78. *Id.* § 7.85.B(2)(b)(3).

FORMULA IX: Formula VII multiplied by the highest value obtained in the following calculation for each such class of stock acquired by the Interested Shareholder on the Announcement Date: the highest price per share paid by the Interested Shareholder for such shares acquired within such period divided by the market value per share of such stock on the first day in such period on which the Interested Shareholder acquired any such stock.[79]	$26 \times 30/30 = 26$

According to this illustration, the second stage preferred shareholders will receive $26.00 per share for their stock, an amount equal to that received by the tendering shareholders for their stock. However, if the illustration is altered such that the Formula V price of $30.00 is lowered to $20.00, the Formula IX multiplier results in the windfall payment of $32.50 to the second stage preferred shareholders (i.e., 26 × (25) = $32.50) — an amount substantially in excess of either the fair market value of the stock or its tendering price. These illustrations indicate two things: (i) the formulas are not necessarily rational, that is, they do not necessarily result in a price borne out by the market, and (ii) if the stock is increasing in value, which is usually the case in a tender offer, second stage shareholders will receive a windfall, especially if the Formula IX multiplier is used. Conversely, if the stock is declining in value, second stage shareholders will suffer a loss.

3. Consideration

The price and procedure provisions require the Interested Shareholder to compensate second stage shareholders either with cash or with the same type of consideration previously used to acquire identical stock.[80] In the event that various types of consideration were used to purchase such stock, the Interested Shareholder is required to compensate the second stage shareholder either with cash or with the same type of consideration used to acquire the largest number of such shares.[81] The cash payment requirement is intended to insure that second stage shareholders receive valuable consideration for

79. *Id.* § 7.85.B(2)(b)(4).
80. *Id.* § 7.85.B(4)(c).
81. *Id.* § 7.85.B(4)(c).

their stock by eliminating acquisitional strategies requiring shareholders to exchange their equity securities in the target for subordinated debt securities of the acquiror, otherwise known as junk bonds.[82]

4. Further Assurances

Section 7.85 provides additional protection to second stage shareholders in terms of further assurances that the corporation will be duly maintained during the period between the expiration of the tender offer and the consummation of the business combination.[83] For example, the shareholders are assured that dividend policies will be maintained[84] and that the Interested Shareholder will not be permitted to take undue advantage of the target by taking loans, advances or other forms of financial assistance from its treasury.[85] Lastly, the shareholders are assured that compliance with the Amendments will not relieve the Interested Shareholder of compliance with the full panoply of fiduciary duties imposed by law.[86]

C. Section 8.85

Section 8.85 provides:

> In discharging the duties of their respective positions, the board of directors, committees of the board, individual directors and individual officers may, in considering the best interests of the corporation, consider the effects of any action upon employees, suppliers and customers of the corporation, communities in which offices or other establishments of the corporation are located and all other pertinent factors.[87]

Section 8.85 expands upon the protections traditionally afforded directors under the business judgment rule[88] by permitting the board to consider, in

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82. *See* Greenblatt & Junewicz, *Illinois Cools the Takeover Fever*, DIRECTORSHIP, Feb. 1986, at 6.

83. Business Corporation Act of 1983 § 7.85.B(2)(d).

84. *Id.* § 7.85.B(2)(a), (b), (d)(1).

85. *Id.* § 7.85.B(2)(e).

86. *Id.* § 7.85.D.

87. *Id.* § 8.85.

88. The business judgment rule restrains the judiciary from interfering with and substituting its own judgment for business decisions made by directors in good faith and with a reasonable basis for believing their decisions to be in the corporation's best interest. 3A FLETCHER, CYCLOPEDIA OF CORPORATIONS § 1039 (1975).

Section 8.30 of the Model Business Corporation Act implicitly incorporates the business judgment rule by requiring a director to perform duties "in good faith, in a manner he reasonably believes to be in the best interests of the corporation, and with such care as an ordinarily prudent person in a like position would use." MODEL BUSINESS CORP. ACT § 8.30 (1984). The Illinois Business Corporation Act of 1983 section 8.05 does not incorporate this language or otherwise discuss the standard by which directors are to exercise their duty. Nevertheless, the Business Corporation Act section 8.75 provides broad indemnification provisions for officers and directors who act in good faith.

the lawful discharge of its duties, factors extrinsic to the immediate financial well-being of the corporation. The business judgment rule is a principle of judicial noninterference with managerial decisions undertaken free of fraud, illegality or conflict of interest.[89] The rule is based on the presumption that management is better suited than the judiciary to direct corporate affairs.[90] Traditionally, the business judgment rule has shielded only those managerial decisions that are commercially reasonable, that is, rationally related to a legitimate business purpose.[91] The legitimate business purpose requirement has been narrowly confined to decisions made by or under the direction of the board which place a premium on maximizing profitability for the benefit of the corporation and its shareholders.[92]

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89. *See* Dynamics Corp. of Am. v. CTS Corp., 794 F.2d 250, at 256 (7th Cir. 1986), *rev'd,* 107 S. Ct. 1637 (1987). In the takeover context, there is no liability for rejection of a proposed takeover if the board's decision is made in good faith and reasonably based on the facts presented. Panter v. Marshall Field & Co., 486 F. Supp. 1168, 1186 (N.D. Ill. 1980), *aff'd,* 646 F.2d 271 (7th Cir.), *cert. denied,* 454 U.S. 1092 (1981).

90. *See supra* notes 88-89.

91. *See, e.g.,* Johnson v. Trueblood, 629 F.2d 287, 293 (3d Cir. 1980), *cert. denied,* 450 U.S. 999 (1981) (where plaintiff shows director's motive was to retain control, the burden shifts to the defendant director to prove a valid business purpose).

Recent case law applying the business judgment rule continues to narrow the class of managerial decisions subject to its protections. For example, the recent case of Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985) held that directors of a target corporation were grossly negligent in approving a friendly merger proposal and, therefore, could be held personally liable for the difference between the merger price and the fair value of the shares. *But see* Herald v. Seawell, 472 F.2d 1081 (10th Cir. 1972) in which the court stated that directors of newspapers have an obligation to "employees, and to the public," as well as to the stockholder. *Id.* at 1091. Thus, the directors were justified in opposing a takeover which they determined would have an "adverse impact on the character and quality" of the newspaper and which would lead to "poor relations with employees." *Id.* at 1092. *See infra* note 104.

