Beyond the Third Generation: An Analysis of Pennsylvania's Latest Attack on Hostile Takeovers

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Beyond the Third Generation: An Analysis of Pennsylvania’s Latest Attack on Hostile Takeovers

I. INTRODUCTION

... once again I rise in this Chamber urging my colleagues to support passage of Senate Bill No. 1310. Senate Bill No. 1310 will significantly curtail the corporate slash and burn techniques utilized by corporate raiders during the decade of the ‘80s. Senate Bill No. 1310 sets new ground rules for the ‘90s, providing Pennsylvania boardrooms with the breathing room necessary to direct their attention to product development and research and global competition rather than fending off takeovers and paying greenmail.1

Accompanied by an abundance of such rhetoric, Pennsylvania’s newest anti-takeover legislation was overwhelmingly approved by the General Assembly in the Spring of 1990.2 On April 27, 1990, the bill was signed into law by Governor Robert P. Casey as Act 36 of the session of 1990.3 Pennsylvania only recently enacted strict anti-takeover provisions4 as part of a complete revision of the Commonwealth’s law governing corporations and unincorporated associations.5 This legislation, which took effect in 1988, is similar to the “moratorium

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2. Senate Bill 1310 was approved by the Senate on April 23, 1990 by a vote of 43 to 6 and by the House of Representatives on April 24, 1990 by a vote of 183 to 17. See History of Senate and House Bills, Sessions of 1989 and 1990, No 12 (August 30, 1990).
3. 1990 Pa Legis Serv No 2 (Purdon), to be codified at 15 Pa Cons Stat Ann §§ 102, 511-12, 1103, 1721, 2502, 2542, 2561-67, 2571-75, 2581-83, 2585-88. All citations to the various sections of Act 36 in this comment: will be as they will appear when codified in Purdon’s.
approach” adopted by Delaware, in that it freezes certain business transactions between target corporations and hostile bidders for specified periods of time. Thus, Pennsylvania has already shown an inclination toward deterring hostile takeovers.

Among other things, Act 36 incorporates into the Commonwealth’s anti-takeover statute the Indiana approach, which impedes the acquisition of voting rights by a hostile bidder, and a truly unique approach, which provides for the disgorgement of profits following an unsuccessful takeover attempt. Pennsylvania thereby has leaned further towards preventing hostile takeovers by adopting both the Delaware and Indiana approaches. However, it is the addition of the unique disgorgement provision which thrusts Pennsylvania to the forefront of the movement to protect corporations from hostile takeover attempts.

This comment will examine the various provisions of Act 36 in detail and analyze their effect on the traditional role and duties of corporate directors. The Act’s impact on the rights and interests of shareholders and employees of corporations and on the communities in which corporations do business will also be explored. This comment will also briefly discuss Act 36 in relation to other states’ anti-takeover statutes and in the context of prior constitutional challenges to such statutes. The Act will be evaluated in regard to its effect on the long range economic well-being of the Commonwealth. Finally, in light of all these issues, an attempt will be made to decide whether Pennsylvania has gone too far in its efforts to protect domestic corporations from hostile takeovers, and to examine the impact of Act 36 in conjunction with the response by the corporate community to its enactment.

II. A SECTION BY SECTION ANALYSIS OF ACT 36

Act 36 amends Pennsylvania’s corporate law by (1) clarifying the nature of directors’ fiduciary duties, (2) giving disinterested shareholders the right to decide whether or not to grant voting


10. 15 Pa Cons Stat Ann §§ 511(d)-(f), 1721(e)-(g).
rights to a bidder attempting to gain control of the corporation,\(^\text{11}\) (3) allowing the corporation to recover short-swing profits realized by bidders who put the corporation “in play,”\(^\text{12}\) (4) providing severance pay for employees terminated within a specified period of time before and after a bidder is granted voting rights,\(^\text{13}\) and (5) requiring those who acquire public corporations to assume all labor contracts existing at the time the bidder is granted voting rights.\(^\text{14}\) The amendments to the directors’ fiduciary duties apply to all Pennsylvania corporations,\(^\text{15}\) while the other new provisions are applicable only to “registered corporations.”\(^\text{16}\) A corporation may elect to “opt-out” of the coverage of any one or more of these provisions by adopting a bylaw to that effect by July 26, 1990.\(^\text{17}\) However, a corporation can only opt-out of the severance pay and labor contract provisions if it also opts-out of the control-share acquisition provision. The decision on whether or not to opt-out by the date specified is an important one. After July 26, 1990 neither the board of directors nor the shareholders can opt-out of any of the provisions of Act 36 unless they reincorporate. This can be an expensive and time-consuming process which a corporation would obviously prefer to avoid.

A. The Amendments to Director’s Fiduciary Duties

Prior to Act 36, Pennsylvania law already permitted directors to consider the effect of their actions upon employees, suppliers and customers of the corporation, upon the communities in which the corporation conducts business and “all other pertinent factors,” without violating their fiduciary duties.\(^\text{18}\) Act 36 clarifies in greater detail the directors’ right to look beyond the interests of shareholders in deciding what is in the best interest of the corporation. Directors are now expressly authorized to consider the long-term interests and plans of the corporation and whether these would be best served by the continued independence of the corporation.\(^\text{19}\)

\(^{11}\) 15 Pa Cons Stat Ann §§ 2561-67.

\(^{12}\) 15 Pa Cons Stat Ann §§ 2571-75.

\(^{13}\) 15 Pa Cons Stat Ann §§ 2581-83.

\(^{14}\) 15 Pa Cons Stat Ann §§ 2585-88.

\(^{15}\) 15 Pa Cons Stat Ann § 502(a) (Purdon Supp 1990).

\(^{16}\) 15 Pa Cons Stat Ann § 2501 (Purdon Supp 1990). Registered corporations in general include any corporation that is required to be to be registered with the Securities Exchange Commission. 15 Pa Cons Stat Ann § 2502 (Purdon Supp 1990).

\(^{17}\) 15 Pa Cons Stat Ann §§ 1721(j), 2561(b)(2), 2571(b)(2).

