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VIRGINIA'S 'AFFILIATED TRANSACTIONS' STATUTE: INDULGING FORM OVER SUBSTANCE IN SECOND GENERATION TAKEOVER LEGISLATION

Stanley K. Joynes, III*
Steven J. Keeler**

I. INTRODUCTION

With the enactment of the new Virginia Stock Corporation Act1 during the 1985 Session of the General Assembly, Virginia joined forces with Maryland, Pennsylvania, and Ohio in adopting second generation state antitakeover regulation.2 The new Act includes an antitakeover provision specifically designed to avoid the constitutional infirmities which have proved fatal to first generation statutes.

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2. At least ten states, including Virginia, have adopted second generation takeover statutes. Maryland, Ohio, and Pennsylvania provide the three basic models.


The Ohio statute imposes voting requirements on acquisitions of controlling blocks of target shares, and has been followed by Wisconsin and Minnesota. See MINN. STAT. ANN. § 80B.01-.13 (West 1986); OHIO REV. CODE ANN. §§ 1701.01-831 (Baldwin 1986); Wis. STAT. ANN. § 180-725 (West Cum. Supp. 1986); see also Kreider, Fortress Without Foundation? Ohio Takeover Act II, 52 U. CIN. L. REV. 108 (1983); Note, Minnesota's Corporate Takeover Act—"Still" Unconstitutional?, 8 HAMLNE L. REV. 255 (1985).

A primary target of the new provision is the so-called "front-end loaded, two-tiered tender offer," a modern day corporate takeover technique thought by some to be inherently coercive and unfair to nontendering minority shareholders.

This article presents a brief summary of the operation and objectives of Virginia's second generation statute. While the new statute is less vulnerable to judicial invalidation than Virginia's first generation law, significant questions concerning the statute's constitutionality remain. In addition, the article suggests that any form of state regulation that effectively proscribes two-tiered tender offers is contrary to true shareholder interests and sound economic policy. Ultimately, the new antitakeover provision fails to distinguish properly the interests of shareholders from those of corporate management.

II. THE AFFILIATED TRANSACTIONS PROVISION

The pertinent section of the new Virginia Stock Corporation Act is Article 14, entitled "Affiliated Transactions." The drafters

3. See infra notes 48-49 and accompanying text.

The new provision is located in Article Fourteen and entitled "Affiliated Transactions." At least to some extent, the affiliated transactions provision is a legislative response to the constitutional assaults on Virginia's first generation statute, the "Take-Over-Bid Disclosure Act," Va. Code Ann. §§ 13.1-528 to -541 (Repl. Vol. 1985). While that statute is not the focus of this article, its relevance is considered at a later point herein. See infra notes 50-56 and accompanying text.

4. One student commentator provides a succinct explanation of this takeover method:

In a front-end loaded, two-tiered tender offer, the acquiring company offers to buy, at a premium price, only enough shares to establish a controlling position in the target company. Typically, the offeror accumulates up to five percent of the target's stock through open market purchases, and then makes a tender offer for enough of the outstanding shares to give it voting control. Once it gains control of the target, the offeror merges the target into itself or a subsidiary and freezes out the target's remaining shareholders by forcing them to accept cash or securities valued at a lower price per share than the original tender offer price.


5. See infra text accompanying notes 9-46.

6. See infra text accompanying notes 47-87.

7. See infra text accompanying notes 88-99.

8. See infra text accompanying notes 106-113.

sought to temper perceived inequities in the two-tiered tender offer process by structuring the statute as a seemingly traditional regulation of the internal affairs of Virginia corporations. In striking contrast to first generation laws, the statute does not directly regulate any aspect of the first-step tender offer in a two-tiered takeover; instead, it imposes restrictions only on the second-step freeze-out merger.

A. *Mechanics of the Statute*

1. **Scope: Affiliated Transactions**

The statute broadly defines an "affiliated transaction" as any merger, share exchange, disposition of assets constituting in excess of five percent of total fair market value, guarantee of indebtedness in excess of five percent of the total market value of corporate assets, sale or other disposition of voting shares having a fair market value in excess of five percent of all outstanding voting shares.

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10. *See infra* text accompanying notes 60-64.

11. This distinction implicates the constitutional validity of the statute and is discussed at a later point. *See infra* text accompanying notes 58-87.


13. The statute includes any share exchange "pursuant to § 13.1-717 of this Act in which any interested shareholder acquires one or more classes or series of voting shares of the corporation or any of its subsidiaries." *Id.*

14. An "affiliated transaction" includes:

   Except for transactions in the ordinary course of business, (i) any sale, lease, exchange, mortgage, pledge, transfer or other disposition (in one transaction or a series of transactions during any twelve-month period) to or with any interested shareholder of any assets of the corporation or of any of its subsidiaries having an aggregate fair market value in excess of five percent of the corporation's consolidated assets as of the date of the most recently available financial statements. . . .

*Id.* Fair market value, in the case of property other than cash or shares, is defined as the fair market value of such property on the date in question as determined by a majority of the disinterested directors. *Id.*

15. An "affiliated transaction" includes:

   Except for transactions in the ordinary course of business . . . (ii) any guaranty by the corporation or any of its subsidiaries (in one transaction or a series of transactions during any twelve-month period) of indebtedness of any interested shareholder in an amount in excess of five percent of the corporation's consolidated assets as of the date of the most recently available financial statements.

*Id.*

16. An "affiliated transaction" also includes:

   The sale or other disposition by the corporation or any of its subsidiaries to an inter-
dissolution\textsuperscript{17} or reclassification of securities\textsuperscript{18} which, in turn, involves or implicates an impact upon an interested shareholder. An "interested shareholder" is defined as any person who is the beneficial owner\textsuperscript{19} of more than ten percent of the outstanding voting

\begin{quote}
\textsc{Id.}

The statute defines fair market value as follows:

In the case of shares, the highest closing sale price of a share quoted during the thirty-day period immediately preceding the date in question on the composite tape for shares listed on the New York Stock Exchange 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 principal 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 bid quotation with respect to a share during the thirty-day period preceding the date in question on the National Association of Securities Dealers, Inc., automated quotations system or any similar system then in general use, or, if no such quotations are available, the fair market value of a share on the date in question as determined by a majority of the disinterested directors . . . .
\end{quote}

\textsc{Id.}

17. More specifically, the statute contemplates the dissolution of the corporation “if proposed by or on behalf of an interested shareholder . . . .” \textit{Id.}

18. An “affiliated transaction” also includes:

Any reclassification of securities, including any reverse stock split, or recapitalization of the corporation, or any merger of the corporation with any of its subsidiaries or any distribution or other transaction, whether or not with or into or otherwise involving an interested shareholder, which has the effect, directly or indirectly (in one transaction or a series of transactions during any twelve-month period), of increasing by more than five percent the percentage of the outstanding voting shares of the corporation or any of its subsidiaries beneficially owned by any interested shareholder who has not been an interested shareholder for at least five years before the date of such transaction.

\textsc{Id.}

19. The “Affiliated Transactions” statute includes voting power, investment power, and the right to acquire either of these in its definition of “beneficial owner”:

A person is deemed to be a “beneficial owner” of voting shares as to which such person and such person’s affiliates and associates, individually or in the aggregate, have or share directly, or indirectly through any contract, arrangement, understanding, relationship, or otherwise:

1. Voting power, which includes the power to vote or to direct the voting or the voting shares;
2. Investment power, which includes the power to dispose or to direct the disposition of the voting shares; or
3. The right to acquire voting power or investment power, whether such right is
shares. Thus, the statute applies to any of a variety of material transactions between the corporation and certain potentially dominant shareholders.

2. Special Voting Requirements

Following the Maryland approach, the Virginia statute imposes supermajority voting requirements with certain specified exceptions on those second-step transactions falling within the purview of the term “affiliated transaction.” Specifically, the statute provides that “an affiliated transaction shall be approved by the affirmative vote of the holders of two-thirds of the voting shares other than shares beneficially owned by the interested shareholder.” This requirement necessitates approval by the disinterested shareholders before the interested shareholder can accomplish a second-step freeze out of the minority shareholders who failed to tender in the first step or initial offer. The statute gives a majority of the “disinterested directors” the authority to determine: (1) whether a person is an interested shareholder, associate, or affiliate; (2) the number of voting shares beneficially owned by any such person; and (3) the relevant amounts and market values of voting stock, corporate assets and; (4) whether the amount of indebtedness guaranteed that may be the subject of an affiliated transaction constitutes more than five percent of the consolidated assets of the corporation.

exercisable immediately or only after the passage of time, pursuant to any contract, arrangement, or understanding, upon the exercise of conversion rights, exchange rights, warrants, or options, or otherwise; provided, that in no case shall a director of the corporation be deemed to be the beneficial owner of voting shares beneficially owned by another director of the corporation solely by reason of actions undertaken by such persons in their capacity as directors of the corporation.