92. *See, e.g.,* Dodge v. Ford Motor Co., 204 Mich. 459, 170 N.W. 668 (1919). Ford Motor Co. had experienced its most profitable year ever, reaping an excess of almost $60,000,000 in profits. Nonetheless, Henry Ford, the 58% shareholder, refused to permit the board to declare a special dividend for the benefit of the shareholders. Mr. Ford preferred to reinvest the profits back into the company to capitalize an expansion program which would increase the volume of cars produced while lowering their price. The immediate net effect of this expansion program would be to reduce the $111,000,000 surplus from which the shareholder's dividends were drawn. The Dodge brothers, 22% owners of the Ford Motor Company, brought an action to compel the company to pay out a special dividend. Ford argued that the board's decision to direct the profits into the expansion program was a legitimate business decision tainted neither by fraud, illegality, nor conflict of interest and, thus, was not subject to judicial review. The court rejected Ford's defense on the grounds that it was improper to operate a for-profit business as if it were an "eleemosynary institution" placing a premium on distributing profits to the employees and the community at large at the expense of the shareholders. *Id.* at 504-10, 170 N.W. at 683-85.

But cf. Shlensky v. Wrigley, 95 Ill. App. 2d 173, 237 N.E.2d 776 (1968). In *Shlensky,* the minority shareholders faced the Ford-like dominance of P.K. Wrigley who insisted that the Chicago Cubs baseball team play only day games because "baseball is a daytime sport" and because he feared night games would have a deteriorating effect on the surrounding neighbor-

Section 8.85 raises the specter of a significantly expanded business judgment rule. Its broad language strongly suggests that the board's section 8.85 considerations may extend not only to nonshareholder constituencies previously excluded from the rule's protection, but also, to "any action" of the acquiror as well as of the board. Although a consequence of section 8.85 may be to minimize the destabilizing effects of takeovers on the long term planning of a corporation, by allowing incumbent management to provide protection for and against a broad range of interests section 8.85, in effect, allows the target's board to develop a ubiquitous environmental impact statement as a defense tactic to a hostile takeover.[93]

Significantly, section 8.85 protects incumbent management from more than the unwarranted grasp of an external challenge. By allowing the board to consider factors traditionally held beyond the protection of the business judgment rule, section 8.85 potentially juxtaposes the interests of the shareholders, to whom the board owes multiple fiduciary duties,[94] against the interests of the corporation's employees, suppliers, customers, or community, to which the board owes no fiduciary duties. Offered almost as a quid pro quo to the target's shareholders in exchange for the fair price and procedure protections of section 7.85, section 8.85 fortifies management's defense posture against its own shareholders by shielding management from internal challenges to the board's defense strategy in the form of shareholder actions alleging breaches of fiduciary duties and violations of the Williams Act.[95]

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hood. *Id.* at 176, 237 N.E.2d at 778. Plaintiff Shlensky alleged that night games would increase the corporation's profits and that the board's rejection of night lights was based on factors extrinsic to the financial success of the corporation. The Illinois Appellate Court affirmed the dismissal of the plaintiff's complaint, finding that the best interests of the corporation may require consideration of nonfinancial factors and that courts should only reluctantly interfere in business decisions: "[C]ourts may not decide these questions [of corporate policy] in the absence of a clear showing of dereliction of duty on the part of the specific directors and mere failure to 'follow the crowd' is not such a dereliction." *Id.* at 183, 237 N.E.2d at 781.

93. It is important to note that section 8.85 generally applies to all management decisions, not just those affecting takeovers. This Article does not address and does not denigrate the potential merit of section 8.85 considerations in contexts other than the tender offer. This Article also does not address the question of whether section 8.85 can be upheld as a rational provision for the economy at large but struck down when applied to the securities economy in the takeover context.

94. *See* Dynamics Corp. of Am. v. CTS Corp., 794 F.2d 250 (7th Cir. 1986), *rev'd*, 107 S. Ct. 1637 (1987). "The officers and directors are the agents and fiduciaries of the shareholders and owe a duty of complete loyalty which is inconsistent with erecting insuperable barriers to hostile takeovers." *Id.* at 254.

95. *Compare* Business Corporation Act of 1983 section 8.85 *with* the right of redemption afforded dissident shareholders under Maryland's takeover statute, MD. CORP. & ASS'NS CODE ANN. §§ 3-601 to -603, 8-301(14) (Supp. 1984) which permits a shareholder who objects to a business combination to demand cash payment for the fair value of his stock. Fair value is determined at an appraisal proceeding by applying the same tests that are used to determine whether or not a business combination is exempt from the higher voting requirements under the formula price provisions of the statute. *Compare* Business Corporation Act of 1983 section

As a result, shareholders will be left defenseless against the hostile maneuvers of their own management.[96]

D. Summary

Applied in concert, sections 7.85 and 8.85 provide incumbent management of Illinois corporations with two potent lines of defense against the modern hostile takeover. Under section 7.85, the first line of defense protects incumbent management against undesirable offers by increasing the risks and expenses of a hostile acquisition. Shareholder approval for the second stage will no doubt be difficult to obtain since management controls the proxy process which inevitably follows the proposal of a business combination.[97] In light of the windfall potential of the pricing formulas, an informed shareholder will have little incentive to tender in the first stage of the acquisition let alone vote for the business combination in the second stage.

Under section 8.85, the second line of defense protects incumbent management by insulating it from the internal challenges of its own shareholders. Considerations which previously had been reserved for the exclusive benefit of the shareholders under the business judgment rule may now extend to a broad range of nonshareholder constituencies. Ironically, while section 7.85 protects minority shareholders from the enemy without, section 8.85 eliminates their protection from the enemy within.