\(^{18}\) 15 Pa Cons Stat Ann § 511(b) (Purdon Supp 1990).

\(^{19}\) 15 Pa Cons Stat Ann §§ 511(d)(2), 1721(e)(3).
Directors are now also permitted to consider the resources, intent, and conduct of any person seeking to gain control of the corporation. Significantly, directors may consider the potential, as well as the past and stated, resources, intent and conduct of such person. In delineating the directors' fiduciary duties, the legislature had previously made no attempt to define the "all other pertinent factors" which directors may consider. While Act 36 goes no further in this regard, the Act makes clear that directors are free to assign whatever weight they deem appropriate to the interests and factors which are considered. In addition, directors are clearly not required to pursue any course of action solely because of the effect their actions would have on an attempt to gain control of the corporation, or on the financial consideration that might be paid to shareholders as a result of a change of control. Finally, Act 36 greatly expands upon the prior law's presumption that the directors' actions are in the best interest of the corporation. The Act expressly provides that the directors' actions in response to an attempt to gain control of the corporation are to be judged by no higher a standard than their actions in any other circumstance. Furthermore, when an attempt to gain control is involved, any action to which a majority of the directors has assented is presumed to comply with their fiduciary duty, unless there exists clear and convincing evidence that the directors did not act in good faith, after a reasonable investigation.

Prior to Act 36, Pennsylvania law gave generic treatment to directors' fiduciary duties, with the relevant provisions being applicable under all circumstances. Act 36, on the other hand, deals almost exclusively with directors' actions in the context of a hostile takeover attempt. Arguably, the legislature has granted directors a "blank check" when a takeover attempt looms on the horizon. Directors may continue to consider the interests of a host of other parties, as well as the omnipresent "all other pertinent factors," in addition to shareholder interests. Any action taken in fending off

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22. 15 Pa Cons Stat Ann §§ 511(e), 1721(f)(3).
23. 15 Pa Cons Stat Ann § 511(c) (Purdon Supp 1990).
24. 15 Pa Cons Stat Ann §§ 511(f), 1721(g).
25. Id.
a takeover attempt would necessarily serve some party's interests and thereby not be violative of the directors' fiduciary duty. Now directors may also look to the long-term plans of the corporation and the potential intent and conduct of the hostile bidder. If the directors justify their actions based on the adverse effects of a hostile bidder's future conduct on the well laid plans of the corporation, could any argument be made that their actions were not in good faith or in the best interest of the corporation? Complaining shareholders would indeed have a difficult task in disputing the directors' assessment of a bidder's future conduct. The directors' arsenal of factors and interests is made even more formidable by the complete freedom to choose which factors and interests are dominant or controlling. In addition, shareholders will never be heard to complain that they lost valuable consideration when a takeover is thwarted, unless they can also point to some other breach of fiduciary duty. Being already armed with these significant obstacles to objections to their actions, the directors are further insulated from attack by a "clear and convincing" evidence standard with regard to any action to which a majority of the directors have assented. Of course, corporate action can only be authorized by a majority vote of the directors, and individual directors can do little to impede a takeover. In reality then, any action taken in response to a takeover attempt will be judged by the "clear and convincing" standard.

Act 36's treatment of the directors' fiduciary duties begins innocently enough as an application of the traditional "Duty of Loyalty" and "Duty of Care" standards. However, when the specter of a hostile takeover attempt arises, the Act quickly surrounds the directors with a veritable fortress from which to fend off any subsequent suits brought by shareholders on behalf of the corporation.

27. One portion of the fiduciary standards left unchanged by Act 36 provides that "... a director ... shall perform his duties ... in good faith, in a manner he reasonably believes to be in the best interest of the corporation and with such care, including reasonable inquiry, skill and diligence, as a person of ordinary prudence would use under similar circumstances." 15 Pa Cons Stat Ann § 511(a) (Purdon Supp 1990).


28. For a discussion of other ways in which states are attempting to protect corporate directors from liability for violating their fiduciary duties in the context of hostile takeovers see, Dale A. Oesterle, The Effect of Statutes Limiting Directors' Due Care Liability in Hostile Takeover Defenses, 24 Wake Forest L Rev 31 (1989).
B. *The Control-Share Acquisition Provisions*

Act 36 adds Subchapter G, entitled “Control-Share Acquisitions,” to Chapter 25 of Pennsylvania’s Business Corporation Law (hereinafter the “BCL”). With the addition of the control-share provisions, disinterested shareholders are given the right to decide whether or not to grant voting rights to a person involved in a “control-share acquisition.” A control-share acquisition occurs with the acquisition of, or proposal to acquire, over 20%, 33 1/3 % or 50% of the voting shares of the corporation. In addition, the corporation is not required to present the issue of voting rights to the shareholders unless the acquiring person (1) delivers to the corporation a complete information statement, and (2) has entered into a definitive financial agreement evidencing the necessary financial capacity, as determined by the board of directors, to complete the control-share acquisition. The information statement must disclose certain background information of the acquiring person and future plans for the corporation, along with other material information. Finally, if the disinterested shareholders fail to grant voting rights to the acquiring person, the corporation has the right to repurchase the acquiring person’s shares at any time within two years at the then fair market value.

Subchapter G contains several exceptions to its overall operation, which exceptions generally apply to holders of large blocks of stock who do not intend to acquire control of the corporation. Also, safe harbors are provided for those who give or hold proxies for reasons other than influencing control of the corporation, and for proxies which give the holder only the authority to vote on specific matters in accordance with the specific instructions of the shareholder.

Unlike those portions of Act 36 dealing with directors’ fiduciary duties, the control-share provisions come into play at the moment the takeover attempt is initiated and are aimed squarely at the hostile bidder. As was obviously its intent, Subchapter G presents

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31. 15 Pa Cons Stat Ann § 2563(a).
32. 15 Pa Cons Stat Ann § 2562.
33. 15 Pa Cons Stat Ann § 2564(d).
34. 15 Pa Cons Stat Ann § 2565(a).
35. 15 Pa Cons Stat Ann § 2566.
36. 15 Pa Cons Stat Ann § 2561.
37. 15 Pa Cons Stat Ann § 2562.1.
formidable obstacles to anyone attempting to change control of the corporation. The requirement that the acquiring person file an information statement and financial information, before having the issue of voting rights submitted to the shareholders, serves to give the corporation ample notice that a takeover attempt is in the works. This is certainly a reasonable and fair objective of anti-takeover legislation. However, the control-share provisions go far beyond merely exposing a hostile takeover attempt in its early stages, by giving shareholders the opportunity to ultimately deny voting rights to the control-shares.