Id.

20. Note, however, that the statute specifically excludes from the definition of “interested shareholder”: (1) the corporation or any of its subsidiaries, (2) any savings, employee stock ownership, or other employee benefit plan of the corporation or any of its subsidiaries, or (3) any fiduciary with respect to any such plan when acting in such capacity. Id.


22. See infra notes 26-42 and accompanying text.

23. See supra text accompanying notes 12-20.


25. Id. § 13.1-726(B). The statute defines a “disinterested director” as to any particular interested shareholder:

(i) any member of the board of directors of the corporation who was a member of the
3. Exceptions to Special Voting Requirements

a. General

The special voting requirements are subject to six statutory exceptions. First, if the "affiliated transaction has been approved by a majority of the disinterested directors," the need for a shareholder vote is eliminated. Second, the special voting requirements are not applicable to relatively small or closely held corporations (i.e., those that have not had "more than 300 shareholders of record at any time during the 3 years preceding the announcement date." Third, no special vote is required if "the interested shareholder has been the beneficial owner of at least eighty percent of the corporation's outstanding voting shares for at least five years preceding the announcement date." Fourth, a shareholder's vote is likewise not required if "the interested shareholder is the beneficial owner of at least ninety percent of the outstanding voting shares of the corporation." And fifth, the supermajority voting requirements are not applicable to investment companies registered under the Investment Company Act of 1940.

board of directors before the later of January 1, 1985, and the determination date and, (ii) any member of the board of directors of the corporation who was recommended for election by, or was elected to fill a vacancy and received the affirmative vote of, a majority of the disinterested directors then on the board.

Id. § 13.1-725. The "determination date," in turn, means the date on which an interested shareholder became an interested shareholder. Id.

26. Id. § 13.1-727(1). Thus, this exception grants the disinterested directors the discretion to avoid application of the statute altogether. "Consequently, a 'friendly' acquisition through tender offer and merger, or merger alone, approved by the requisite percentage of disinterested directors, escapes the special voting rule . . . ." Murphy, supra note 1, at 126 n.154.

27. VA. CODE ANN. § 13.1-727(2) (emphasis added).

The "announcement date" means the date of the first general public announcement of the proposed affiliated transaction or of the intention to propose an affiliated transaction or the date on which the proposed affiliated transaction or the intention to propose an affiliated transaction is first communicated generally to shareholders of the corporation, whichever is earlier.

Id. § 13.1-725.

28. Id. § 13.1-727(3).

29. Id. § 13.1-727(4). For purposes of this ninety percent ownership exception, the statute excludes "shares acquired directly from the corporation in a transaction not approved by a majority of the disinterested directors." Id.

30. Id. § 13.1-727(5).
b. "Fair Price" Exception

The sixth and, perhaps, most noteworthy exception to the special voting requirements of Article 14 is contained in the so-called "fairness" provisions of the statute.31 Similar fairness prerequisites are found in the Maryland statute. One commentator explains:

These requirements are designed to protect minority shareholders by guaranteeing that they will receive the same consideration for their stock in the second step of the two-tiered takeover that the majority received in the tender offer. Some of the fairness prerequisites relate to price, and others relate to non-price aspects of the transaction.32

While an exhaustive discussion of the fair price provisions is beyond the scope of this article, the essential components of the exception warrant consideration. To begin with, the statute requires that the value of the consideration for each class of voting shares received in the affiliated transaction equal at least the highest of the following: (1) the highest per share price paid by the interested shareholder for any shares acquired within the two-year period preceding the announcement date or in the transaction in which the shareholder became an interested shareholder, whichever is higher;33 (2) the fair market value of such shares on the announcement date or on the determination date, whichever is higher;34 (3) such fair market value multiplied by a specified statutory ratio;35 and (4) the highest preferential amount, if any, to which the hold-
In addition to these price conditions, the fairness exception to the special voting requirements provides that the consideration received by the stockholders shall be cash or "the same form as the interested shareholder has previously paid." Furthermore, during that portion of the three-year period preceding the announcement date that the interested shareholder was, in fact, an interested shareholder: (1) periodic dividends must have been declared and paid on the regular dates; (2) there cannot have been any reduction in the annual rate of dividends paid on any class and there must have been an increase in such annual rate as was necessary to reflect any transaction which reduced the number of outstanding shares; and (3) the interested shareholder must not have acquired any additional shares. Also during such period, the interested shareholder must not have "received the benefit" of any loans, advances, financial assistance or any tax advantages provided by the corporation. Finally, a "proxy or information statement describing the affiliated transaction and complying with the requirements of the Securities Exchange Act of 1934" must be mailed to the shareholders at least twenty-five days prior to consummation of the transaction.

4. Application of Article 14

The statute expressly provides that it shall not apply "to any corporation that adopts an amendment of its articles of incorporation stating that this article shall not apply to the corporation."
Such an amendment, or a subsequent one repealing it, requires the "affirmative vote of the holders of two-thirds of the voting shares other than shares beneficially owned by any interested shareholder."  

B. Principal Objective

The Joint Bar Committee explained that Article 14 "is designed to limit the likelihood that someone can acquire a controlling block of the outstanding shares and then use his voting power to squeeze out the remaining shareholders at a price that does not reflect the fair value of their shares."  

Clearly, the statute is premised on a negative view of the two-tiered takeover technique. For reasons that will be discussed in the following section, the statute's direct regulatory impact is restricted to the second-step merger of such a takeover—to "transactions that state law has traditionally required to be approved by stockholder vote and transactions that involve a conflict of interest." The statute's practical effect is to require the approval of either the disinterested shareholders or disinterested directors or, alternatively, compliance with some rather demanding fairness prerequisites before certain controlling shareholders can freeze out minority shareholders.

III. CONSTITUTIONAL UNCERTAINTY

Article 14 of the new Act exemplifies the response of state legislatures to the United States Supreme Court's decision in Edgar v. MITE Corp. MITE appeared to spell the end for first generation

44. Id. § 13.1-728(A), (B).

The source of the Article is the growing concern about the unfairness to minority shareholders that can result when a dominant shareholder proposes to engage in a significant transaction with the corporation where his control may enable him to cause the corporation to enter into the transaction even though it may not be in the best interest of the shareholders.

Id.

46. Scriggins & Clarke, supra note 2, at 273. The statute "regulates only the new majority's use of the statutory voting provisions to force out the minority at a low price. Thus, [it] prevents acquiring stockholders from using the voting provisions of a modern general corporation statute in a context for which they were never intended." Id. at 267 (describing the Maryland Act, after which the Virginia statute is modeled).
47. 457 U.S. 624 (1982). In MITE, a Delaware corporation which had initiated a tender offer for all outstanding shares of an Illinois-based company, sought a declaratory judgment in federal district court that the Illinois Business Take-Over Act was preempted by the
state antitakeover statutes which seek to regulate directly the first-step tender offer of two-tiered takeovers.48 Less than seven months

Williams Act and violated the Commerce Clause. The Illinois Act required a tender offeror to notify the Secretary of State and the target company of its intent to initiate a tender offer, and to specify the terms thereof, at least 20 days prior to the effective date of such offer. During that 20-day period, the statute prohibited the offeror from communicating its terms to the target’s shareholders. Target management was free to provide information to its shareholders regarding the offer. In addition, the Illinois Act required registration of all takeover offers with the Secretary of State. The Illinois statute applied when 10% of a target company’s shareholders were Illinois residents or alternatively, when any two of the following conditions were satisfied: (1) the target corporation’s principal office was in Illinois; (2) the target was incorporated in the state; or (3) at least 10% of the target’s stated capital and paid-in surplus was represented within the state. See MITE, 457 U.S. at 631-32. The district court issued a preliminary injunction prohibiting enforcement of the statute and later issued a declaratory judgment and permanent injunction. See generally, Note, State Takeover Statutes Under Attack—Casualties in the Battle for Corporate Control—MITE Corp. v. Dixon, 30 De Paul L. Rev. 989 (1981) (discussing the Seventh Circuit opinion); Note, The Supreme Court, 1981 Term, 96 Harv. L. Rev. 62, 62-71 (1982) (discussing the MITE case and its effect on state antitakeover statutes).


after *MITE* was decided, the Court of Appeals for the Fourth Circuit declared Virginia's first generation antitakeover statute unconstitutional. Thus, a brief examination of this statute, the "Take-Over-Bid Disclosure Act," is relevant to consideration of the constitutionality of Virginia's second generation statute.