III. COMMENTARY

According to Justice White, who wrote the *Edgar v. MITE* opinion, several provisions of the 1978 Act violated the supremacy clause because they

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8.85 *with* Pennsylvania's takeover statute, PA. STAT. ANN. tit. 15, § 1910 (Purdon Supp. 1985) which, in addition to containing section 8.85 language, also contains an offsetting "put" provision which entitles shareholders to the right to demand the fair value for their stock in cash following a "transaction" in which an acquiror "crosses a particular ownership threshold." *See* Junewicz, *The Supremacy Clause and the Second Generation State Takeover Statutes,* in A.L.I.-A.B.A. COURSE OF STUDY: DIRECTIONS IN STATE TAKEOVER REGULATION: THE SECOND GENERATION STATUTES 129, 176 (1986).

96. To date, there is scarce case law addressing the questions of whether directors may oppose takeover bids that are in the best interests of the shareholders on the basis of adverse impact on nonshareholder constituencies or, conversely, whether directors can support takeover bids that are not in the shareholders' interest. *See* Junewicz, *supra* note 95, at 162-64. *See also, e.g.,* Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985). In *Unocal,* the Delaware Supreme Court extended business judgment protection to defensive measures "reasonable in relation to the threat posed." *Id.* at 949. The court defined "threat" to include impact on nonshareholder constituencies such as creditors, customers, employees, and the general community. *Id.* at 955.

97. *See* Junewicz, *supra* note 95, at 170. An Interested Shareholder is required to acquire shares held by management, shares held by pension funds subject to management control, shares held by shareholders who never vote, and shares held by shareholders who will always oppose a takeover. To date, no bidder has successfully overcome these obstacles. Hanks, *supra* note 68, at 34.

conflicted with the time and informational provisions of the Williams Act[98] and imposed both direct and indirect burdens on interstate commerce that far exceeded the local benefits it purported to serve.[99] Illinois' second generation takeover legislation attempts to avoid these pitfalls by steering a wholly different course. Whereas the 1978 Act ran afoul of the Williams Act by directly regulating the tender offer stage of the acquisition, the 1985 Amendments purport to regulate only the second stage of the takeover wherein the corporation, by undergoing a fundamental corporate change, forces out the second stage shareholders at a price below that offered to the tendering shareholders. The Amendments attempt to mitigate the sting of the force-out by requiring the Interested Shareholder to comply with either the fair price or supermajority voting requirements.

Theoretically, by defining the rights and duties as between controlling and minority shareholders in transactions resulting in fundamental corporate changes, the Amendments should implicate only the internal affairs of the corporation and suffer no conflict with either the supremacy or commerce clauses. Such a conflict is manifest, however, in the theoretical justification offered for the Amendments. Although the Amendments purport to regulate merely the internal affairs of domestic corporations, their secondary effects on the market place raise the specter of economic protectionism violating both the supremacy and commerce clauses. The Amendments violate the supremacy clause because they pose a program for deterring acquisitional activity in Illinois that is incompatible with the regulatory scheme provided by the Williams Act. By deterring acquisitional activity in Illinois, the Amendments also impose burdens on interstate commerce that far exceed the local interests they purport to serve. Hence, the Amendments must fall of their own weight under either the supremacy clause, the commerce clause, or both.

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98. *MITE*, 457 U.S. at 639. The Williams Act seeks to protect the investor by prohibiting "fraudulent, deceptive, or manipulative acts," as well as false and misleading statements made in connection with a tender offer. 15 U.S.C. § 78n(e) (1986). To further protect shareholders, the Williams Act requires that upon commencement of a tender offer, the offeror provide a Schedule 14D-1 to the Securities and Exchange Commission (SEC), the target, and its shareholders disclosing information about its background and identity, the source of the funds to be used in making the purchase, the purpose of the purchase including any plans to liquidate the company or make major changes in its corporate structure, and the extent of the offeror's holdings in the target company. 15 U.S.C. § 78m(d)(1) (1986). The Williams Act also permits shareholders who have tendered their shares to withdraw them during the first fifteen days of the tender offer, 17 C.F.R. § 240.14d-7(a)(1) (1985), and at any time after sixty days from the commencement of the offer. 15 U.S.C § 78n(d)(5). A shareholder who has already tendered may receive the benefit of an increased offering price. 15 U.S.C. § 78n(d)(7) (1981). Furthermore, SEC Rule 14e-1(a) requires that a tender offer remain open for a minimum period of twenty business days. *See MITE*, 457 U.S. at 632.

99. *MITE*, 457 U.S. at 646.

A. The Supremacy Clause

The supremacy clause[100] stands for the proposition that when a state law so conflicts with a federal law that compliance with the state law prevents compliance with the federal law, the state law must yield.[101] Although the Williams Act does not necessarily preempt state regulation of cash tender offers,[102] it is clear after *Edgar v. MITE* that second generation takeover legislation may neither conflict with specific provisions of the Williams Act, nor run afoul of its market approach[103] of providing full disclosure to investors, nor provide either contender with an undue advantage that could frustrate the investors' exercise of that informed choice.[104]

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100. Article VI of the United States Constitution states:

> This Constitution, and the Laws of the United States which shall be made in Pursuance thereof . . . shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of and State to the Contrary notwithstanding.

U.S. CONST. art. VI.

101. *MITE*, 457 U.S. at 640.

102. *See* Great W. United Corp. v. Kidwell, 577 F.2d 1256 (5th Cir. 1978), *rev'd on venue grounds sub. nom.* Leroy v. Great W. United Corp., 443 U.S. 173 (1979). "Congress did not explicitly prohibit States from regulating takeovers; it left the determination whether [a particular state] statute conflicts with the Williams Act to the courts." Edgar v. MITE Corp., 457 U.S. 624, 631 (1982). Subsequent Supreme Court cases have found that the supremacy clause will preempt a state statute where: (i) a valid federal statute expressly prohibits the state regulation imposed; (ii) "compliance with both federal and state regulation is a physical impossibility;" Florida Lime & Avocado Growers, Inc. v. Paul, 373 U.S. 132, 142-43 (1963); (iii) the state "law stands as an obstacle to the accomplishment and execution of the full purposes and objective of Congress." Hines v. Davidowitz, 312 U.S. 52, 67 (1941). *See MITE*, 457 U.S. at 631. *MITE's* supremacy clause analysis of the Illinois takeover statute raised the issue of whether the statute "frustrates the objectives of the Williams Act in some substantial way." *Id.* at 632. *See generally* Junewicz, *supra* note 95, at 133-34.