The control-share provisions provide significant incentives for waging a proxy battle for control of a corporation, as opposed to the outright acquisition of shares. A majority of the disinterested shares of the corporation must approve the granting of voting rights, and any shares which the hostile bidder acquires beneficial ownership over are no longer disinterested shares. As absurd as it sounds, a bidder could acquire beneficial ownership of 51% of the voting shares and still fail to gain control of the corporation when the remaining shareholders fail to grant voting rights to the controlling shares. Aside from failing to gain control of the corporation, a bidder who is not granted voting rights may also be faced with a significant financial loss. Because the corporation has the right to redeem the control-shares at any time within two years (at their fair market value), an unsuccessful bidder, who probably paid a premium for the shares, is at the mercy of the board of directors. The corporation can redeem the shares at their pleasure, at a point where the directors feel that the value of the stock has bottomed out. The resultant financial loss to the unsuccessful bidder should be an effective deterrent to hostile takeover attempts. (Note that only in cases where the takeover attempt results in an appreciation in the value of the shares can such a loss be avoided.) This right of redemption by the corporation provides an additional disincentive to commencing a takeover attempt by purchasing shares, as opposed to waging a proxy battle.

Subchapter G contributes significantly to the overall objective of deterring takeover attempts embodied in Act 36. While the Act, taken as a whole, may arguably operate to the detriment of shareholders, the control-share provisions provide an ancillary benefit to shareholders. When a tender offer is made at a premium, shareholders find themselves in an unenviable position. Although they

38. This issue will be discussed in detail in subsequent portions of this comment.
are not in favor of the takeover they may be compelled to tender their shares, rather than being forced to sell them later at a substantially lower price should the takeover bid succeed.\footnote{See Justice Powell’s discussion of the evils of the “two-tier tender offer” in \textit{CTS Corporation v Dynamics Corporation of America}, 481 US 69, 82-3 (1987).} Subchapter G helps avoid this dilemma by giving those who hold their shares the power to withhold voting rights from the person making the tender offer.\footnote{For a favorable reaction to control-share statutes and a discussion on how they may benefit shareholders, see Richard A. Booth, \textit{The Promise of State Takeover Statutes}, 86 Mich L Rev 1635, 1681-99 (1988) and Richard A. Booth, \textit{State Takeover Statutes Revisited}, 88 Mich L Rev 120 (1989).}

\section*{C. The Disgorgement Provisions}

Act 36 adds Subchapter H,\footnote{15 Pa Cons Stat Ann §§ 2571-75.} entitled “Disgorgement by Certain Controlling Shareholders Following Attempts to Acquire Control,” to Chapter 25 of the BCL. Subchapter H, as its title indicates, allows the corporation to recover any short-swing profits realized by the “controlling person.”\footnote{15 Pa Cons Stat Ann § 2574.} A controlling person is a person or group which (1) acquires, proposes to acquire, or announces an intention to acquire control over 20\% or more of the voting shares of a corporation, or (2) announces an intention to acquire control of the corporation through any other means.\footnote{15 Pa Cons Stat Ann § 2573.} The profits realized from the disposition of any shares within eighteen months of attaining the status of controlling person are recoverable by the corporation, if the shares are acquired within two years prior to, or eighteen months subsequent to, attaining such status.\footnote{15 Pa Cons Stat Ann § 2574(1) & (2).}

The express purpose of the disgorgement provisions is to protect the corporation from the manipulative practice of putting the corporation “in play” and from being exposed to paying “greenmail.”\footnote{15 Pa Cons Stat Ann § 2572. Greenmail is the name given to the process by which a corporation pays a hostile bidder a premium for the shares of stock which he has already acquired, in order to abort the takeover attempt.} The objective of a person who puts a corporation “in play” is not to ultimately acquire control of the corporation or to benefit the corporation in any way, but simply to realize personal financial gain. This practice is, of course, especially repugnant to lawmakers. The attempt to put the corporation in play can only succeed if the bidder acquires control over enough of the voting shares to make
the takeover a real possibility. This may cause the bidder to reach the 20% threshold, thereby becoming a controlling person. Even if the threshold is not met, the disclosure requirements of Subsection G will cause the bidder to announce his intention to gain control of the corporation. Either way, the legislature has effectively precluded the bidder from realizing any short-term speculative gains.

Like the control-share provisions, the disgorgement provisions contain several exemptions to their application for holders of large blocks of stock when no attempt to gain control of the corporation is involved. In addition, these provisions do not apply to proxy contests that are not part of a scheme to put the corporation "in play;" nor do they apply to the solicitation of proxies by, or on behalf of, the corporation.

The disgorgement provisions should certainly be effective in achieving their stated objective, especially when considered in relationship to the control-share provisions. The corporation's right to recover short-term profits explicitly includes profits realized from the disposition of shares to the corporation under Subchapter G. Since the corporation has the right, under Subchapter G, to redeem the control shares at any time within two years, the controlling person is effectively precluded from simply holding the shares beyond the eighteen month time limit of Subchapter H and disposing of them at a profit. A bidder who fails to gain voting rights is completely at the mercy of the corporation. If the value of the shares, following a failed takeover attempt, is less than what the bidder paid for them, the corporation can simply redeem the shares immediately at a loss to the bidder. If the bidder sells the shares at a profit, the profit is recovered by the corporation. Finally, even if the bidder holds appreciated shares, the corporation can redeem them before eighteen months and recover whatever profit accrues from the sale.