A. Virginia's First Generation Statute: The "Take-Over-Bid Disclosure Act"

Virginia's first generation statute, the Take-Over-Bid Disclosure Act, remains on the books, although suspicion regarding its constitutional validity has precipitated several legislative modifications since its original enactment in 1968. There is extensive literature challenging the constitutionality of first generation statutes that directly regulate tender offers. The constitutional discussion below borrows from the traditional constitutional analysis applied to

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49. See Telvest, Inc. v. Bradshaw, 697 F.2d 576 (4th Cir. 1983); see infra notes 50-57 and accompanying text.


first generation laws. The conclusion is that the attempt to avoid the infirmities of the first generation with the development of a second generation has failed.\textsuperscript{53}

The purpose of the Take-Over-Bid Disclosure Act was "to protect the interests of offerees, investors and the public by requiring that an offeror make fair, full and effective disclosure to offerees of all information material to a decision to accept or reject a take-over bid."\textsuperscript{54} Like many first generation statutes, Virginia's fell prey to partial invalidation when, in \textit{Telvest, Inc. v. Bradshaw},\textsuperscript{55} the Fourth Circuit Court of Appeals struck down a provision of the Act governing open market purchases and requiring the filing of a statement of intent by the offeror with the State Corporation Commission and the target company.\textsuperscript{56} The court found the particular provision violative of the commerce clause insofar as it could affect transactions between individuals outside of Virginia:

In sum, we think that the burden on interstate commerce created by the 1980 amendment to Virginia's Take-Over-Bid Disclosure Act is a lesser one than the Illinois statute held invalid in \textit{MITE}. But we think that the protections purportedly offered Virginia shareholders of Virginia corporations are too speculative to sustain the Virginia statute's validity as it applies in this case.\textsuperscript{57}

Likewise, Virginia's recently enacted affiliated transactions provision is vulnerable to the same commerce and supremacy clause.

\footnotesize{\textsuperscript{53} See \textit{infra} notes 59-87 and accompanying text. \textsuperscript{54} VA. CODE ANN. § 13.1-528 (Repl. Vol. 1985). \textsuperscript{55} 697 F.2d 576 (4th Cir. 1983). \textsuperscript{56} Id. at 582. The provision invalidated VA. CODE ANN. § 13.1-529(b)(iii), \textit{amended by} 1983 Va. Acts 408. Only a few years before that holding, the Fourth Circuit upheld the district court's refusal to grant a preliminary injunction enjoining enforcement of this statute. See \textit{Telvest, Inc. v. Bradshaw}, 618 F.2d 1029 (4th Cir. 1980). \textsuperscript{57} \textit{Telvest}, 697 F.2d at 582. The court took note of expert testimony which identified the following deleterious economic effects of Virginia's efforts to regulate open market purchases: (1) investment in Virginia companies would be discouraged by the increased cost and uncertainties of investing; (2) the ability of a free market efficiently to price securities and allocate resources would be impaired; and (3) the incentive to incumbent management to perform well and thus support a high market price for the securities of the enterprise would be reduced. Id. at 580. The Act had enjoyed significant changes since its 1968 enactment. For discussions of these changes and the development of this Act, see Note, \textit{Take-Over-Bid Disclosure Act}, 12 U. Rich. L. Rev. 749 (1978); Gibson & Freeman, \textit{supra} note 50.}
attacks which were successfully leveled against first generation antitakeover statutes. 58

B. Commerce Clause

State takeover legislation generally has been attacked as constitutionally invalid under both the commerce clause and the preemption doctrine. 59 At the beginning of Edgar v. MITE Corp., the Court, in its discussion of the commerce clause, 60 explained that while incidental regulation of interstate commerce by the states is constitutionally permissible in certain circumstances, direct regulation is prohibited. 61 A plurality of the Court found the Illinois Act to be a direct restraint on interstate commerce insofar as it directly regulated interstate tender offers. 62 Thus, the Act was held to constitute an invalid direct regulation of interstate commerce having a "sweeping extraterritorial effect." 63

The new Virginia statute, like many second generation ones, successfully avoids constitutional suspicion under this direct restraint rationale. Indeed, the statute was structured specifically to avoid such a classification and its provisions are reserved for the second-

58. See supra notes 48-49.


60. U.S. CONsT. art. I. § 8, cl. 3 ("Congress shall have Power . . . [t]o regulate Commerce . . . among the several States."). For detailed discussions of commerce clause analysis in the context of state takeover regulation, see Langevoort, State Tender-Offer Legislation: Interests, Effects, and Political Competency, 62 CORNELL L. REV. 213 (1977); Shipman, Some Thoughts About the Role of State Takeover Legislation: The Ohio Takeover Act, 21 CASE W. RES. 722 (1970); Note, Commerce Clause Limitations upon State Regulation of Tender Offers, 47 S. CAL. L. REV. 1133 (1974).


62. Justices White, Blackmun, Burger, and Powell joined in this determination. The Illinois Business Take-Over Act required tender offerors to notify the Secretary of State and the target company of their intent to make an offer and the offer's terms 20 days prior to the offer becoming effective. MITE, 457 U.S. at 627. The opinion states:

The Illinois Act differs substantially from state blue-sky laws in that it directly regulates transactions which take place across state lines, even if wholly outside the State of Illinois. A tender offer for securities of a publicly held corporation is ordinarily communicated by the use of the mails or other means of interstate commerce to shareholders across the country and abroad. Securities are tendered and transactions closed by similar means . . . . These transactions would themselves be interstate commerce . . . . [T]he Act could be applied to regulate a tender offer which would not affect a single Illinois shareholder.

Id. at 641-42.

63. Id. at 642; see also Southern Pac. Co. v. Arizona, 325 U.S. 761, 775 (1945) (striking down a state statute on commerce clause grounds where the "practical effect of [the] regulation is to control [conduct] beyond the boundaries of the state").
step, traditionally intracorporate transaction. The second part of MITE's commerce clause analysis, however, may create significant problems even for second generation statutes like Article 14.

Relying on the balancing test expounded in Pike v. Bruce Church, Inc., a majority of the MITE Court held the Illinois Act to be unconstitutional albeit as a form of indirect regulation. In the Court's view, the putative state interest in shareholder protection, as well as in regulating the internal affairs of domestic corporations, was "insufficient to outweigh the burdens" imposed on interstate commerce. Justice White's elaboration as to these burdens is particularly enlightening:

The effects of allowing the Illinois Secretary of State to block a nationwide tender offer are substantial. Shareholders are deprived

64. See supra text accompanying notes 10-11; see also Scriggins & Clarke, supra note 2, at 289-90. Scriggins and Clarke note:

Because the new Maryland statute regulates the forced transaction stage of a take-over rather than the tender offer stage, its effect on the tender offer, and thus on interstate commerce, is patently indirect. Therefore, even if the direct-indirect distinction continues to have significance in commerce clause jurisprudence, the Act is safe from invalidation on that score.

Id. An alternate view is that such statutes successfully avoid "placing impermissible direct restraints on interstate commerce" due to the fact that they do not "put conditions on tender offers communicated across state lines, but [focus] primarily on the internal corporate affairs of companies incorporated within the state." Note, Second Generation State Takeover Legislation: Maryland Takes a New Tack, 83 Mich. L. Rev. 433, 455 (1984). Professor Sargent also observes:

[S]econd-generation statutes do not directly condition or restrain the tender offer or the consequent tender of shares; instead, they readjust the target's internal ordering mechanism in a way that will have a substantial impact on what can happen after the tender offer is completed. In essence, the new direction shifts the focus from securities regulation to corporate law.