103. The Williams Act is premised upon a market oriented approach, the goal of which "is to get information to the investor by allowing both the offeror and the incumbent managers of a target company to present fully their arguments and then let the investor decide for himself." Great W. United Corp. v. Kidwell, 577 F.2d 1256 (5th Cir. 1978), *rev'd on venue grounds sub. nom.* Leroy v. Great W. United Corp., 443 U.S. 173 (1979). The market approach assumes that neutrality between the target, its shareholders, and the offeror is essential to the proper operation of the market. National City Lines, Inc. v. LLC Corp., 687 F.2d 1122, 1129 (8th Cir. 1982). *See also* Piper v. Chris Craft Indus., Inc., 430 U.S. 1, 29 (1977) ("Congress was committed to a policy of neutrality in contests for corporate control."). Once the appropriate information is forthcoming, the Williams Act presumes that "the takeover battle should be decided by the 'market,' and that federal law should not tilt the regulatory balance toward either target management or the bidder." Sargent, *supra* note 39, at 195 (quoting Warren, *Developments in State Takeover Regulation:* MITE *and Its Aftermath*, 40 BUS. LAW. 671, 674 n.18 (1985)).

104. *MITE*, 457 U.S. at 634. It is noteworthy in *MITE* that Justice White could secure the votes of only Chief Justice Burger and Justice Blackmun in finding that the 1978 Act violated the supremacy clause. *MITE*, however, did not interrupt the unbroken string of decisions which found first generation state takeover laws unconstitutional under the supremacy clause. *Compare* the following post-*MITE* cases: Martin-Marietta Corp. v. Bendix Corp., 690 F.2d 558, 565-66

Unlike the 1978 Act, the Amendments do not directly regulate the tender offer stage of the takeover.[105] Rather, the Amendments directly regulate only the second stage of the acquisition in which the corporation undergoes a fundamental corporate change. Thus, the Amendments do not pose a direct conflict with specific provisions of the Williams Act. Nonetheless, the Amendments may run afoul of the supremacy clause if by indirection or implication they embody a philosophy of takeover regulation that is incompatible with the balance of neutrality between incumbent management and the acquiror required by the Williams Act.[106]

There are several provisions of the Amendments that weight the contest in favor of incumbent management. Section 7.85.A significantly increases the cost to the bidder of engaging in a hostile takeover campaign against an Illinois corporation.[107] Section 7.85.B(1) allows the Disinterested Directors to vote for their own entrenchment.[108] Section 7.85.B(2) exempts friendly tender offers from the price and procedure constraints of section 7.85.B(1). Section 9.05 exempts self-tenders from any of the provisions of section 7.85.[109] Finally, section 8.85 allows management to develop, with impunity, defense strategies premised upon factors of attenuated importance to the corporation.[110] Each provision is ripe with the potential of benefitting management against unwelcome tender offer activity.

What countervailing advantages do the Amendments offer the takeover bidder? None. The clear thrust of the Amendments is to accelerate the risks and costs of a hostile takeover in the second stage of the acquisition for the purpose of inhibiting the making of the tender offer in the first stage. As a consequence, the Amendments clearly shift the balance of neutrality in favor of incumbent management. Do the additional benefits afforded management run afoul of the supremacy clause?[111] Not necessarily. The Williams Act requires "maintenance of an equitable balance between con-

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(6th Cir. 1982) (Michigan act); National City Lines v. LLC Corp., 687 F.2d 1122 (8th Cir. 1982) (Missouri act) and Esmark, Inc. v. Strode, 639 S.W.2d 768 (Ky. 1982) (Kentucky act) *with* the following pre-*MITE* cases: Kennecott Corp. v. Smith, 637 F.2d 181 (3d Cir. 1980) (New Jersey act); Great W. United Corp. v. Kidwell, 577 F.2d 1256 (5th Cir. 1978) (Idaho act).

105. In *Edgar v. MITE,* the Court defined a tender offer as the stage of the acquisition that "contemplate[s] transfer of stock by stockholders to a third party and [which] do[es] not [itself] implicate the internal affairs of the target company." *MITE,* 457 U.S. at 644.

106. *See supra* note 102. *See generally* Sargent, *supra* note 2, at 689, 694 (discusses judicial views on how various statutory takeover provisions effectuate or interfere with neutrality).

107. *See supra* notes 56-96 and accompanying text.

108. *See supra* note 38 and accompanying text. It is noteworthy that the term "Disinterested Director" may be a misnomer since it refers to persons who may have either professional or personal stakes in maintaining the status quo. *See* Greenblatt & Junewicz, *supra* note 82, at 7.

109. *See supra* notes 56-86.

110. *See supra* notes 87-96.

111. *See* Sargent, *supra* note 2, at 714-15.

tending sides . . . as a principal means of investor protection."[112] Certainly the Amendments do not prohibit altogether tender offers of domestic corporations, nor do they tilt the balance so far in management's favor as to insure it of an outright victory.[113] On the other hand, the Amendments will significantly deter, if not eliminate,[114] certain types of tender offer activity which, in turn, will deprive shareholders not only of the opportunity to sell their shares at a premium, but of the need to make an informed decision in the first instance.[115] In this regard, the Amendments' pro-management bias may vary impermissibly from the balance of neutrality unless it is counterbalanced by provisions that "substantially enhance" the target shareholders' ability to make an informed decision.[116]

What countervailing protections do the Amendments provide shareholders? By insuring that all shareholders receive "full" value for their stock, the Amendments minimize the coercive effects of the second stage of the takeover while enabling the shareholders to make a rational choice in the first stage.[117] This result enhances the protection afforded shareholders by the time and informational provisions of the Williams Act. Furthermore, the price and procedure constraints of section 7.85.A should deter only those bidders whose strategies are premised upon differential compensation as between tendering and nontendering shareholders.[118] Even assuming the desirability of takeovers, there is nothing in the Williams Act suggesting that minority shareholders may be subject to a forced squeeze-out at an inadequate price.[119]