Admittedly, not realizing a profit is a fair and just result for a corporate raider whose only interest is being paid greenmail. The problem is that the disgorgement provisions are a blunt instrument that make no distinctions based on the bidders' motives. The possibility of serious financial losses seems to be harsh medicine for an individual who initiates a takeover attempt because of the genuine belief that the corporation is poorly managed and could profit from

46. See notes 32-34 and accompanying text.
47. 15 Pa Cons Stat Ann § 2573.1.
48. 15 Pa Cons Stat Ann § 2572(b).
49. 15 Pa Cons Stat Ann § 2574.
new leadership.

D. *The Severance Pay And Labor Contract Provisions*

Subchapter I was added to Chapter 25 of the BCL by Act 36. This subchapter provides for severance pay for employees terminated in the course of a control-share acquisition. In effect, the BCL now contains a statutory "golden parachute" for employees of target corporations. However, unlike severance arrangements created by the corporation itself, which are generally limited to upper echelon employees, Act 36's severance provisions apply to employees at all levels of the organization. To be eligible for the severance pay, an employee need only be employed within the Commonwealth, have at least two years service with the company, and be employed within ninety days prior to the granting of voting rights to the control-shares. Once eligibility is established, any employee terminated within ninety days prior to, or two years subsequent to, the granting of voting rights is entitled to a one-time lump sum severance payment. The severance amount is the weekly compensation of the employee multiplied by the years of service completed, up to a maximum of twenty-six times the weekly compensation. In effect then, eligible employees may receive up to one half of their annual salary.

Subchapter J was also added to Chapter 25 of the BCL by Act 36. This subchapter generally provides for the continuation of labor contracts in the event of a "business combination transaction." A business combination transaction is basically any disposition affecting all, or substantially all, of the corporation's assets. Additionally, the labor contract must cover workers engaged in employment within the Commonwealth and must relate to opera-

50. 15 Pa Cons Stat Ann §§ 2581-83.
51. 15 Pa Cons Stat Ann § 2582(a).
52. For a brief discussion, with references to other sources, of "golden parachutes," see Henn and Alexander, *Laws of Corporations*, § 254 at 689 (cited in note 27).
53. 15 Pa Cons Stat Ann § 2581. Employees are defined simply as "Any person lawfully employed by an employer." Id.
54. Id.
55. 15 Pa Cons Stat Ann § 2582(a). Employees otherwise qualified are entitled to severance pay unless they are terminated for willful misconduct. Id.
56. 15 Pa Cons Stat Ann § 2581. This amount is reduced by payments which the employer is obligated to make due to the termination, except for payments made under pension, savings or retirement plans. 15 Pa Cons Stat Ann § 2582(a)(2).
57. 15 Pa Cons Stat Ann §§ 2585-88.
58. 15 Pa Cons Stat Ann § 2587.
59. 15 Pa Cons Stat Ann § 2586.
tions owned by the corporation at the time voting rights were granted to the control-shares.\(^{60}\)

Together, the severance pay and labor contract provisions provide significant security for employees of target corporations. Long-term employees may receive substantial severance payments, and if a labor contract exists, the benefits of such contract cannot be taken away during its term. The Pennsylvania Legislature is to be applauded for protecting employees of the Commonwealth from the arbitrary actions of ruthless corporate raiders who see the world only in terms of dollar signs, having no regard for the effects of their actions on corporate employees. While these provisions do not directly impede takeover attempts, they may provide significant financial disincentives. This is especially true if the takeover bid is motivated by the belief that the profitability of the company can be improved by reducing or eliminating some of the corporation's operations and/or being relieved of the contractual obligations of a labor agreement. By restricting the reduction in expenses that could otherwise be achieved in the time period immediately following a takeover, this portion of Act 36 clearly subordinates the interests of the shareholders to those of the corporation's employees.\(^{61}\)

III. CONSTITUTIONAL ANALYSIS

Pennsylvania's control-share provisions are patterned after the Indiana Control Share Acquisition Act,\(^{62}\) which was held to be constitutional in *CTS Corporation v Dynamics Corporation of America*.\(^{63}\) The Indiana Act was part of a general restructuring of anti-takeover statutes by state legislatures in response to the United States Supreme Court's decision in *Edgar v MITE Corporation*.\(^{64}\) In *MITE*, the Court invalidated the Illinois Business Takeover Act on commerce clause grounds;\(^{65}\) a plurality of the

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60. Id.
64. 457 US 624 (1982).
65. *MITE*, 457 US at 646. In addition to other qualifying criteria, the Illinois statute applied to any corporation in which shareholders located in Illinois owned 10% of the stock subject to a tender offer. Id at 642. The Court held that the burden imposed on interstate commerce by the regulation of foreign corporations was not outweighed by any legitimate
Court also concluded that the Williams Act\textsuperscript{66} preempted the Illinois statute.\textsuperscript{67} In \textit{Dynamics}, the Supreme Court upheld the validity of the Indiana Act against a federal preemption challenge because the act contained none of the features of the Illinois Act that had frustrated the policy of the Williams Act.\textsuperscript{68} In addition, the \textit{Dynamics} Court validated the Indiana Act against a commerce clause challenge because the act applied equally to resident and foreign bidders and applied only to domestic corporations.\textsuperscript{69}

Following the Supreme Court's decision in \textit{Dynamics}, the Pennsylvania Legislature took a conservative approach in amending the Commonwealth's anti-takeover legislation. The 1988 version did not include a "control share acquisition" provision of the type validated in \textit{Dynamics}. Instead, Pennsylvania only enacted the "moratorium" approach first adopted in New York and Delaware.\textsuperscript{70} Thus, the legislature declined to join those states which had enacted both types of statutes,\textsuperscript{71} so that Pennsylvania was lagging behind a bit in the anti-takeover race. Act 36 has cured that deficiency with a vengeance. The legislature has now supplied the missing control share acquisition provision, changed the nature of directors' fiduciary duties so that their conduct during a takeover attempt is virtually unassailable, and provided for severance pay and the continuation of labor contracts in the event of a takeover. Not satisfied with merely being among those states most hostile to takeover attempts, the lawmakers added the disgorgement provi-

\textsuperscript{66} 15 USC §§ 78 m(d)-(e), 78 n(d)-(f) (1982). In general, the Williams Act requires disclosure of information about a tender offer and establishes procedural rules governing such offers.

