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ATTORNEY GENERAL OPINION NO. 87- 87

Roger N. Walter
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Landon State Office Building
900 S.W. Jackson St., Suite 552
Topeka, Kansas 66612

Re: Corporations--Securities; Take-Over
Bids--Constitutionality

Synopsis: The Kansas Take-Over Bids Act is unconstitutional pursuant to the Supremacy and Interstate Commerce Clauses of the United States Constitution. As applied to entities required to register securities under federal law, the state act is pre-empted. As applied to other entities, the act frustrates the neutral Congressional position between management and acquiring entities, and is therefore pre-empted. In addition, the act is invalid on the grounds that it creates an undue burden on interstate commerce. State regulation of tender offers is not entirely prohibited. However, if the state wishes to regulate, it must do so by legislative action rather than by judicial application of a broad severability clause. Cited herein: K.S.A. 17-1276; 17-1277; 17-1279; 17-1284; 17-1285; 15 U.S.C. §§781, 78m, 78n, 78bb; 17 C.F.R. §§240.14d, 240.14e.

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Dear Mr. Walter:

As counsel for the Office of the Securities Commissioner, you have requested our opinion concerning the constitutionality of the Kansas Take-Over Bids Act, K.S.A. 17-1276 et seq. In light of recent court decisions declaring similar state acts unconstitutional, you specifically inquire whether the Kansas act is pre-empted by federal law, or whether it unduly burdens interstate commerce.

We begin our analysis with the rule that a statute is presumed constitutional. All doubts as to the constitutionality of the statute are to be resolved in favor of its validity. State v. Carpenter, 231 Kan. 235, 237 (1982).

I. Is the Kansas Take-Over Bids Act constitutional as applied to tender offers regulated under federal law?

Federal regulation of hostile take-over bids is accomplished through the Williams Act, which is a series of amendments to the Securities Exchange Act of 1934, now codified at 15 U.S.C. §§78m(d)-(e) and 78n(d)-(f). The filing and disclosure requirements of the act apply to any issuer of securities (1) engaged in interstate commerce, or whose securities are traded through instrumentalities of interstate commerce, (2) having total assets exceeding \$5,000,000, and (3) whose securities are held by more than 500 shareholders. In addition, an issuer may register a class of securities with the commission, even though such filing is not required by the act. See generally 15 U.S.C. §78l(g), and regulations promulgated thereunder.

If an issuer who is subject to the filing and disclosure requirements becomes the target of a take-over bid, then the provisions of 15 U.S.C. §§78m(d) and 78n(d) apply. Section 78m(d) (1) requires that a person who acquires beneficial ownership of more than five per centum of a class of registered securities must file a statement of disclosure with the commission, with the exchange where the security is traded, and with the issuer of the security. The statement must be filed within ten days after the acquisition. Section 78n states that it is unlawful for a person to make a tender offer for a class of registered securities if the acquisition would result in the beneficial ownership of more than five per centum of such class, unless information required by section 78m(d) is on file with the commission. In summary, the filing

and disclosure provisions of the act require that either the acquisition of, or a tender offer for, a class of equity securities which are registered pursuant to section 781 involve a disclosure of the circumstances of such acquisition or tender offer.

The purpose of the filing and disclosure provisions of the federal act is to enable holders of securities to base their decision to tender on complete and accurate facts. Gray Drug Stores, Inc. v. Simmons, 522 F.Supp. 961, 964 (D.Ohio 1981). This places investors on an equal footing with the takeover bidder. Piper v. Chris-Craft Industries, 430 U.S. 1, 30, 97 S.Ct. 926, 51 L.Ed.2d 124 (1977). The congressional goal was to provide a shield for investors, not a sword for management. In order to deny management a sword with which to defeat a tender offer, a policy of neutrality between management and those attempting a take-over was adopted. Prevention of tender offers could potentially harm, rather than protect, investors. See Great Western United Corp. v. Kidwell, 577 F.2d 1256, 1277 (5th Cir. 1978), Rev'd on other grounds, sub. nom. Leroy v. Great Western United Corp., 443 U.S. 173, 99 S.Ct. 2710, 61 L.Ed.2d 464 (1979).

The congressional commitment to neutrality between takeover bidders and management is undermined by the Kansas Take-Over Bids Act. The Kansas Act favors management by requiring pre-commencement notification of an intent to make a tender offer. K.S.A. 17-1277 states in relevant part:

"(a) No offeror shall make a take-over bid unless, at least thirty (30) days prior thereto, such offeror files with the [state] securities commissioner and the target company, copies of all information required by K.S.A. 17-1279. The target company may, within fifteen (15) days following such filing, request a hearing before the commissioner. . . ."