Will these shareholder protections save the Amendments from challenge under the supremacy clause? Not necessarily. While section 7.85.D imposes on the Interested Shareholder the traditional panoply of fiduciary duties, it makes no mention of the duties imposed on incumbent management.[120] Rather, the duties to which incumbent management are held are addressed in section 8.85 which allows the board to consider, on a parity with its fiduciary duties, factors of potentially attenuated importance to the corporation and its shareholders. In so doing, section 8.85 interposes on management's behalf a statutory defense—the welfare of nonshareholder constituencies—to the

112. MITE Corp. v. Dixon, 633 F.2d 486 (7th Cir. 1980), *aff'd sub nom.* Edgar v. MITE Corp., 457 U.S. 624 (1983).

113. *MITE,* 633 F.2d at 498.

114. *See* Greenblatt & Junewicz, *supra* note 82, at 6.

115. *See* Dynamics Corp. of Am. v. CTS Corp., 794 F.2d 250, 253-56 (7th Cir. 1986), *rev'd,* 107 S. Ct. 1637 (1987).

116. *See* Sargent, *supra* note 2, at 715.

117. *See* Scriggins & Clark, *supra* note 11, at 289.

118. *MITE,* 457 U.S. at 643.

119. *But see* Martin Marietta Corp. v. Bendix Corp., 549 F. Supp. 623, 630-631 (D. Md. 1982); Radol v. Thomas, 534 F. Supp. 1302, 1311-13 (S.D. Ohio 1982) (implicitly recognizing and permitting the front-end-loaded takeover under the federal regulations).

120. Business Corporation Act § 7.85.D.

shareholders' remedy for abuse of fiduciary duty.[121] The attendant sterilization of the target's shareholders provides "a weapon for management to discourage takeover bids"[122] in contravention of the Williams Act's policy of protecting investors by "providing a check on entrenched but inefficient management."[123]

In sum, section 7.85 neither directly nor indirectly conflicts with the specific provisions or underlying policies of the Williams Act. Although the thrust of section 7.85 clearly favors incumbent management, its provisions eliminating compensation differentials between tendering and nontendering shareholders and thus, the coercive effects of the front-end-loaded takeover, are philosophically and practically compatible with the Williams Act's policy of investor protection. Accordingly, although section 7.85 shifts the balance of neutrality in favor of management, the balance is arguably restruck within acceptable limits by the pricing protections afforded shareholders. Section 8.85, however, poses a philosophy of takeover regulation which is inconsistent not only with the balance of neutrality struck by the Williams Act, but with the purported shareholder protections conferred by section 7.85 as well. The broad and unqualified language of section 8.85 not only fortifies incumbent management as against "any action" by the aggressor, but also provides an effective shield against shareholder challenges to management's own defense tactics. By shifting the balance of neutrality heavily in favor of incumbent management with no countervailing shareholder protection, section 8.85 causes the entire regulatory scheme posed by the Amendments to fall beyond any acceptable range of neutrality contemplated by the Williams Act.

B. The Commerce Clause

The Supreme Court has consistently interpreted the commerce clause[124] as a limitation upon the power of the states to erect barriers to interstate commerce.[125] Accordingly, the commerce clause prohibits direct regulation

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121. *See supra* notes 94-96 and accompanying text.

122. *MITE*, 457 U.S. at 633 (citing Rondeau v. Mosinee Paper Corp., 422 U.S. 49, 58 (1975)).

123. *Id.* at 633 (citing S. REP. No. 550, 90th Cong., 1st Sess. 3 (1967)). *See* Dynamics Corp. of Am. v. CTS Corp., 794 F.2d 250 (7th Cir. 1986), *rev'd*, 107 S. Ct. 1637 (1987).

124. The commerce clause provides that "Congress shall have Power . . . [t]o regulate Commerce . . . among the several states." U.S. CONST. art. I, § 8, cl. 3. In Hughes v. Oklahoma, 441 U.S. 322 (1979) the Supreme Court observed that these "few simple words":

> reflected a central concern of the Framers that was a immediate reason for calling the Constitutional Convention: the conviction that in order to succeed, the new Union would have to avoid the tendencies toward economic Balkanization that had plagued relations among the Colonies and later among the States under the Articles of Confederation.

Id. at 325-26.

125. *See, e.g.*, Lewis v. BT Inv. Managers, Inc., 447 U.S. 27, 35 (1980).

of interstate commerce by the states[126] but permits the states to indirectly regulate interstate commerce if they do so "evenhandedly to effectuate a legitimate local interest, and [the] effects on interstate commerce are only incidental . . . unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits."[127] Hence, the pertinent inquiry under the commerce clause is whether the Amendments regulate intra- and interstate activities evenhandedly or whether they impose burdens on interstate commerce that are excessive in light of the local interests they purport to protect.[128]

The Amendments purport to regulate only the internal affairs[129] of Illinois corporations by defining the rights and duties between minority and majority shareholders in certain business combinations. Section 8.85 defines the parameters of reasonable board action by specifying the factors upon which the board can rely in discharging its duties to the corporation. Section 7.85 addresses the duties to which minority shareholders can hold majority shareholders in the event of a fundamental corporate change undertaken pursuant to a control transaction. Accordingly, under the internal affairs approach, the Amendments should impose no greater burdens on interstate commerce than similar control transactions regulated by the Business Corporation Act. For example, under section 11.20 a merger cannot be consummated unless it has received approval of two-thirds of the shares entitled to vote. Such state regulation undoubtedly delays and deters some acquisitional activity yet has not been deemed an excessive extraterritorial grasp that offends "sister states and exceeds the inherent limits of the state's power."[130] Similarly, the Amendments require the Interested Shareholder to comply with either the supermajority voting requirements or the formula-price requirements

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126. *MITE*, 457 U.S. at 640; Great Atl. & Pac. Tea Co. v. Cottrell, 424 U.S. 366, 370-71 (1976) (quoting Freeman v. Hewitt, 329 U.S. 249, 252 (1946)).