\textsuperscript{67} \textit{MITE}, 457 US at 633-40. The plurality decided that the Illinois statute went too far in enabling corporations to fend off tender offers and thus frustrated the Williams Act's policy of offeror-management neutrality. The plurality's view of the Williams Act attributes to Congress the intent place hostile bidders and incumbent management on equal footing. Id at 635.

\textsuperscript{68} \textit{Dynamics}, 481 US at 80-81. The specific provisions of the Illinois statute which \textit{MITE} identified as frustrating the policy of the Williams Act were (1) a twenty day period during which management could present its position to the shareholders, while the offeror was denied such access, (2) a stay of any tender offer pending the completion of a hearing conducted by the Secretary of State, with no set deadline for the completion of the hearing, and (3) a review of the tender offer by the Secretary of State to determine the fairness of the offer. \textit{MITE}, 457 US 624, 634-40.

\textsuperscript{69} \textit{Dynamics}, 481 US at 87-93.

\textsuperscript{70} See notes 6-7 and accompanying text.

\textsuperscript{71} At the time of the 1988 amendments, Idaho, Nebraska, South Carolina, and Tennessee had adopted a combination of both approaches. See Comment, 27 Duquesne L Rev at 722, note 9 (cited in note 6).
sions. An anti-takeover device like none ever seen before, the disgorgement provisions make Pennsylvania the undisputed leader in the anti-takeover movement.

As might be expected with such a unique and restrictive piece of legislation, the constitutionality of Act 36 is already being challenged in federal court. The Belzberg family of Canada, whose attempted takeover of Armstrong World Industries sparked the enactment of Act 36, is challenging the Act’s validity in First City Financial Corporation Ltd. v Armstrong World Industries. In addition, shareholders of the company are challenging the Act in Armstrong World Industries v Adams. These lawsuits allege that Act 36 violates the commerce clause, the supremacy clause, the First Amendment’s guarantee of freedom of speech and that the Act constitutes an unlawful taking under the Fifth Amendment.

Because of their close similarity to the Indiana Act upheld in Dynamics, Act 36’s control-share provisions should be immune from either a commerce clause or supremacy clause challenge. Given the Supreme Court’s expansive application of the “internal affairs” doctrine in Dynamics, Act 36 should survive the commerce clause challenge, even with the addition of the disgorgement provisions. The supremacy clause challenge may present a more

72. Pennsylvania undoubtedly pioneered the disgorgement approach. However, publicity surrounding the enactment of Act 36 allowed at least one other state, that being Ohio, to enact similar legislation practically unnoticed. See Patty Tascarella, Cast In Concrete, 9 Executive Report 22, 28 (Sept 1990).

73. For a sampling of the numerous publications heralding Pennsylvania’s anti-takeover legislation as the most restrictive in the nation, see Rosalyn Retkwa, States Set Traps for Corporate Raiders as Investors Protest, 11 Corporate Cashflow 7 (July 1990) and Takeover Defenses: Fortress Pennsylvania, 24 Mergers and Acquisitions 22 (March/April 1990).

74. For an interesting account of the Belzberg’s takeover bid and the political maneuvering behind the passage of Act 36, see Tascarella, 9 Executive Report at 23-7 (cited in note 72).

75. No. 90-2922 (E D Pa 1990).

76. No. 90-2920 (E D Pa 1990).

77. See Debra Cassens Moss, Anti-Takeover Battle - Armstrong Shareholders, Bidder File Suit Against Pa. Law, 76 ABA J 24 (July 1990). The pending litigation is also discussed in Retkwa, 11 Corporate Cashflow 7 (cited in note 73).

78. The internal affairs doctrine, as applied to corporations, holds that the rights and liabilities of a corporation are determined by the law of the state which has the most significant relationship to the subject matter and the parties involved. This is generally the state of incorporation.

79. Dynamics, 481 US 69, 89-94. In the course of discussing the role of the nation’s stock exchanges in providing the necessary capital for American business, the Court stated:

This beneficial free market system depends at its core upon the fact that a corporation - except in the rarest situations - is organized under, and governed by, the law of a single jurisdiction, traditionally the corporate law of the state of it’s incorporation. Id at 90.
formidable obstacle to the Act’s constitutionality. With the extreme deference now given to directors’ conduct in response to attempted takeovers and the addition of the disgorgement provisions, it is difficult to characterize Act 36 as not offending the federal policy of offeror-management neutrality. However, this interpretation of the Williams Act commanded only a plurality of the Court in *MITE*; and in *Dynamics*, the Court was less than enthusiastic in acknowledging the policy of neutrality. Apparently, the preemptive force of the Williams Act is questionable at the present time.

The First Amendment question arises due to the application of the control-share provisions to a proxy solicitation. Acquisition of voting power over shares of the corporation, alone, is sufficient to constitute a control-share acquisition. A bid to gain control of the corporation, through the solicitation of proxies, would trigger the right of the disinterested shareholders to deny voting rights to the control-shares. The control-shares can only be granted voting rights by a majority vote of both (1) all the voting shares of the corporation, and (2) all the disinterested shares of the corporation.

80. See notes 64-67 and accompanying text.
81. In *Dynamics*, the Court stated:
As the plurality opinion in *MITE* did not represent the views of a majority of the Court, we are not bound by its reasoning. We need not question that reasoning, however, because we believe the Indiana Act passes muster even under the broad interpretation of the Williams Act articulated by Justice White in *MITE*.

The Court went on to emphasize that the Williams Act was designed to protect investors and that a basic purpose of the Act was to place investors on an equal footing with the hostile bidder. Id at 82. Thus, the Court seems to be shifting the thrust of the Williams Act away from management and towards the independent shareholders.

82. In *Dynamics*, the Court held that the Indiana Act did not favor management in any significant way. Thus, even under the offeror-management neutrality interpretation of the Williams Act, the Indiana Act was constitutionally valid. *Dynamics*, 481 US at 82, n.7. By characterizing the primary result of the Indiana Act as protecting independent shareholders, the Court concluded that the Act paralleled the federal policy embodied in the Williams Act. See note 79. *Dynamics*, 481 US at 82-3.