65. 397 U.S. 137 (1970). The MITE opinion noted that "[a] state statute must be upheld if it 'regulates evenhandedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental . . . unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits.'" 457 U.S. at 640 (quoting Pike, 397 U.S. at 142).

66. 457 U.S. at 643. Note that this was the only part of the MITE decision embraced by a majority of the Justices.

"The MITE decision is not a model of judicial unanimity." Note, supra note 50, at 236. For a discussion of the complex allocation of the Justices' votes in MITE, see Note, The Unsung Death of State Takeover Statutes: Edgar v. MITE Corp., 24 B.C.L. Rev. 1017, 1039-44 (1983); see also Comment, Front-End Loaded, supra note 4, at 830 ("The import of the case, Edgar v. MITE Corp., is difficult to determine because the Court issued six different opinions.").

67. 457 U.S. at 643.
of the opportunity to sell their shares at a premium. The reallocation of economic resources to their highest valued use, a process which can improve efficiency and competition, is hindered. The incentive the tender offer mechanism provides incumbent management to perform well so that stock prices remain high is reduced.8

It is uncertain whether Virginia's second generation statute can successfully pass the Pike test for indirect restraints on commerce. The question as to whether the burdens imposed on interstate commerce are excessive in relation to the local interests served by the statute must be answered in both constitutional and economic terms.9 As perceptively recognized by one commentator, "it is impossible to weigh the burdens on interstate commerce or to define the nature and importance of the state interests without considering the economic arguments . . . regarding the structural role of hostile takeovers in the corporate system."70

While the economic burdens imposed by the Virginia statute are addressed in more detail in another section,71 it is sufficient to note here that even second generation antitakeover laws discourage and increase the cost of takeover attempts which serve both to improve corporate resource allocation and to discipline inefficient management.72 Furthermore, the putative local interests which serve as a

68. Id. at 643. At this point, the opinion cites Easterbrook & Fischel, The Proper Role of a Target's Management in Responding to a Tender Offer, 94 Harv. L. Rev. 1161, 1173-74 (1981). The authors embrace the views of Professors Easterbrook and Fischel and give them further consideration in a subsequent section of this article. See infra notes 91-93 and accompanying text; see also supra notes 47-57 indicating the deleterious economic effects of Virginia's first generation statute identified in Telvest, Inc. v. Bradshaw, 697 F.2d 576, 580 (4th Cir. 1983).

69. For purposes of organization, the authors have chosen to address in more detail the economic criticisms of state takeover regulation in a subsequent section. See infra text accompanying notes 88-105.

70. Sargent, supra note 64, at 7. Professor Sargent suggests:

The burdens imposed on interstate commerce and the benefits provided to the state by internal affairs regulation must be defined and balanced in economic terms . . . . This premise does not suggest that the Commerce Clause expresses a constitutional preference for "free" markets or any other market structure. It suggests, instead, that state attempts to regulate economic enterprise must be analyzed in economic terms.

Id. at 25-26 (emphasis added).

71. See infra text accompanying notes 88-105.

72. See generally Dennis, Two-Tiered Tender Offers and Greenmail: Is New Legislation Needed? 19 Ga. L. Rev. 231 (1985); Note, supra note 64, at 456-57 (suggesting that Maryland's second generation statute may be unconstitutional insofar as the state's interest in "regulating corporate internal affairs and protecting investors may not offset the burdens . . . [placed] on interstate commerce.")

The following statement was made about the Maryland second generation statute:


justification for such legislation are questionable. In particular, other commentators have suggested that state antitakeover statutes might be viewed appropriately as a form of economic protectionism. Moreover, as suggested in MITE, a provision such as the one in Virginia's statute, which exempts from statutory coverage a corporation's acquisition of its own shares, cannot be reconciled with the purported objective of shareholder protection.

Assuming that corporate takeovers are to be viewed as beneficial to the workings of an otherwise free market, Virginia's second generation statute arguably imposes economic burdens that outweigh the local interests which the statute's proponents claim it

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[1] It burdens commerce by increasing the costs of corporate takeovers. Corporate takeovers may be desirable from the standpoint of interstate commerce because they serve as a discipline on inefficient management. Business combinations after a takeover may improve resource allocation and produce economies of scale. The MITE Court emphasized that these salutory effects are negated by antitakeover legislation. Id. at 456 (citing MITE, 457 U.S. at 643); see also supra text accompanying note 68.

73. Professor Sargent has noted that:
What the state legislatures had in mind, . . . was protection of local companies from hostile takeovers. While this sentiment reflected a concern for protection of local jobs rather than target management per se, such parochialism remains exactly what the Commerce Clause was designed to prevent. The protectionist impulse that accounts for much of the success of these statutes in the state legislatures thus could prove fatal to them in the courts. The cases involving the first-generation statutes have made it clear that this state “benefit” will not outweigh any burden imposed on interstate commerce.

Sargent, supra note 64, at 31-32.

The position that “the intention of the state statutes could only be the insulation of local target companies from possible liquidation or relocation of corporate assets and the consequent loss of local revenue and employment” has also been advocated. Note, supra note 60, at 244 (quoting Note, Securities Law and the Constitution: State Tender Offer Statutes Reconsidered, 98 YALE L.J. 520, 528 (1979); see also Langevoort, supra note 60, at 241-53; Wilner & Landy, supra note 48, at 18; Note, supra note 64, at 457; Note, supra note 60, at 1159. In MITE, the Court doubted the shareholder protection interest because there was no legitimate state interest in protecting non-resident shareholders. See Sell, supra note 2, at 478.

74. See supra note 20. The MITE Court explained:
While protecting local investors is plainly a legitimate state objective, the State has no legitimate interest in protecting nonresident shareholders. . . . We note, furthermore, that the [Illinois] Act completely exempts from coverage a corporation's acquisition of its own shares . . . . This distinction is at variance with Illinois' asserted legislative purpose, and tends to undermine appellant's justification for the burdens the statute imposes on interstate commerce.

457 U.S. at 644; see also Telvest, Inc. v. Bradshaw, 697 F.2d 576, 581 (4th Cir. 1983) (noting that Virginia's first generation statute similarly exempts purchases by an issuer of its own stock and citing VA. CODE ANN. § 13.1-529(b)(ii)); Kreider, supra note 2, at 122-23 (“[d]iscussions are framed in terms of shareholder interest although all recognize these laws are aimed at protecting incumbent management”); Note, supra note 2, at 267, 274.

75. See infra notes 88-105 and accompanying text.
furthers. As a consequence, judicial application of the Pike test will likely result in invalidation of Article 14, as well as other second-generation statutes, as an indirect restraint on interstate commerce. Indeed, one commentator has suggested that "MITE serves as a warning that a state's mere claim that its takeover statute provides additional protection to resident shareholders will not be sufficient to outweigh the greater burden imposed on interstate commerce as a result of the statute's extraterritorial impact."

C. Preemption Doctrine: Conflict with Congressional Objectives

In Edgar v. MITE Corp., three Justices concluded that the Illinois Act was invalid under the supremacy clause. Holding that the takeover statute was preempted by the Williams Act, Justice

76. The potential extraterritorial reach of the statute alone may be deemed constitutionally unacceptable. For the observation that the "extraterritorial impact that is necessarily a characteristic of state takeover statutes cannot be easily avoided" see Note, supra note 2, at 272. Professor Sargent points out that if one adheres to the view that takeovers serve to allocate corporate assets to their optimal use and to discipline managers to maximize shareholder utility rather than their own, then second-generation statutes "cannot reasonably be said to serve any legitimate state interest." Sargent, supra note 64, at 33.

77. Note, supra note 2, at 274. The commentator also noted that: "[t]he Court has served notice that if a state's takeover statute even indirectly affects interstate commerce, some additional, more pervasive local interest must be shown than was proffered by Illinois to sustain the law against a constitutional challenge." Id. at 275. Virginia, in all likelihood, will claim that its new statute serves the same interests that Illinois unsuccessfully cited in MITE—the protection of resident stockholders and the regulation of the internal affairs of domestic corporations. See MITE, 457 U.S. at 644.