127. *MITE*, 457 U.S. at 640 (quoting with approval Pike v. Bruce Church, Inc., 397 U.S. 137, 142 (1970) which cites Huron Cement Co. v. Detroit, 362 U.S. 440, 442 (1960)).

128. *MITE*, 457 U.S. at 640.

129. There is little consensus as to the definition of "internal affairs." A frequently cited definition was set forth in North State Copper & Gold Mining Co. v. Field, 65 Md. 151, 20 A. 1039 (1885):

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

Id. at 154, 20 A. at 1040.

In theory, corporate internal affairs usually refer to the duties and liabilities of directors and officers, voting and meeting procedures, transfers of shares, and access to records, etc. In practice, however, corporate internal affairs can be external in reach. *See* DeMott, *Perspectives in Corporate Internal Affairs*, 28 CORP. PRAC. COMMENTATOR 347, 369 (1986). *See also* Sargent, *supra* note 39, at 192-95.

130. *MITE*, 457 U.S. at 643 (citing Shaffer v. Heitner, 43 U.S. 186, 197 (1977)).

before causing the target to enter into a merger or other fundamental corporate change. Hence, by imposing similar restrictions on similar transactions, the Amendments should have no greater or lesser extraterritorial effect upon interstate commerce than similar provisions adopted by the Business Corporation Act and traditionally subject to state regulation.[131]

The internal affairs approach to takeover regulation, however, must be counterbalanced against the requirements of the commerce clause. Assuming that Illinois, or any state, has the power to regulate interstate activity at all, it must do so evenhandedly.[132] Therein lie the three principle weaknesses of Illinois's internal affairs approach to takeover regulation.[133]

1. *The Internal Affairs Rule*

In *Edgar v. MITE,* the Court characterized corporate internal affairs as discrete "matters peculiar to the relationships among or between the corporation and its current officers, directors and shareholders."[134] Because of

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131. *See* Sargent, *supra* note 2, at 727.

132. Pike v. Bruce Church, Inc., 397 U.S. 137, 142 (1970). Recent commerce clause cases impose upon the states the necessity of demonstrating that no less restrictive alternatives exist to legislative schemes that burden interstate commerce. *See* Hughes v. Oklahoma, 441 U.S. 322, 337 (1979); City of Philadelphia v. New Jersey, 437 U.S. 417 (1978).

133. Five recent decisions have held unconstitutional control share acquisition statutes. *See supra* note 6. In distinguishing between laws that regulate the acquisition of stock and laws that regulate how stock is used in a corporation's internal affairs, the court in APL Ltd. Partnership v. Van Dusen Air, Inc., 622 F. Supp. 1216 (D. Minn. 1985) rejected the state's argument that the control share acquisition statute was analogous to internal affairs laws requiring shareholder approval for asset sales or corporate reformation. The *APL* court offered the following distinction between the two types of laws:

> In the present case the [statute] restricts the ability of a nonresident shareholder to sell shares to a nonresident third party. The defendant's argument that the [statute] is simply an 'internal affairs' regulation stems from a failure to distinguish between the *acquisition of shares* and the exercise of power as a result of that acquisition. The acquisition of shares does not implicate the internal affairs of the target corporation. The use of that power *once the shares have been acquired* may well be a proper subject of state regulation, but that is not what the [statute] regulates.

Id. at 1223-24 (emphasis in original). *See generally* Scriggins & Clark, *supra* note 11, at 272-79 (Maryland law affects only the second step—the state law voting requirement for mergers); Hanks, *supra* note 68, at 34-46.

134. *MITE,* 457 U.S. at 645. In general, the Court noted that the internal affairs doctrine was a conflict of laws principle "of little use to the State in this context." *Id.* at 644. In particular, the Court rejected Illinois' assertion that the 1978 Act merely regulated the internal affairs of domestic corporations as "incredible" in light of its extraterritorial impact. *Id.* Even assuming the applicability of the internal affairs doctrine, the Court was skeptical that it would "substantially enhance" the shareholders' decision making ability, *id.,* since the pertinent provisions under the 1978 Act added nothing to comparable Williams Act provisions while increasing the "risk that the tender offer [would] fail due to [the] defensive tactics employed by incumbent management." *Id.* at 645. Moreover, the Court noted that the 1978 Act exempted self-tenders, thus leaving the target's shareholders to the protections of the federal securities laws, "which Illinois view[ed] as inadequate to protect investors in other contexts." *Id.* at 644.

their predominantly domestic impact, the regulation of internal affairs has been relegated to the exclusive province of the states.[135] The internal affairs approach to state takeover regulation rejects the position that takeovers are merely securities transactions that "contemplate transfers of stock by stockholders to a third party and do not themselves implicate the internal affairs of the target company."[136] Rather, the internal affairs approach assumes that takeovers "are devices by which a frequently irreversible change in the ownership and structure of a corporation is affected: their amenability to federal regulation as securities transactions does not eliminate the possibility of the need for state regulation of them as instruments of fundamental corporate change."[137]

Section 7.85 transactions do not, on their face, differ substantially from other control transactions regulated by the Business Corporation Act.[138] The critical difference between such transactions is that section 7.85.A transactions require an Interested Shareholder—a person who has already acquired a significant interest in the corporation. By definition, section 7.85.A includes a successful tender offeror although it could include other acquirors as well. By contrast, a simple merger pursuant to section 11.20 does not require an Interested Shareholder. Rather, it can apply even where there has been no tender offer or no prior acquisitional activity. Thus, section 7.85.A, which facially resembles an internal affairs provision, differs significantly from such provisions by specifically implicating tender offers. Unlike other control transactions which may be extraterritorial in scope and only incidentally affect interstate commerce, section 7.85.A transactions are specifically drafted to reach the interstate market for securities and corporate control.