It appears that the success of Act 36 in surviving a supremacy clause challenge may well hinge on (1) whether the federal courts, and ultimately the Supreme Court, continue to distance themselves from Justice White’s offeror-management neutrality view and (2) whether the Act’s disgorgement provisions will be characterized as primarily benefitting management or the independent shareholders. For now, it is worth noting that shareholders obviously do benefit when the corporation avoids paying greenmail, which is the basic objective of the disgorgement provisions.

83. 15 Pa Cons Stat Ann §§ 2562, 2563(a)(1) and (2).
84. For readers particularly interested in the constitutional issues involved, the full text of the complaints filed in both *Armstrong* cases can be found in Chapter 2, App A,
son are included in the latter group, but if a majority of this group refuses to grant voting rights, the proxies become useless. The traditional right of shareholders to express their wishes and participate in the management of the company is thus thwarted. If proxies are viewed as an essential means by which shareholders may communicate with each other and express their desires to management, then perhaps a good argument could be made that their freedom of speech and association is being violated.

In contrast to the commerce clause and the supremacy clause arguments raised in Dynamics, the First Amendment is an untested basis for challenging control-share statutes. The Fifth Amendment challenge, on the other hand, appears to be directed at the disgorgement provisions. Because of the uniqueness of the disgorgement provisions, this type of claim also has no constitutional track record upon which to rely. Speculation as to the outcome of the First and Fifth Amendment claims, as well as a detailed analysis of all of the constitutional challenges to Act 36, is beyond the scope of this comment. The purpose here is merely to make the reader aware of the general nature of the plaintiff's claims and that the Armstrong cases are pending.

IV. POLICY ANALYSIS

If one accepts the premises that some Pennsylvania corporations are poorly managed and that a mismanaged corporation is not in the best interest of the corporation's shareholders or employees or the community in general, then it is difficult to deny the conclusion that a takeover attempt, made with the genuine intent of making the company more competitive, is a desirable method of correcting corporate inefficiency. Indeed, a hostile takeover bid may be the only plausible way that a poorly managed corporation is going to change at all. In situations where mismanagement is not a recent development, the status quo will most likely be maintained as long as top management is doing "ok" for themselves. At


86. It is worth noting that Harvard law professor Laurence Tribe, one of the nation's premier constitutional scholars, has predicted that Act 36 will be upheld in court. See Moss, 76 ABA J 24 (cited in note 77).
the other end of the spectrum is a well managed corporation harassed by the scoundrel who would put the corporation "in play," purely for his own financial benefit. Ideally, anti-takeover legislation should deter such a person from any personal gain without unduly burdening takeovers which are beneficial to all concerned (excepting, of course, the incumbent management). Perhaps it is not possible to deter coercive takeovers without burdening those that are beneficial. Promoting either of these objectives may entail at least partially sacrificing the other. If so, how far one goes in erecting barriers to corporate takeovers might well depend on the assumptions one makes about the business world. If one assumes that corporate management is generally honest and competent and that corporate raiders are unsavory characters, then one would risk restricting all takeovers in order to avoid the coercion of corporations. If one takes the opposite view, then one would accept the risk of some unscrupulous tactics by corporate raiders in order to avoid perpetuating incompetent management.87

With the passage of Act 36, the Pennsylvania General Assembly seems to have adopted the view that corporate management is inherently good and corporate raiders inherently bad. However, a closer examination of the various subsections of the Act seems to indicate that there are other considerations involved. The disgorgement provisions, by allowing the corporation to recover short-swing profits, would by themselves effectively deter the practice of putting the corporation "in play," while minimizing the burden imposed on legitimate takeover attempts. Why then are the other subsections of Act 36 necessary? The answer lies in the fact that the interests of shareholders, employees, suppliers, and customers of the corporation are not necessarily co-extensive. In reality, the shareholder's interests will most often diverge from those of the other groups.88 Corporate decisions that benefit shareholders financially may cost employees their jobs, leave suppliers without an outlet for their goods or customers looking for another source of supply, and have a generally depressing effect on the economy of

87. At least one author has suggested that the market itself will punish the bad takeovers and reward the good ones, thereby making legislation unnecessary. See Jason Zweig, Socialism, Pennsylvania Style, 145 Forbes 42 (May 14, 1990).
88. The most typical scenario would involve a mismanaged corporation and a takeover by a party genuinely concerned with making the company more competitive and profitable. Toward this end the new management may find it desirable to sell-off or eliminate some of the company's operations or, in the most extreme case, to relocate the corporate headquarters or business enterprises to another state.
the local community. This is where the other subsections of Act 36 come into play.

The control-share provisions are particularly adapted to thwarting takeovers that may ultimately benefit shareholders but will be detrimental to non-shareholder interests. The extensive informational requirements of these provisions will put directors on notice as to what the hostile bidder's future plans are and provide the directors with ample time to rally opposition to the takeover. The shareholders can then stop the attempted takeover dead in its tracks by refusing to grant voting rights to the control-shares. The severance pay and labor contract provisions provide additional protection specifically for employees, while also creating financial disincentives to a takeover attempt. Finally, the amendments to the directors' fiduciary duties provide directors with wide latitude in their conduct in response to takeover attempts, specifically authorizing them to consider the interests of non-shareholder groups.

Of course, it is entirely reasonable for the Legislature to protect the interests of the citizens of the Commonwealth in the context of corporate takeovers. As usual, however, there are two sides to every coin. A certain amount of takeover activity can be desirable, for weeding out mismanaged companies and ensuring that only the fit survive. The financial world certainly takes note of this process. Overly restrictive takeover legislation can result in corpora-

89. There may be another motive behind the enactment of tough anti-takeover legislation that is less often articulated by the lawmakers. Corporations are obviously a desirable thing to have located in your state and strict anti-takeover statutes may be considered a factor in the decision of where to incorporate. After all, it is difficult to imagine a corporate director or officer that would not welcome the security that legislation such as Act 36 provides.