For the observation that the Maryland Act "raises novel Commerce Clause issues" and that it might "reduce the aggregate number of takeover bids for Maryland corporations," see Sargent, supra note 64 at 11. Professor Sargent further notes:

The [second generation] statutes . . . all affect interstate commerce through conditioning the manner in which hostile takeovers are to be accomplished, raising the cost of such takeovers, and altering the balance between the bidder and target management. They thus do not differ in this regard from the first generation statutes invalidated on Commerce Clause grounds in MITE.

Id. at 12-13.

78. 457 U.S. 624, 630-40 (Opinion of White, J., in which Burger, C.J., and Blackman, J., joined); see U.S. Const. art. VI, § 2 ("This Constitution, and the Laws of the United States . . . 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 any State to the Contrary notwithstanding."). For extensive treatment of the preemption doctrine, see generally Note, A Framework for Preemption Analysis, 88 Yale L.J. 363 (1978) [hereinafter Preemption Analysis]; Note, The Preemption Doctrine: Shifting Perspectives on Federalism and the Burger Court, 75 Colu. L. Rev. 623 (1975) [hereinafter Federalism and the Burger Court].

79. 15 U.S.C. §§ 78m(d)-(e), 78n(d)-(f) (1982); see also L. Tribe, American Constitutional Law 342-44 (1978); Note, Federalism and the Burger Court, supra note 78; Note, Preemption Analysis, supra note 78. See generally Fogelson, Wenig & Friedman, Changing the Takeover Game: The Securities and Exchange Commission's Proposed Amendments to
White explained that, in enacting that federal legislation, Congress sought to "strike a balance between the investor, management, and the takeover bidder." The opinion noted that a state statute is void to the extent that it "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." Thus, insofar as the requirements of the Illinois statute tipped the balance in favor of target management, the Justices agreed with the Seventh Circuit that it conflicted with congressional objectives:

The Williams Act was designed to protect shareholders and to preserve a neutral balance between incumbent management and offeror. Because state takeover statutes hinder the successful completion of tender offers by providing management with a powerful weapon of delay, such statutes "[disrupt] the neutrality indispensable for the proper operation of the federal market approach," and therefore "[stand] as . . . obstacles to the accomplishment and execution of the full purposes and objectives of the Williams Act."

Virginia's second generation statute, with its special voting re-

the Williams Act, 17 HARV. J. ON LEGIS. 409, 412-21 (1980); Wilner & Landy, supra note 48, at 23-24 (discussing the subtle and often ignored distinction between supremacy clause and preemption analysis). The disclosure provisions of the Williams Act regulating tender offers are embodied in amendments to sections 13(d) and 14(d) of the Securities Exchange Act of 1934.

80. MITE, 457 U.S. at 634.

Congress enacted the Williams Act in 1968 to provide the target company shareholder with full and fair disclosure of all relevant facts concerning the offer and offeror. This disclosure provides the shareholder with an opportunity to make an informed decision of whether to accept or reject the offer. The Williams Act also embodies a policy of evenhandedness and neutrality. This policy reflects congressional conviction that neither the offeror nor the target company management should enjoy any advantage over the shareholder's decision-making process.

Note, supra note 2, at 235-56; see also Steinberg, Some Thoughts on Regulation of Tender Offers, 43 Md. L. Rev. 240, 251 (1984) ("The disclosure provisions of the Williams Act were intended by Congress to ensure that shareholders, after hearing from both the offeror and target corporations with neither side having an unfair advantage over the other, would have sufficient information to make informed decisions in determining whether to tender their shares.").


82. MITE Corp. v. Dixon, 633 F.2d 486, 495 (7th Cir. 1980), aff'd sub nom. Edgar v. MITE Corp., 457 U.S. 624, 634 (1982) ("We, therefore, agree with the Court of Appeals that Congress sought to protect the investor not only by furnishing him with the necessary information but also by withholding from management or the bidder any undue advantage that could frustrate the exercise of an informed choice.") (citing Dixon, 633 F.2d at 496).
quirements and fair price provisions, clearly conflicts with the congressional objectives of neutrality and shareholder protection. The statute will, in all likelihood, have the practical effect of discouraging two-tiered offers thereby securing the position of incumbent management.\textsuperscript{83} The resultant disincentive to initiate tender offers, caused by increased costs and risk, will ultimately deny stockholders both the opportunity to sell their shares at a premium and the benefit of replacing inefficient management.\textsuperscript{84} Furthermore, the Virginia statute reduces shareholder autonomy by giving disinterested directors the discretion either to avoid or submit to the statute's provisions,\textsuperscript{85} tilting the regulatory balance even more in favor of target management.\textsuperscript{86} For these reasons, the Virginia statute ap-

\textsuperscript{83} For the observation that "[a]n acquiror may be discouraged from making the initial tender offer if he realizes that he may not be able to acquire one hundred percent of the entity," see Murphy, supra note 1, at 126.

Many statutes employ similar provisions, such as supermajority voting provisions, to discourage takeover tender offers.

Supermajority provisions are the most widely adopted anti-takeover tactic. The requirement of a supermajority to accomplish certain changes in the corporation, such as a merger or sale of assets, will raise the offeror's cost of acquiring control, will make takeover difficult or impossible when management controls enough stock to block the vote even if an offeror buys out all other shareholders, and may enable management to arrange a friendly acquisition.

Newlin & Gilmer, supra note 2, at 121. Referring to a similar Maryland statute, one commentator states:

Supermajority provisions make it difficult and expensive to consummate a two-step takeover. Were it not for the existence of the fair price provision, Maryland's supermajority requirement could virtually give management a veto power over business combinations. Such a pro-management bias runs counter to the investor protection goal of the neutral stance of the Williams Act.

Note, supra note 64, at 464-65. For the position that the MITE majority "should have nullified the Illinois Act on supremacy clause grounds as well as on the commerce clause grounds," see Note, supra note 50, at 244 (quoting Note, Edgar v. MITE Corp.: The Death Knell for the Indiana Takeover Offers Act, 16 IND. L. REV. 517, 525 (1983)).

84. A more detailed discussion of the economic benefits provided to investors by an unhindered market for two-tiered takeovers has been reserved for the next section. See infra text accompanying notes 88-105.


86. See Sargent, supra note 52, at 694 ("[A]dministrative review of the substantive fairness of a takeover bid has been invalidated by some courts on the ground that such review 'is in conflict with the market approach and frustrates the express congressional intent that the shareholders make their decisions.'"); Note, supra note 64, at 466-67 (arguing that the Maryland law "replaces investor autonomy with a benevolent bureaucracy"); see also Great W. United Corp. v. Kidwell, 577 F.2d 1286, 1279 (5th Cir. 1978), rev'd sub nom. on other grounds, Leroy v. Great W. United Corp., 445 U.S. 173 (1979); Newlin & Gilmer, supra note 2, at 118. ("The Fifth Circuit found that Idaho's takeover law was preempted by the Williams Act because 'Congress intended for the investor to evaluate a tender offer; Idaho [through a pre-offer notice requirement] asks the target company management to make that decision on behalf of the shareholders.'").
pears to be inconsistent with the federal objectives embodied in the Williams Act and is thereby preempted.87

IV. A MATTER OF STATE POLICY: VIRGINIA'S REJECTION OF THE EFFICIENT MARKET MODEL

A. The Economic Argument Against State Takeover Regulation

As noted earlier in this article,88 the constitutional and economic issues raised by Virginia's takeover legislation can appropriately be considered in tandem.89 However, the economic considerations are significant enough to warrant independent attention here. An economic analysis premised on the "efficient capital market model"90

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87. As one student commentator aptly concludes with regard to the Maryland model, after which the Virginia statute is patterned:

The Maryland statute clearly does provide some benefits. It eliminates the coercion inherent in partial and two-tier offers by assuring nontendering shareholders a voice in the second step or, at least, treatment no worse than that received by tendering shareholders. These benefits are provided, however, at the expense of tender offerors who are stripped of a useful acquisition technique and, more importantly, at the expense of those investors who desire to receive tender offers for their shares. The Maryland statute's potential anti-takeover effect cannot be reconciled with the concepts of neutrality and investor protection in the Williams Act. The statute is incompatible with congressional objectives in regulating tender offers and is therefore preempted. Note, supra note 64, at 468-69. But see Scriggins & Clarke, supra note 2, at 291 (concluding that "the constitutionality of the [Maryland] Act should be beyond doubt").