The affect of K.S.A. 17-1277(a) is to allow management an opportunity to either delay a tender offer by use of the hearing procedure, or to defeat a tender offer by other means. Delay may be fatal to a take-over bid. In Commerce Clause Limitations Upon State Regulation of Tender Offers, 47 S.Calif. L.R. 1133 (1974), the author notes that, "if the tender offeror has not acquired enough shares for control

within the first few days the offer will most likely be defeated." Id., at 1143.

As originally enacted, the Kansas take-over bids statute was inapplicable "to any corporation registered under the securities exchange act of 1934, as amended, and currently subject to the rules and regulations of the securities and exchange commission pertaining to tenders and take-over bids." K.S.A. (1975 Supp.) 17-1285. This section was repealed by L. 1976, ch. 101, §1. By the repeal of section 17-1285, the inferred legislative intent was to make issuers of securities regulated by the federal act subject to the Kansas act as well.

Since the Kansas act, when applied to federally regulated securities, is inconsistent with the federal policy of neutrality, we believe that the state statute is pre-empted by the federal law. Congress has allowed some state regulation in the field, by including in the act of 1934 the following provision:

"[n]othing in this chapter shall effect the jurisdiction of the securities commission . . . of any State over any person insofar as it does not conflict with the provisions of this chapter or rules and regulations thereunder." 15 U.S.C. §78bb(a).

In other words, the federal act does not expressly pre-empt state law unless a conflict arises. However, conflicts arise in the application of state law to issuers of securities registered pursuant to federal law. Where state law "stands as an obstacle to the accomplishment and execution of the full purpose and objectives of Congress," state law is nullified under the pre-emption doctrine. See Kansas Attorney General Opinion No. 87-62, at pages 5-6.

Our opinion is consistent with recent court decisions. In Edgar v. MITE Corp., 457 U.S. 624, 73 L.Ed.2d 269, 102 S.Ct. 2629 (1982), a plurality opinion, some members of the Court believed that federal law pre-empted the Illinois take-over bids statute. The majority of the Court held that the statute, which was not materially distinguishable from the Kansas act, was an impermissible burden on interstate commerce, making the pre-emption analysis unnecessary. While MITE is not binding in pre-emption matters, CTS Corp. v. Dynamics Corp., _____ U.S. _____, 55 U.S.L.W. 4478, 4481

(1987), it has had an influence on the courts' determination of the state's ability to regulate take-over bids. See e.g., L.P. Acquisition Co. v. Tyson, 772 F.2d 201, 209 (6th Cir. 1985) (Michigan statute unconstitutional); National City Lines, Inc. v. LLC Corp., 687 F.2d 1122, 1128 (8th Cir. 1982) (Missouri statute unconstitutional). In addition, a pre-Mite decision held that the Idaho statute was pre-empted. Great Western United Corp., 577 F.2d at 1279.

In light of these federal courts' decisions striking down similar state statutes, and in light of the Kansas act's standing as an obstacle to the federal act's purpose of neutrality, it is our opinion that the Kansas act is unconstitutional as applied to corporations regulated by the federal act.

II. Is the Kansas Take-Over Bids Act constitutional as applied to entities not registered pursuant to the federal act?

Two theories have been advanced to invalidate state statutes which are similar to the Kansas act. First, it has been argued that the federal anti-fraud portions of the federal act pre-empt such state regulation. Second, it has been argued that the state control imposes an undue burden on interstate commerce.

Federal law has some pre-emptive effect on the Kansas statute beyond involvement with registration and disclosure matters. The anti-fraud section of the federal act is not restricted in its application to offers for registered securities. Section 78n(e) states:

"It shall be unlawful for any person to make any untrue statement of a material fact or omit to state any material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading, or to engage in any fraudulent, deceptive, or manipulative acts or practices, in connection with any tender offer or request or invitation for tenders, or any solicitation of security holders in opposition to or in favor of any such offer, request, or invitation. The commission shall, for the purposes of this subsection, by rules and regulations

define, and prescribe means reasonably designed to prevent, such acts and practices as are fraudulent, deceptive, or manipulative." 15 U.S.C. §78n(e) (emphasis added).