For an article subscribing to the view that such a motive is behind many anti-takeover statutes, see Sterling North, States Creating Legislation Aimed at Limiting Corporate Takeover Activity, 9 New England Business 60 (June 15, 1987). This author suggests that in their desire to attract corporations, state legislatures have been blind to the benefits of takeovers.

90. One of the most forceful advocates of this view is T. Boone Pickens, possibly the nation's premier takeover artist. For Mr. Pickens' views on how takeovers keep corporate America competitive, see Kathryn M. Welling, The World According to Pickens, 65 Barron's 8 (Sept. 23, 1985). See also, Marc I. Steinberg, Should the Feds Take Over State Takeover Laws?, 65 Business and Society Review 54 (Spring 1988), in which the author laments the ineffectiveness of the Williams Act and implores Congress to preempt state takeover statutes; and Doug Bandow, Are Hostile Takeovers Good For the Economy?, 63 Business and Society Review 45 (Fall 1987), in which the author answers the question posed in the title with an emphatic yes.

91. How dramatically financial markets react to restrictions on takeover activity is certainly debatable. Some analysts do feel that the reaction can be quite drastic. For example, see Mark L. Mitchell and Jeffry N. Netter, Triggering the 1987 Stock Market Crash: An-
tions that are less attractive to investors, thus decreasing the value of the corporations' stock and inhibiting the investment of capital within the Commonwealth.\textsuperscript{82} Indeed, this was the primary objection of those few members of the general assembly who opposed Act 36.\textsuperscript{83}

V. Conclusion

Whether Pennsylvania has gone too far with the current amendments to the Commonwealth's anti-takeover legislation has been, and will undoubtedly continue to be, the subject of much debate. The conclusion one reaches may differ, depending on whether one asks this question from an ideological/political point of view or from a purely economic perspective. From the former perspective, the issue is clearly a question of whose rights and interests are paramount - those of the shareholders or those of non-shareholder groups.\textsuperscript{84} The obvious answer would appear to be that the share-

\textit{takeover Provisions in the Proposed House Ways and Means Tax Bill}, 24 J of Financial Economics 37 (Sept 1989). This article suggests that the mere possibility of anti-takeover legislation may negatively effect the entire stock market.

\textsuperscript{82} Some of the immediate reaction to Act 36 is noted in Retkwa, 11 Corporate Cashflow 7 (cited in note 73), wherein the author indicates that Institutional Shareholder Services, an organization which advises institutional investors, planned to ask forty Pennsylvania corporations to either opt-out of Act 36 or incorporate in another state.

For a similar report on the negative reaction to Act 36 by institutional investors, see Curtis Vosti and Marcia Parker, \textit{Armstrong in 2 - Front War}, 18 Pensions and Investments 2, 32 (March 5, 1990).

It would also appear that strict anti-takeover legislation can have a very immediate adverse effect on shareholders. A study by two Drexel University professors found that stock prices of large Pennsylvania corporations fell 9% from the time Act 36 was introduced until it was signed into law, as opposed to a 3% drop in other randomly selected stocks. See Bill Stieg, \textit{Study: Takeover Law Hurts Stocks}, Pittsburgh Post-Gazette 23 (October 16, 1990). The author indicates that this study estimates that shareholders of these corporations lost approximately four billion dollars during this period.

\textsuperscript{83} In particular, see the remarks of Senator Fumo, Legislative Journal - Senate, 1949-50 (April 23, 1990). In the course of speaking against Act 36 Senator Fumo read into the record a letter appearing in the \textit{New York Times} on April 22, 1990, which read in part:

\hspace{1cm} Pennsylvania has sent a very clear message to investors, whose only logical response is to avoid the securities of Pennsylvania-based corporations, perhaps their products and services too.

\textsuperscript{84} This perspective does not imply that all shareholders have a single-minded devotion to maximizing the value of their investments. Many shareholders may also be employees of the corporation and members of the local community, and be willing to accept less of a return on their investment in order to advance non-shareholder interests. Even shareholders who have no other connection with the corporation may be sympathetic to the plight of employees and the local community, and have no objection to protecting non-shareholder interests to a degree. The same would probably not be true for institutional investors, however.
holders' right to the maximum return on their investment is superior, being that they are the owners of the corporation. However, keep in mind that corporations exist as a matter of legislative grace. The right to incorporate is established by the people, acting through their elected officials. Absent a constitutional infirmity, should the citizens of the Commonwealth and their elected representatives not be free to proscribe the rules by which corporations are governed? Since the opportunity to incorporate is created by the will of the people, is there anything inherently wrong with corporate business being conducted in a manner which benefits employees, customers and suppliers of the corporation and the community in general?  

From a purely economic standpoint, shareholder and non-shareholder interests will likely clash at the outset. However, in the long run the two groups interests will merge, regardless of the economic impact of strict anti-takeover legislation. Although the effect such legislation has on capital investment most immediately affects the shareholders by influencing the value of their shares, in the long term the amount of capital investment also impacts on economic growth, jobs, and business opportunities for companies that deal with corporations. From this perspective, the issue is merely whether or not strict anti-takeover statutes are good for the economic health of the Commonwealth.

There seems to be little doubt that overly restrictive takeover laws will ultimately stifle investment. Appropriate anti-takeover

95. For a critical commentary on the notion that corporations must be managed exclusively for the benefit of the shareholders, see Peter Rona, Shareholders Have Too Much Power, 120 Fortune 125 (August 28, 1989). This author goes so far as to suggest that the single-minded devotion to increasing shareholder value has been responsible for American corporations' inability to compete in the international market.

See also, Donald N. Frey, The Social Contract is Threatened, 51 Chief Executive 10 (May/June 1989), in which the author argues that the proliferation of institutional investors is responsible for the subordination of non-shareholder interests. Because of the resultant adverse effect on competitiveness, the author views anti-takeover legislation as a regrettable necessity.

96. See note 88 and accompanying text.

97. Understandably, this is of little concern to persons faced with immediate plant closings and/or massive lay-offs following a successful hostile takeover. Perhaps, one could not expect legislators, upon hearing these types of horror stories from their constituents, to be overly concerned with the potential long-term effects of their actions.