88. See supra text accompanying notes 69-70.

89. For an interesting discussion as to why analysis of second generation takeover statutes must, by necessity, "draw upon the insights of economic analysis," see Sargent, supra note 64, at 33.

90. Professor Henry G. Manne was probably the first to apply this concept of financial theory to various corporate law problems. See Manne, Mergers and the Market for Corporate Control, 73 J. Pol. Econ. 110 (1965); see also Dennis, supra note 72, at 308-09 (excellent discussion of the theoretical underpinnings of the efficient market model). Professor Dennis explained the efficient market model as follows:

The efficient market model posits that all public information is reflected in the share price of a particular firm. This model portrays the operation of the stock market as an information exchange. The aggregate behavior of the market represents a competitive equilibrium created by numerous buyers and sellers producing and processing information. Individual investors may not have all the information available to the market and may not properly evaluate the relevant data, but the competition of the market produces an equilibrium price which represents an unbiased estimate of value based on current information.

The efficiency of management is an integral part of the mix of data known about the firm. The value of a particular firm, as measured by the market, has two components—the value of the firm under current management and the discounted value of a potential takeover at a premium price. Raiders must believe that by placing the assets of the target firm under more efficient management, the aggregate value of these two components will be increased. The target firm is only undervalued in that present managers of the company are not likely to undertake other methods of man-
is consistent with both congressional policy and general notions of free enterprise. Such a view necessarily results in the conclusion that corporate takeovers should be encouraged and that state takeover regulation of any lineage should be minimized.

Several general conclusions follow from the efficient market model. First, an unrestricted market for corporate control increases the potential for gain-producing transactions which ultimately maximize the value of a target company's stock.\textsuperscript{9} Second, an active takeover market serves to monitor the performance of incumbent management as one component of the company's overall value, and thus maintains a check on potentially poor management.\textsuperscript{92} The bottom line is that corporate takeover activity should

\textsuperscript{9}See Dennis, supra note 72, at 322. Professor Dennis acknowledges Professors Easterbrook and Fischel as the "leading academic defenders of two-tiered offers": They take the position that shareholders should prefer legal rules that maximize the value of all their holdings \textit{ex ante} in the aggregate over rules which require \textit{ex post} equal treatment but which may reduce the number of gain sharing transactions. They argue that unequal gain sharing might be necessary to accomplish many control transactions . . . . Under the Easterbrook-Fischel model, pretransaction market value is the sole measure of whether a shareholder receives adequate compensation for her investment. A shareholder must receive at least this amount of consideration in any second step transaction.


\textsuperscript{92} The \textit{Proper Role}, supra note 91, at 1169; ("The most probable explanation for unfriendly takeovers emphasizes their role in monitoring the performance of corporate managers. The tender bidding process polices managers whether or not a tender offer occurs, and disciplines or replaces them if they stray too far from the service of the shareholders."); see
in no way be discouraged—it increases shareholder welfare by driving stock prices to premium levels and by insuring that management commits company resources to their optimal use. Indeed, target management's role should be limited in takeover situations and, furthermore, legislation which discourages takeover attempts should be rejected.93 Such would reflect "sound public policy."94

While many commentators have contested this line of reasoning,95 support can be found in the legislative history of the Williams Act and in the MITE decision. Through enactment of the Williams Act, Congress demonstrated its reliance on the "market approach" to investor protection.96 Indeed, as one commentator observed:

also Note, supra note 50, at 227; Comment, supra note 4, at 826.
93. See Dennis, supra note 72, at 311; The Proper Role, supra note 91.
94. Dennis, supra note 72, at 341. Professor Dennis prefaced his article with the observation:

[E]ncouraging an active market for corporate control is sound public policy. While inefficient managers can be disciplined by several forces—the product market, the employment market, and the shareholder-initiated regulation through proxy fights or legal mechanisms—, the market for corporate control is an important ingredient in insuring that society's resources are used to their fullest potential. An active market for corporate control encourages the replacement of inefficient managers and creates synergies between firms.

Id. at 283.

The MITE Court recognized the benefits of unregulated tender offer activity in its commerce clause analysis. See MITE, 457 U.S. at 643-44 (citing The Proper Role, supra note 91); see also Note, At the Crossroads of Corporate Takeover Legislation, 63 Neb. L. Rev. 345, 359 n.94 (1984).
95. See, e.g., Brudney & Chirelstein, Fair Shares in Corporate Mergers and Takeovers, 88 Harv. L. Rev. 297 (1974); Lowenstein, supra note 52; Brudney & Chirelstein, A Restatement of Corporate Freezeouts, 87 Yale L.J. 1354 (1978); Scriggins & Clarke, supra note 2; Note, supra note 59, at 388 ("The best way to insure adequate protection is to effectively regulate second step transactions in two-tiered takeovers.").
96. See Great W. United Corp. v. Kidwell, 577 F.2d 1256 (5th Cir. 1978), rev'd sub nom. on other grounds, Leroy v. Great W. United Corp., 433 U.S. 173 (1979); see also Note, supra note 64, at 449-50 ("The [Kidwell] court stated that Congress recognized that tender offers often benefit individual investors and thus Congress advocated a narrow regulatory role in the tender offer area."). See generally Weiss, Defensive Responses to Tender Offers and the Williams Act's Prohibition Against Manipulation, 35 Vand. L. Rev. 1087, 1100-14 (1982).

[T]he correct view of the Williams Act lies close to the "market approach" view. The "market approach" view recognizes the interrelatedness of neutrality and the Williams Act's concept of investor protection. The legislative history of the Act indicates that Congress believed that a neutral balance between tender offers and target management would benefit investors by preserving their opportunity to receive attractive tender offers and by providing a check on inefficient management.

Note, supra note 64, at 452 (citing 113 Cong. Rec. 24,665 (1967)); see also Piper v. Chris-Craft Indus., 430 U.S. 1, 30 (1977); MITE Corp. v. Dixon, 633 F.2d 486, 496 (7th Cir. 1980) (Congress perceived neutrality and investor protection as integrated principles), aff'd sub nom. Edgar v. MITE Corp., 457 U.S. 624; Note, supra note 94, at 357 n.87.
The courts have emphasized that the underlying purpose of the Williams Act is the protection of investors and that Congress intended to protect investors by ensuring adequate and timely disclosure of material information about the takeover bid so that the investor may make an informed decision. This “market approach,” as the legislative history of the Williams Act seems to show, reflected Congress’ belief that investor protection does not require prevention or discouragement of takeovers since some takeovers may, in fact, benefit investors.\(^7\)

Similarly, the MITE Court referred in its preemption analysis to the Williams Act legislative history and concluded that “Congress intended for investors to be free to make their own decisions.”\(^8\) In addition, the opinion recognized that tender offer activity provides the benefits of high stock prices and positive management incentive.\(^9\) While Congress and the judiciary have not expressly adopted the efficient market model, it seems fair to say that congressional policy, as interpreted by the courts, is consistent with that modern economic theory.

B. Shareholder Protection or Economic Parochialism?

One should consider whether Virginia’s persistence with regard to regulating two-tiered tender offers is grounded in concern for the welfare of minority shareholders or in a fear that, given the current takeover trend, many Virginia companies will eventually be controlled by out-of-state interests.\(^{100}\) Even if the objective of


\(^{98}\) MITE, 457 U.S. at 640. The Court stated: “[T]he state thus offers investor protection at the expense of investor autonomy—an approach quite in conflict with that adopted by Congress.” Id. (quoting Dixon, 633 F.2d at 494).

\(^{99}\) Id. at 643; see also supra note 68.

\(^{100}\) For the observation that while the first motive for Virginia’s antitakeover statute “was a growing concern about the unfairness to minority shareholders,” the second motive “was the desire to protect Virginia Corporations from certain takeover tactics,” see Murphy, supra note 1, at 124. A similar statement was made about Maryland’s statute:

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

Note, supra note 64, at 457. Another commentator notes:

It has been observed that “[a] number of states apparently feared that established
Article 14 is to moderate the coercive impact of two-tiered takeovers, the statute nonetheless benefits incumbent management more than shareholders as a class. The disinterested directors are afforded the discretion of deciding when the statute will apply and, thus, which takeover attempts will enjoy success. And while the benefits of a free market are withheld from shareholders, the decrease in the number of takeover attempts will only leave management more secure.