Pursuant to the above, the commission has promulgated Regulation 14E, 17 C.F.R. §240.14e-1 et seq. The substantive provisions of Regulation 14E include a requirement that tender offers be held open for at least 20 days, §240.24e-1(a); a requirement that the target company publish or send an opinion to security holders regarding a recommendation to reject or accept the bidder's offer, §240.14e-2(a); and a prohibition of acting on non-public information, §240.14e-3.

Regulation 14E is applicable to any tender offer for securities, and is not limited to those registered under section 781. 17 C.F.R. §240.14d-1(a). In addition, it was the actual intent of the commission to pre-empt state regulation in this area. 44 Fed. Reg. 70337, December 6, 1979. When Congress has lawfully delegated legislative rulemaking authority to an administrative agency, if the rule has substantive characteristics and is the product of a procedurally sound rulemaking process, then the rule has the force of law. Such properly promulgated rules pre-empt state law under the Supremacy Clause. See generally, Capital Cities Cable, Cin. v. Crisp, 467 U.S. 691, 404 S.Ct. 2694, 81 L.Ed.2d 580 (1984); Chrysler Corp. v. Brown, 441 U.S. 281, 295-96, 99 S.Ct. 1705, 60 L.Ed.2d 208, 221 (1979);

Regulation 14E has, as its primary purpose, the function of preserving neutrality between management and potential acquirers of securities. 44 Fed. Reg. 70337, December 6, 1979. To the extent that the Kansas act upsets this balance, it is pre-empted. Our opinion on this point follows L.P. Acquisition Co. v. Tyson, 772 F.2d 201 (6th Cir. 1985) (Michigan Take-Over Offers Act pre-empted). In Tyson, the plaintiff-appellant commenced a tender offer for the Evening News Association, a Michigan corporation which was not required to register its securities under §781. The court held that the Michigan act permitted delay by management, and therefore frustrated the purposes of the Williams Act.

The Kansas act is distinguishable from the Michigan act in one respect. The Michigan act required that the offer must be held open for not less than 60 days. M.C.L.A. §451.905(2). Our statute has no similar requirement, however, this

distinction is largely immaterial. While there may not be a physical impossibility of complying with both the federal act and the state law as was the case with the Michigan statute, the rationale of Tyson is still applicable. Management has the opportunity under state law to delay or even defeat a tender offer by requesting a hearing. Such delay is contrary to the neutral policy of the Williams Act. In addition, the state act favors management by requiring a 30-day precommencement notice which, as noted previously, gives management time to defeat the take over bid.

To the extent that the Kansas provisions regarding pre-commencement filing and hearing procedures frustrate the neutral policy of the Williams Act, it is our opinion that state law is pre-empted. Such pre-emption occurs whether or not the bid is for securities subject to registration under section 781.

The second theory on which the Kansas act is subject to challenge is its burden on interstate commerce. While such an attack applies equally to securities registered under section 781, we have already opined that federal law regarding those securities pre-empts state law. The commerce clause argument therefore becomes more relevant when considering securities which are not subject to federal registration requirements.

In light of the ruling in Edgar v. MITE Corp., 457 U.S. 627, 102 S.Ct. 2629, 73 L.Ed.2d 269 (1982), we believe that the Kansas Take-Over Bids Act impermissibly burdens interstate commerce. In MITE, the Illinois take-over bids statute was declared unconstitutional, the majority of the court holding that the statute indirectly regulated interstate commerce, 457 U.S. at 643-46, 73 L.Ed. 2d at 284-85. The substantive provisions of the Kansas act very nearly parallel the Illinois statute, and must therefore fall under the MITE rationale. Like the Illinois statute, the Kansas act includes "nationwide reach which purports to give [the state] the power to determine whether a tender offer may proceed anywhere." See MITE, 457 U.S. at 643, 73 L.Ed.2d at 284. The Kansas act defines a take-over bid as:

"the acquisition or offer to acquire, pursuant to a tender offer of any equity security of a corporation organized under the laws of this state or having its principal place of business and substantial assets within this state, which has as its purpose the changing of

control or management of the company and which, after acquisition thereof such offeror would, directly or indirectly, be a record or beneficial owner of more than twenty percent (20%) of any class of the issued and outstanding equity securities of such corporation." K.S.A. 17-1276(a). [Compare Ill. Rev. Stat., ch. 121 1/2, §137.54A (1979).]

To illustrate the burden imposed by this broad definition, assume that corporation A is a Delaware corporation, and that corporation B is an Illinois corporation with its principal place of business and substantial assets located in Kansas. When A makes a take-over bid for shares of B's securities, the laws of Delaware, Illinois and Kansas apply. Without even considering the potential conflict-of-law problems, we first note that, by invoking the hearing provisions of the act in an effort to delay the offer, management located in Kansas could defeat the acquisition which really only involves two foreign corporations.