98. In the mid-1980's, at the height of the takeover frenzy, the Federal Reserve Board was the only federal agency favoring restrictions on takeovers. Among those taking the opposite view was The 1985 Economic Report of the President, which contended that hostile takeovers are good because they increase the value of target corporations. See John Thackray, The Great Trade Robbery, Management Today 80 (March 1986).
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legislation should, therefore, strive to strike some sort of balance, taking into account both the immediate conflict between shareholder and non-shareholder interests and the long-term effects on everybody's interests. The financial interests of the shareholders should be protected to the extent the economic vitality of the communities in which corporations operate is not too seriously effected. In so doing, a balance is also maintained between the Commonwealth's immediate economic well-being and securing a sound economy for the future.

As amended by Act 36, Pennsylvania's anti-takeover legislation balances nothing. It is absolutely pro-management. For now, it appears that the future has been sacrificed in the name of the present.

Regardless of one's opinion of Act 36, there is a development which has followed the Act's passage which should not escape mention. As of the cut-off date of July 26, 1990, more than sixty publicly-held Pennsylvania companies have opted-out, at least in part, of Act 36's coverage. Although there exists approximately three hundred corporations eligible for the Act's protection, those opting-out have included some of the largest and best known corporations in the Commonwealth. Most notable among this group is Westinghouse Electric, the Commonwealth's largest corporation. Other commentators who suggest that overly restrictive takeover statutes adversely effect jobs and competitiveness include: Jason Zweig, 145 Forbes 42 (cited in note 87); Marc I. Steinberg, Federal Preemption of State Antitakeover Statutes: The Time For Congressional Action Is Now, 16 Securities Regulation L J 80 (1988); and Lyman Johnson and David Millon, Does the Williams Act Preempt State Common Law in Hostile Takeovers?, 16 Securities Regulation L J 339 (1990). However, Johnson and Millon also take the position that states should be free to protect the rights of non-shareholders.

See also, the discussion of investors' reactions to Act 36 in note 92.

99. See Jim McKay, Mixed Response to Anti-takeover Law, Pittsburgh Post-Gazette 10 (July 26, 1990). This article also reports that included among those corporations opting-out is Conrail. This may be particularly embarrassing to supporters of Act 36 because, as McKay goes on to report, Conrail was used during the debate as an example of a company that needed protection.

100. See McKay, Pittsburgh Post-Gazette at 10 (cited in note 99). Note that the number of corporations reported in this article as opting-out is based on the private tabulations of an attorney who opposed Act 36. The article reports that, because the Act is self-enforcing, there are no official figures, and that generally only those corporations which opt-out have made announcements. The author indicates that corporations which do not opt-out are reluctant to publicize their decision due to the wide spread negative reaction to Act 36 by institutional investors.

101. See McKay, Pittsburgh Post-Gazette at 10 (cited in note 99). The author reports that Westinghouse feels that the best takeover defense is to be a well-run company. The article quotes a Westinghouse spokesman as saying:

The company wants to be judged on its ability to increase shareholder value. By opt-
The substantial number of corporations which have distanced themselves from Act 36 raises some disturbing questions. Is anyone in a better position to judge the desirability of such legislation than corporate officers and directors themselves? If anyone would be biased in favor of Act 36, would it not be this group of people? If corporate officers and directors who stand to benefit significantly from Act 36 do not want it, was there any need for the Act in the first place. Because there are no official records on how many corporations have opted-out of Act 36 and corporations are not obligated to publicize their decisions, such tabulations are not particularly precise. Although difficult to determine so objectively, it would seem logical that well-managed corporations have opted-out, while companies which are poorly managed, and therefore more vulnerable, have sought the protection of Act 36. Some time must pass before the true impact of Act 36 can accurately be

Id at 10.

Ironically, by attacking hostile takeovers with such zeal, the Legislature may have failed, to a large extent to achieve many of Act 36’s desired benefits. With so many corporations opting-out, a significant portion of both corporations and citizens of the Commonwealth remain subjected to the onerous effects of bad-faith takeover bids. A well planned, balanced piece of legislation, with no opt-out provision, would have more effectively achieved what Act 36 set out to accomplish. Unfortunately, the opportunity has been lost, at least for now. Of course, the beauty of the legislative process is that nothing is written in stone and the only certainty is that things can and do change. However, the business climate of the Commonwealth would be much improved if the legislature would endeavor to find the right course initially, instead of enacting reactionary legislation and steering wildly between extremes.

In addition, many observers believe that the era of the hostile takeover has passed with the collapse of the junk bond market, which fueled much of the takeover frenzy of the 1980’s. See Jason Zweig, 145 Forbes 42 (cited in note 87). One author has suggested that “... maybe, passing a strict anti-takeover law is not unlike locking the barn door after the horses all ran away.” Tascarella, 9 Executive Report at 28 (cited in note 72).

See note 100.

See the discussion of Westinghouse Electric’s rationale for opting-out in note 100. 105. What has happened at Fischer & Porter Company, a manufacturer of process control equipment based in Warminster, Pennsylvania, may be informative in this regard. The company’s sales rose by just 2% annually during the 1980’s and the return on equity was never more than 8%. In addition, the company lost two million dollars in the first quarter of 1990. Less than three years after leaving Pennsylvania and incorporating in Delaware, Jay Tolson, the company’s chief executive officer (who also controls over half of the voting shares), is reincorporating in Pennsylvania. See Jason Zweig, Damn the Shareholders, Full Speed Astern, 145 Forbes 64 (June 25, 1990).

It has also been reported that analysts figure that Fischer & Porter Co. is “worth 37% more dead than alive” and that Mr. Tolson has paid himself more than 10% of the company’s net profits in salary and bonuses. See Tascarella, 9 Executive Report at 23 (cited in note 72).
determined. If, in fact, poorly run corporations are generally the ones remaining within the protective cloak of Act 36, then the Legislature’s efforts have caused a rather absurd result. The primary effect of Act 36 may well be to provide poorly-managed companies with the means by which to continue to operate in a blissful state of incompetence.

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