2. *"Domestic Corporations"*

Illinois attempted to minimize the extraterritorial impact of the Amendments by limiting their reach to "domestic corporations" only. Under sections 1.80(a) and (b), a domestic corporation is one that is subject to the provisions of the Business Corporation Act and is not organized under the

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135. Korn v. Mutual Assurance Soc'y, 10 U.S. (6 Cranch) 192, 199-200 (1810) ("The law of the state of incorporation governs the fundamental questions of a corporation's powers, governance, and the rights of shareholders."). *See also* Cort v. Ash, 422 U.S. 66, 84 (1975); United States v. Insurance Co., 89 U.S. (20 Wall.) 99, 103-104 (1874); Profusek & Gompf, *State Takeover Legislation After* MITE: *Standing Pat, Blue Sky, or Corporation Law Concepts?*, 7 CORP. L. REV. 3, 29 (1984); Sargent, *supra* note 2, at 724.

136. *MITE,* 457 U.S. at 645. *See also* Great W. United Corp. v. Kidwell, 577 F.2d 1256, 1280 n.53 (5th Cir. 1978), *rev'd on venue grounds sub nom.* Leroy v. Great United Corp, 443 U.S. 173 (1979) (Idaho takeover statute was preempted by the Williams Act on the grounds that it placed an impermissible burden on interstate commerce).

137. *See* Sargent, *supra* note 2, at 725.

138. *E.g.*, Business Corporation Act of 1983 § 11.20 (mergers, consolidations, share exchanges); § 11.60 (sale, lease, or exchange of assets other than in the regular course of business); § 11.65 (right to dissent).

laws of any other state.[139] Presumably, this definition is intended to restrict the Amendments' reach to businesses incorporated under the Business Corporation Act and already subject to its provisions. However, a definition of domestic corporation that serves the Act's primarily local interests may be too broad to satisfy the extraterritorial constraints of the Williams Act.

For example, under the internal affairs doctrine, the law of the state of incorporation governs the corporation's internal affairs.[140] That the corporation has little, if any, local identity is irrelevant to the internal affairs doctrine *qua* choice of law question.[141] Illinois' definition of "domestic corporation" fails to account for corporations which, although incorporated under Illinois law, have few resident shareholders, or insubstantial local activities, or insubstantial assets within Illinois.[142] Under the commerce clause analysis, Illinois would be hard pressed to counterbalance a legitimate state interest in protecting such nonlocal corporations against its clear intrusion upon interstate commerce. To define a class of corporations of genuinely local character, the Amendments should have limited the definition of "target" to those "domestic corporations" having certain levels of resident shareholders, business activities, or shareholdings in Illinois.[143]

3. *Internal Inconsistencies*

The Amendments are internally inconsistent with the legislative scheme upon which they are based. The Amendments assume that the business combinations it regulates implicate only the internal affairs of domestic

139. *Id.* § 1.80(a), (b).

140. RESTATEMENT (SECOND) OF TORTS § 302 (1971).

141. *See* Sargent, supra note 2, at 720.

142. *Compare* Illinois' definition of "target" *with* New York's definition of "target" which requires that the corporation (i) be incorporated in New York, (ii) have significant business operations located in New York, and (iii) have at least ten percent of its voting stock beneficially owned by New York residents. N.Y. BUS. CORP. LAW § 912 (McKinney 1986).

143. *See* Cardiff Acquisitions, Inc. v. Hatch, 751 F.2d 906 (8th Cir. 1984) (upholding the Minnesota Takeover Act against a commerce clause challenge because it limited the definition of target to corporations located in Minnesota, owned by at least 20% Minnesota residents, and having "substantial assets" in Minnesota).

For an interesting framework for analyzing the internal affairs rule under the commerce clause, see DeMott, *supra* note 131, at 371 which proposes the following inquiries:

> Assessing the validity of these 'outreach' choice of law doctrines under the commerce clause thus requires that a number of questions be addressed: (1) to what extent does the application of local corporate law to internal affairs questions in foreign corporations involve the regulation of interstate commerce; (2) if interstate commerce is thereby regulated, is it regulated directly or only incidentally; (3) if the regulation is incidental, does it burden interstate commerce; (4) if interstate commerce is burdened by the regulation, is the burden disproportionate to any legitimate local interests furthered by the regulation? Although answering some of these questions is far from easy, the analytical process demonstrates considerable constitutional vulnerability in the 'outreach' approach.

Id. at 371.

corporations undergoing fundamental corporate changes. Theoretically, such business combinations need not afford shareholders greater protection than other transactions subject to the Business Corporation Act which also result in fundamental corporate changes. Under the Business Corporation Act, such transactions may be adopted by two-thirds of the shares entitled to vote.[144] Transactions subject to the Amendments, however, require adoption by eighty percent of the shares entitled to vote.[145] Thus, the Amendments recognize that some transactions resulting in fundamental corporate changes are so potentially injurious to minority shareholders as to require increased protection. The Amendments, however, do not provide increased shareholder protection. Rather, the Amendments provide increased management protection. For example, the Amendments exempt friendly takeovers[146] from compliance with the rigorous price and procedure requirements of section 7.85.A by carrying forward the pro-management self-tender exemption objected to in *MITE.*[147] Consequently, second stage shareholders may not necessarily receive either a full or fair price for their stock if the Interested Shareholder can successfully woo the target's board.

More importantly, the inevitable thrust of section 7.85's rigorous price and procedure requirements is to deter acquisitional activity for Illinois corporations. The quid pro quo for section 7.85 is that all shareholders will be guaranteed full value in any front-end-loaded takeover that is successful — provided any is attempted. In the event that a non-front-end-loaded takeover is attempted, sections 7.85 and 8.85 leave the target's shareholders virtually without recourse against either the aggressor or the defensive maneuvers of the target's own board. Hence, the *MITE* objections, which may well pertain to the Amendments' self-tender and friendly takeover exceptions, are compounded by the inhibiting effects of sections 7.85 and 8.85.[148]

It can also be argued that by alleviating the threat of a hostile takeover, the Amendments diminish managerial incentives to maximize corporate value at the expense of their own entrenchment.[149] The attendant interference with

144. Many sections of the Illinois Business Corporation Act permit or require a simple majority or two-thirds share approval of corporate action. *See, e.g.,* Business Corporation Act of 1983 § 8.35 (requires simple majority vote for removal of directors); § 10.20 (requires two-thirds share vote to amend articles); § 11.20 (requires two-thirds share approval for share exchange, merger, or consolidation); § 11.60 (requires two-thirds share approval for sales, leases, exchanges not in usual and regular course of business).