Finally, if shareholder welfare is truly at the heart of the statute, the crucial distinction between shareholder interests and those of incumbent management has obviously been either discounted or ignored. Shareholders are interested in a high return on their investment, which can frequently be better achieved through corporate takeovers. In contrast, management is concerned with job security and thus may view an active takeover market as a threat. Experience has shown that incumbent management is usually acting in its own interest when it takes measures necessary to deflect a potential takeover. This motivation increases the potentiality that valid shareholder interests will be sacrificed. Because the respective interests of shareholders and management are

local concerns might, through the tender offer device, be taken over by outside interests who would then close down plants and leave local residents jobless . . . . This purpose may . . . be inferred from the fact that the majority of acts exempt offers approved by management.

Wilner & Landy, supra note 48, at 18; see also Note, supra note 2, at 274-75; Note, supra note 60, at 1159.

101. See supra note 45.


103. For the suggestion that second generation statutes may “eliminate or significantly reduce the number of partial and two-step takeover bids” and “function like legislatively enacted shark repellants, preventing certain kinds of takeovers from being launched at all and perhaps reducing the aggregate number of takeovers,” see Sargent, supra note 64, at 27.

104. See Comment, Front-End Loaded, supra note 4, at 821 (“In resisting takeover attempts, . . . officers and directors often are motivated simply by a desire to keep themselves in control of the target corporation.”). Professor Steinberg recognizes the inherent conflict in affording management authority over the takeover process. Steinberg, supra note 80, at 243 (“[T]arget management is likely to have a disabling conflict of interest . . . . Directors and officers of the target corporation know that they are likely to be replaced if an offer succeeds.”).

105. Comment, Front-End Loaded, supra note 4, at 826 (“Because an active takeover market encourages removal of inefficient managers, any policy that inhibits takeovers is detrimental to the welfare of shareholders.”); see Note, supra note 50, at 227 (shareholders benefit from the incentive for increased effectiveness of management that the threat of a tender offer provides). See generally Hessen, The Modern Corporation and Private Property: A Reappraisal, 26 J.L. & Econ. 273 (1983) (discussing separation of ownership and control in modern public corporation).
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divergent with regard to potential takeovers, a statute demonstrat-
ing pro-management bias clearly cannot insure shareholder
welfare.

V. CONCLUSION: TAKING THE GLOVES OFF

The enactment of Virginia's second generation antitakeover statute is consistent with the burgeoning efforts of various states to provide attractive environments for incorporations of new businesses and reincorporations of existing companies. Thus, it is not surprising to note both that the affiliated transactions provision was given an earlier effective date than the rest of the statutory framework into which it was inserted and that Virginia had, in 1984, greatly liberalized the permissible scope of indemnification which corporations could afford their officers and directors. One hopes it would be an overstatement to conclude from these developments that Virginia has joined the "race to the bottom," but examination of Virginia's antitakeover statute indicates the question is open.

The "Affiliated Transactions" statute is artfully drafted to appear merely as regulation of the intracorporate affairs of Virginia corporations. Moreover, it is buried in the midst of the new Stock Corporation Act provisions dealing with matters such as the formation and dissolution of corporations. The drafters gave it the innocuous title of "Affiliated Transactions."

Irrespective of its label and its placement within the statutory framework, Virginia's provision dealing with so-called "Affiliated Transactions" is an antitakeover statute. As such, it clearly conflicts with the purpose of the Williams Act which, as expressed by Justice White in Edgar v. MITE Corp., was to avoid favoring either management or the takeover bidder. Moreover, inasmuch as many of the shareholders sought to be "protected" by the statute

109. Id. §§ 13.1-742 to -756.
110. See supra text accompanying notes 78-87.
are not Virginia residents, and given that the undeniable effect of the statute will be to impede the takeover efforts of foreign corporations, the aim of the statute is not merely regulation of the internal corporate affairs of Virginia corporations. Indeed, its extraterritorial reach infects it with the same malady as was deemed fatal to the first generation statute in Telvest, Inc. v. Bradshaw; namely, it impermissibly burdens interstate commerce. Finally, if the drafters' purpose truly was to insure that minority shareholders will receive fair value for their shares in the event of merger, then their efforts may be unnecessary in light of the rights already afforded by statute in Virginia to dissenting shareholders.113

112. See supra text accompanying notes 54-56.

Any discussion involving corporate takeovers and minority shareholders brings to mind the notion of the “appraisal remedy” or “dissenters' rights.” Consistent with former law, the new Virginia Stock Corporation Act provides so-called “dissenters' rights” to shareholders entitled to vote on mergers, share exchanges or sales of assets. See id. However characterized, such rights generally entitle shareholders to dissent from certain extraordinary corporate transactions and to obtain payment of the “fair value” of their shares. Id. § 13.1-730(A). As the Joint Bar Committee Commentary (Introductory Comment) to the Virginia Stock Corporation Act points out, these dissenters' rights are, in effect, the shareholders' exclusive remedy since as “[a] shareholder entitled to dissent and obtain payment for his shares may not challenge the corporate action creating his entitlement unless the action is unlawful or fraudulent with respect to the shareholder or the corporation.” Id. § 13.1-730(B); see also HOUSE AND SENATE DOCUMENTS OF VIRGINIA, REPORT OF THE VIRGINIA CODE COMMISSION, HOUSE Doc. No. 13, at 272 (1985). Characterization of the rights as “dissenters,'” as opposed to “appraisal,” rights was consistent with the General Assembly's intent to minimize the technicalities, delay and expense of traditional appraisal statutes. Making such rights the shareholders' exclusive remedy was thought to provide more protection to the corporation “from suits by dissenters who either have a fanciful notion of their shares' value or who attack the transaction giving rise to dissenters' rights for purposes of obtaining a nuisance settlement.” VIRGINIA CORPORATION LAW, supra note 45, at 235 (Introductory Comment to Joint Board Committee Commentary).

While a thorough coverage of the “appraisal remedy” is beyond the scope of this article, several aspects of the dissenters' rights provisions of the Virginia statutes warrant comment. First, VA. CODE ANN. § 13.1-730(C)(3) excludes “affiliated transactions” as defined in § 13.1-725 from the statute's otherwise general denial of dissenters' rights to certain larger publicly traded companies. Thus, it is apparent that the drafters of the new Act were cognizant of the interplay between the traditional appraisal remedy and the newly created “rights” afforded minority shareholders under the affiliated transactions provision. Second, the dissenters' rights provision would compensate dissenting shareholders with some notion of “fair value.” VA. CODE ANN. § 13.1-730(A). To the extent that the definition of “fair value” excludes “any appreciation or depreciation in anticipation of the corporate action unless exclusion would be inequitable,” such provision for dissenters' rights proves less beneficial to minority shareholders. Id. § 13.1-729. In any event, if the affiliated transactions provision is primarily intended to protect minority shareholders by guaranteeing some measure of fair value for their shares, the authors would ask what it accomplishes in that regard over and above dissenters' rights? Any advantages to minority shareholders provided by the affiliated transactions provisions, such as the assurance of a cash payment, could have been provided them more simply by amendment to the dissenters' rights provisions and at less expense to
In the final analysis, Virginia’s “Affiliated Transactions” statute must be judged by its true substance and not merely its form. It appears undeniable that the purpose and effect of the statute is to impede hostile takeover attempts of corporations organized and incorporated in Virginia. This being so, the statute upsets the delicate balance so carefully prescribed and maintained by federal law and, thus, the true purpose of the statute portends its ultimate demise.

ADDENDUM

SUBSEQUENT HISTORY: CTS Corp. v. Dynamics Corp. of America

If the value of legal commentary increases with its timeliness, so too does the risk that its premises and conclusions will be rejected by the final arbiter in the land. On April 21, 1987, the United States Supreme Court decided CTS Corp. v. Dynamics Corp. of America,114 declaring Indiana’s antitakeover law to be constitutional under both the supremacy and commerce clauses. In an opinion by Justice Powell, the court declined to embrace the efficient market model advanced by the authors and others, and concluded that the Control Share Acquisitions Chapter of Indiana’s Business Corporation Law protects shareholders from coercion and affects interstate commerce only to a limited extent. The decision is significant for Virginia’s affiliated transactions statute because Indiana’s antitakeover law, like Virginia’s, closely tracks the Maryland approach.115

An in-depth critique of the reasoning and probable impact of the CTS decision, as well as analysis of the distinctions between the Indiana and Virginia statutes, is left to other commentators. The authors must, however, comment on the broader ramifications of a decision which they find fascinating but wrong. First, though, sev-

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114. 107 S. Ct. 1637 (1987). Justice Powell was joined by Chief Justice Rehnquist and Associate Justices Brennan, Marshall, and O’Connor. Justice Scalia concurred in the Court’s judgment and wrote separately.
115. See supra note 2.
eral aspects of the Court’s opinion should be noted.