When the hearing provisions are invoked in the example above, the Kansas commissioners would determine whether the offeror's disclosure was "fair, full and effective." K.S.A. 17-1277. One item of disclosure would include a statement of plans by the offeror to relocate the operations of the target company outside the state of Kansas. K.S.A. 17-1279(d). With the exception of management relocation, the Kansas disclosure requirements parallel those included in the federal act. The burden on interstate commerce is clear. There is no reason to believe that all or even a substantial number of Kansas investors will be involved in the decision to tender. Even if the purported goal of the state statute is to protect investors, the act is not calculated to protect Kansas investors. The state has no legitimate interest in protecting non-Kansas investors. MITE, 457 U.S. at 644, 73 L.Ed.2d at 284. In addition, while the bid involves two foreign corporations, the acquisition may be defeated by operation of Kansas law even though there is little nexus between the state of Kansas and the transaction. This protection of local management creates an impermissible burden on interstate commerce, while affording little, if any, benefit to local shareholders. C.f., MITE, 457 U.S. at 642, 73 L.Ed.2d at 283. See also, Mesa Petroleum Co. v. Cities Service Co., 715 F.2d 1425 (10th Cir. 1983); Televest, Inc. v. Bradshaw, 697 F.2d 576 (4th Cir. 1983); Martin-Marietta Corp. v. Bendix Corp., 690 F.2d 558 (6th

Cir. 1982). In short, the Kansas act does not further a legitimate state interest which would justify the burden it imposes on interstate commerce.

To summarize, the reach of the Kansas act extends beyond permissible regulation of local concerns. As the burden on interstate commerce is more than slight, it is our opinion that the broad reach of the Kansas Take-Over Bids act is unconstitutional as applied to entities which are not registered pursuant to the federal act.

III. Validity of the Act.

In section I. we opined that federal law pre-empts the Kansas act as it is applied to entities which register their securities under the federal act. In section II. we opined that, to the extent that state law upsets the neutral balance between management and the offeror, and to the extent the state regulation imposes an undue burden on interstate commerce, the Kansas act is invalid as applied to securities not registered pursuant to federal law. Both constitutional attacks involve the precommencement notice and hearing provisions of the Kansas law. These provisions constitute the majority of the regulatory scheme. While the act includes a comprehensive severability clause, K.S.A. 17-1284, we believe that it may not be applied in this instance.

Whether constitutionally infirm portions of a statute may be severed, leaving the remainder of the act intact and in force, depends on legislative intent. State v. Carpenter, 231 Kan. 235, 240 (1982). A severability clause indicates a legislative intent to retain that which is not defective. State v. Next Door Cinema, Corp., 225 Kan. 112, 118 (1978). However, the infirmities of the Kansas Take-Over Bids Act permeate the entire regulatory scheme. To cure the defects, words would actually have to be written into the act. The severability clause is therefore ineffective. C.f., Federal Land Bank of Wichita v. Bott, 240 Kan. 624, 637 (1987). We believe that the burden of curing the defects of the act must fall on the legislature, not the courts.

Subsequent to your opinion request, the United States Supreme Court announced its decision in CTS Corp. v. Dynamics Corp. of America, 55 U.S.L.W. 4478 (1987). In CTS, it was held that the Indiana Control Share Acquisitions act was neither pre-empted by federal law, nor was it invalid as burdening interstate commerce. The relevancy of CTS is the Supreme Court's acknowledgement that states may regulate tender offers

to some extent. In light of CTS and 15 U.S.C. §78bb, noted previously at page 4, we believe there is some room for state legislation which is calculated to protect legitimate state interests.

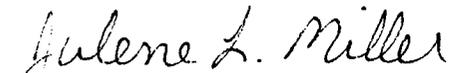
IV. Conclusion.

In conclusion, it is our opinion that the Kansas Take-Over Bids Act is unconstitutional. As applied to entities who are required to register their securities under federal law, the act is pre-empted. As applied to other entities, the act frustrates the neutral position taken by Congress, and is therefore pre-empted. In addition, the act creates an undue burden on interstate commerce, and is therefore invalid. State regulation of tender offers is not entirely prohibited. However, if the state wishes to regulate, it must do so by legislative action rather than by judicial application of a broad severability clause.

Very truly yours,



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