145. Business Corporation Act of 1983 § 7.85.A.

146. Business Corporation Act of 1983 § 9.05.

147. *MITE,* 457 U.S. at 644.

148. *See* Greenblatt & Junewicz, *supra* note 82, at 7.

149. *See* Dynamics Corp. of Am. v. CTS Corp., 794 F.2d at 253-56 (7th Cir. 1986), *rev'd,* 107 S. Ct. 1637 (1987). The court stated, "To allow management to use its control of the board of directors to frustrate all hostile takeovers would nullify an important protection for shareholders. The threat of hostile takeover plays a vital role in keeping management on its toes." *Id.* at 253-54.

the market for corporate control may be inimical to the shareholders' long term interest in profiting from their investments and to their short term interest in making the investment in the first place.

C. Summary

In sum, the *MITE* Court rejected Illinois' assertion of a legislative scheme which purported to regulate the internal affairs of domestic corporations but which, in fact, strengthened the defense posture of incumbent management to the detriment of the shareholders and the acquiror. Although cast in a different format, the 1985 Amendments have not overcome these objections.

Although the Amendments do not directly regulate tender offers or violate specific provisions of the Williams Act, they do directly regulate those business combinations that are typically an integral phase of an acquisitional program. More importantly, by favoring management against an unwelcome aggressor, and by protecting management from its own shareholders, the Amendments pose a philosophy of takeover regulation that is incompatible with the market approach deemed critical to the balance of neutrality struck by the Williams Act. As a result, Illinois' interpretation of the internal affairs doctrine will result in extraterritorial extensions of its purportedly state-specific laws and, in so doing, impose unreasonable burdens on interstate commerce.

Conclusion

By enacting sections 7.85 and 8.85, the Illinois General Assembly has taken one step forward and two steps back in its effort to provide economic and legal protection to domestic corporations subject to unwelcome takeover bids. Theoretically based upon the protection of minority shareholders from the exploitative maneuvers of a potentially hostile controlling shareholder, the Amendments, in fact, derogate shareholder protection in favor of incumbent management.

Section 7.85 is premised upon the assumption that even though the purchase of tendered stock is beyond the state's regulatory power, the exercise of control over such stock is not. In effect, the tender offeror is free to purchase stock over which it can exercise limited control unless it pays full consideration to all shareholders of the target. Undoubtedly, the supermajority voting requirements and price and procedure requirements of section 7.85 will so increase the compliance and financial costs of a front-end-loaded takeover bid as to substantially reduce the likelihood of such acquisitional activity in Illinois. By making such tender offers less certain of success and more costly to the offeror, the Amendments will substantially reduce the aggregate number of opportunities for tendering shareholders to receive the highest possible value for their investments. On the other hand, under section 7.85, no shareholder will be coerced into tendering prematurely for fear of being forced out later at an inadequate price. Incumbent management will be permitted to stand its ground unless and until the acquiror pays full consideration to all of the target's shareholders. Under the auspices of section 7.85, the front-end-loaded takeover and its attendant coercion based upon compensation differentials between the first and second stage shareholders will be substantially reduced. On its own merits, section 7.85 has negotiated successfully the legal obstacles set forth in *MITE.*

The General Assembly, however, did not stop with section 7.85. It went on to enact section 8.85's ubiquitous board considerations and in so doing wrote incumbent management a "blank check endorsed with the 'business judgment rule.' "[150] Under the guise of the internal affairs doctrine,[151] section 8.85's pro-management bias so discriminates against shareholders and acquirors as to conflict with the balance of neutrality required by the Williams Act's market approach to takeover regulation. Section 8.85's antishareholder and antiacquiror bias so discriminates against a broad range of intra- and interstate control transactions as to impose unnecessary burdens on interstate commerce without countervailing justification. As a consequence, acquirors and shareholders will be prevented from benefiting from control transactions having the potential of maximizing the profitability and economic well-being of the corporation.

Taken in concert, the Amendments pose a program of corporate detente: they reduce the risk of the target's eventual demise in the second stage of the acquisition by escalating the financial and compliance costs to the aggressor in the first stage. As a result, aggressors will refrain from sending up their missiles knowing that, if provoked, the targets will send up theirs. Like detente, while the contenders are assessing their capabilities, the shareholders are powerless to alter the course of the ultimate outcome. Whatever may be the merits of detente in minimizing conflict on an international basis, its principles are inimical to the market approach of maximizing wealth on the corporate level.

It is one thing for section 7.85 to protect target shareholders and management from economically questionable transactions such as the front-end-loaded takeover. It is quite another thing for section 8.85 to sterilize the target shareholders by juxtaposing their interests against those of the corporation's employees, creditors, suppliers, and communities. The effect of section 7.85 may be to reduce some acquisitional interest in Illinois corporations. It may be economically unwise, but it is not unconstitutional. The effect of section 8.85, however, will be to reduce substantially investment

150. *Id.*

151. Under similar circumstances, the Court has admonished lower courts not to be "bound by the 'description, or characterization given it by the legislature or the courts of the state,' but [to] determine for itself the practical impact of the law." Hughes v. Oklahoma, 441 U.S. 322, 336 (1979) (quoting LaCosta v. Department of Conservation, 263 U.S. 545, 550 (1924)).

interest in Illinois corporations by assisting the entrenchment of incumbent management at the expense of shareholder protection. The section 8.85 wildcard casts substantial doubt upon the constitutionality of the entire regulatory scheme. Consequently, not only do the prospects for the Amendments bode poorly when subject to constitutional scrutiny, but should the Amendments survive constitutional scrutiny, their consequences bode even more poorly for Illinois' corporate well-being.