A. The Divided Opinion

The CTS decision will certainly be noted as a retreat from the preemption analysis employed in MITE: “As the plurality opinion in MITE did not represent the views of a majority of the Court, we are not bound by its reasoning.” CTS also represents a noteworthy departure from the MITE majority's commerce clause analysis, which employed terms such as “economic resources,” “efficiency,” and “competition.”

Inasmuch as dissenting opinions often provide the catalyst for legal debate and judicial reexamination, attention should be paid the dissenting opinion of Justice White in CTS:

The majority today upholds Indiana’s Control Share Acquisitions Chapter, a statute which will predictably foreclose completely some tender offers for stock in Indiana corporations. I disagree with the conclusion that the Chapter is neither pre-empted by the Williams Act nor in conflict with the Commerce Clause. The Chapter undermines the policy of the Williams Act by effectively preventing minority shareholders, in some circumstances, from acting in their own best interests by selling their stock. In addition, the Chapter will substantially burden the interstate market in corporate ownership, particularly if other States follow Indiana’s lead as many already have done. The Chapter, therefore, directly inhibits interstate commerce, the very economic consequences the Commerce Clause was intended to prevent. The opinion of the Court of Appeals is far more persuasive than that of the majority today, and the judgment of that court should be affirmed.

While the authors agree with the dissenting opinion, they observe that the dissent departs from the economic reasoning adopted in this article and focuses on the distinction between protection of individual shareholders and protection of shareholders as a group. In any event, the authors approve the dissent’s recognition of the “practical impact” of the Indiana law, the dissent’s

116. 107 S. Ct. at 1645.
117. See supra text accompanying notes § 59-68.
118. 107 S. Ct. at 1653-54 (White, J., dissenting). Justice White was joined by Justices Blackmun and Stevens.
119. Id.
concern for "economic protectionism," and its implicit rejection of a "form over substance" approach to constitutional analysis.\textsuperscript{120}

B. Questionable Constitutional Jurisprudence

\textit{CTS} reflects a fundamental difference of opinion regarding the premise underlying the authors' thesis—that constitutional analysis of state takeover legislation necessitates consideration of the economic desirability of an unrestricted market for corporate control.

As candidly admitted by Justice Powell in the majority opinion, the real issue presented in \textit{CTS} extends beyond any narrow question regarding the desirability or propriety of the Indiana statute. Indeed, it appears fair to say that the essence of the Court's reasoning is embodied in Justice Powell's declaration that "The Constitution does not require the States to subscribe to any particular economic theory."\textsuperscript{121} While this statement may seem innocuous enough, statements made by the Court in passing sometimes have a way of evolving into doctrine. The implications of any such doctrine would be significant and somewhat frightening.

For obvious reasons, those few questions which are the subject of specific constitutional language rarely find their way to the Supreme Court. Thus, the Court can sidestep virtually every constitutional issue presented to it by merely declaring, as in \textit{CTS}, that the Constitution does not require or prescribe the particular action or inaction in controversy. Traditionally, however, the Court has not availed itself of this escape hatch. Indeed, the Court has, on many occasions, grappled with difficult questions of social and economic policy, the specifics of which are not even remotely addressed in the Constitution. Thus, the Court's statement in \textit{CTS} that the Constitution does not embody any particular economic theory is, at best, unsatisfying.

When confronted with fundamental questions not addressed in the Constitution, the Court has routinely examined societal norms and precepts in reaching its decisions. Examples include the following issues: 1) whether the individual has the right to decide to use contraceptives or to abort a pregnancy; 2) whether the govern-

\textsuperscript{120} See 107 S. Ct. at 1654-55. The majority implicitly exalts the form of a corporate law over its substance: "No principle of corporation law and practice is more firmly established than a State's authority to regulate domestic corporations, including the authority to define the voting rights of shareholders." \textit{Id.} at 1649.

\textsuperscript{121} 107 S. Ct. at 1651.
ment may make reference to God on its coins and currency; and
more recently, 3) whether the state may proscribe certain homo-
sexual conduct. In these and many other cases, the Court has
based its decisions, not upon any express language in the Constitu-
tion, but rather upon what it perceives to be fundamental values
comprising the very fabric of American society. In deciding these
questions, the Court has concluded that the following basic Ameri-
can values mandate certain outcomes: 1) a commitment to the in-
dividual’s right to a measure of privacy; 2) a belief that ours is
fundamentally a religious nation notwithstanding the anti-estab-
lishment clause; and 3) the notion that certain homosexual conduct
is sufficiently aberrant that it may be proscribed. Whether one
agrees with any of these conclusions or not, the fact remains that
the Court’s constitutional jurisprudence has always relied on fund-
damental principles nowhere appearing in the Constitution.

If we are prepared to permit reference to a deity on our currency
because we perceive ourselves to be a fundamentally religious na-
tion; and if it is permissible for the states to proscribe certain ho-
mosexual practices because they have historically been viewed as a
gross deviation from the norm, can we then deny that American societ-
al structure does not presuppose some form of capitalist eco-
nomic system? To be sure, an enormous amount of economic regu-
lation is permissible within our system. Moreover, Justice Scalia’s
statement in his concurring opinion in CTS that “[a] law can be
both economic folly and constitutional” is probably true. Nevertheless, it is quite a different matter to declare that the states are
free to adopt whatever economic system which the vicissitudes of
time and the whims of state legislatures indicate is politically or
economically expedient, without regard to the supremacy and com-
merce clauses of the constitution. While legislation may permis-
sibly constitute “economic folly,” any such legislation exceeds the
constitutional limit when it imposes substantial burdens on the
free market without advancing a legitimate and important state
objective.

The authors do not advocate a return to the jurisprudence of the

122. 107 S. Ct. at 1653. (Scalia, J., concurring) ("I do not share the Court’s apparent high
estimation of the beneficence of the state statute at issue here.") For a pointed discussion of
the suspect political motivations underlying the enactment of some states’ takeover legisla-
tion, see Romano, State Takeover Laws: Constitutional But Dumb, Wall St. J., May 14,
1987, at 28.
123. See supra note 9.
Lochner era\(^\text{124}\) when the Court routinely invalidated state economic legislation as being beyond the scope of the state's police power. There exists, however, a vast and fertile middle ground between the statement that the Constitution does not embrace any particular economic theory, and the invalidation of any state statute which may have an impact on interstate commerce.

The authors do not purport to know what the CTS decision portends, either in the narrower area of corporate law or in the considerably broader arena of constitutional jurisprudence. A divided Court in CTS questioned the rationale of the sharply fragmented MITE Court, yet specifically declined to overrule the latter decision. Therefore, neither opinion can be regarded as a clear pronouncement of the law governing state takeover legislation.\(^\text{125}\) Accordingly, the debate continues and critics of the Virginia statute are left to attack the rationale of a divided Supreme Court, to distinguish Virginia's law from Indiana's, and to call for a resurrection of MITE.

\(^{124}\) Lochner v. New York, 198 U.S. 45 (1905). Interestingly, Justice Powell's suggestion in CTS that the Constitution does not prescribe any particular economic theory is consonant with Justice Holmes' dissent in Lochner. In disagreeing with the majority in that case, Justice Holmes observed: "[A] constitution is not intended to embody a particular economic theory, whether of paternalism and the organic relation of the citizen to the State or of laissez faire." 198 U.S. at 75 (Holmes, J., dissenting).

\(^{125}\) The lineup of justices in MITE demonstrates that the present state of the law is unclear. There, Justice Powell concurred in the majority's view, as expressed by Justice White, that the Illinois statute offended the commerce clause. Conversely, in CTS, Justice Powell parted company with Justice White on the commerce clause analysis, concluding that the Indiana statute did not sufficiently burden interstate commerce to require its invalidation on constitutional grounds.