DELAWARE STATUTORY PROVISIONS AND CASE-LAW APPLICABLE TO DIRECTOR AND SHAREHOLDERS MEETINGS

BY PETER J. WALSH*

PROFESSOR LEVIN: The next topic on our agenda is presentations on the Delaware statutory provision and case law which are applicable to director and shareholder meetings. Our presenters are Mssrs. Peter Walsh and Mike Goldman. Mr. Walsh is the first presenter.

MR. WALSH: I'd like to refer to my outline and the way I propose to proceed is to highlight and briefly discuss some of the cases mentioned in the outline in order to give you the flavor of this subject.[1] Within the time constraints, it is not going to be possible for me to discuss each item in the outline.

My presentation is an overview of a very broad subject — shareholder meetings and director meetings — and Mike Goldman is going to follow up on that with a discussion of the summary proceedings in the chancery court relating to this area of corporate democracy.[2] Let me start off by referring you to the introduction of my outline, in which I mention several cases which I think are quite significant, not only for the particular holding of the case as it relates to a particular item in the outline, but to give you some idea of the view of the Delaware courts with respect to the rights of shareholders at meetings, special and annual.

I refer to the *Schnell v. Chris-Craft*[3] case as a leading case with respect to the matter of corporate democracy. This was a minority shareholder injunction action attempting to stay management's acceleration of an annual meeting. The case resulted from a proxy fight, a contest for control wherein the annual meeting was scheduled for January and the board of directors of the company, in full compliance with Delaware law and its own bylaws, met and accelerated the meeting from January to December. The effect, of course, was to cut off the ability of the dissidents to marshall their forces. This action of amending the bylaws was in full compliance with section 211[4] regarding the setting of meetings and section 222[5]

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1. See Appendix D, p. 353 *infra*.
2. See address by Mr. Goldman, this issue, p. 191 *infra*.
3. Schnell v. Chris-Craft Indus., 285 A.2d 437 (Del. 1971), *rev'g* 285 A.2d 430 (Del. Ch. 1971).
4. DEL. CODE ANN. tit. 8, § 211 (1974).
5. *Id.* § 222 (1976).

regarding the requirements for notice. The chancery court denied the dissidents injunctive relief and in effect said that the parties were engaged in a vigorous contest and management was able, through a technical legal compliance with the statute, to accelerate the date of the meeting as one of its strategems in the control contest. The supreme court reversed, holding that it was obvious that the strategem was designed to perpetuate management in office and to obstruct the legitimate efforts of the dissident shareholders. The court made this observation, and I quote: "Inequitable action does not become permissible simply because it is legally possible."[6] I think this case is significant in demonstrating that the courts will not allow technical compliance to overcome fundamental propositions of corporate democracy. I think it is further significant that the *Schnell* decision, in my opinion, was the springboard for the decision by the supreme court in *Singer v. Magnavox* about which you will hear much later on tomorrow.[7]

On the other hand, and I refer you to the *Savin Business v. Rapifax*[8] decision, the court will not become involved in every contest in an effort to resolve differences and it will not attempt to overturn management's reasonable compliance with procedures for establishing a meeting. In this case, several shareholders sought to compel a meeting, and on that score the only inquiry is (a) is the shareholder a holder of record, and (b) has there been a thirteen-month period without a meeting. The court found that the statutory prerequisite for relief under section 211[9] was there; however, it refused to direct a meeting because the factual situation was such that the two parties involved in the dispute had on several occasions attempted to get together to establish a meeting date but the plaintiff rejected two prior dates which had been suggested by the other side. The substance of this action was not, according to the court, an effort to have a meeting but an effort to direct the court to accelerate the time of the meeting. On this point, the court simply held that it was within the discretion of the court to decide the timing of the meeting and the court was satisfied that the plaintiff had not proceeded in good faith, that the defendant was attempting to have a meeting at a mutually-convenient date.

Let me direct your attention to the general topic of stockholders meetings. As noted, if there is not an annual meeting and the statute

6. 285 A.2d at 439.

7. Singer v. Magnavox Co., No. 289, 1976 (Del. Sept. 23, 1977, revised Nov. 2, 1977). See address by Mr. Herrmann, this issue, p. 307 *infra* and *Panel Discussion*, this issue, p. 313 *infra*.

8. Savin Business Mach. Corp. v. Rapifax Corp., 375 A.2d 469 (Del. Ch. 1977).

9. DEL. CODE ANN. tit. 8, § 211 (1974).

directs that there will be an annual meeting, if there is not one within a thirteen-month period a summary proceeding may be instituted to compel one. In the summary proceeding under section 211(c), there are only two simple prerequisites: (1) the plaintiff has to be a shareholder, and (2) no meeting within the past thirteen months. Generally, the court will not go beyond that inquiry. Generally, the court will stick to the statutory mandate of summarily ordering an annual meeting if those two conditions be the case. This situation is illustrated by the *Coaxial Communications v. CNA*[10] case. There, there was a request for an annual meeting. The defendant interposed the objection and sought a stay on the ground that there was a companion federal district court action involving the same parties in which the plaintiff in the chancery court proceeding had also in the federal court proceeding requested as a part of the relief an annual meeting. The chancery court held that notwithstanding the federal proceeding, notwithstanding that the federal court could do equity and direct a meeting, there was no showing that the federal court was prepared to proceed promptly. The court summarily ordered the annual meeting.

The summary nature of the section 211 proceeding is equally demonstrated by the *Tweedy v. Cambridge*[11] case. In that case, there was a request for the appointment of a master, and I've included the case in my outline for that point. But the principal interest of this case, I believe, is that here the defendant corporation was attempting to resist the direction of a meeting on the grounds that it was involved in having the proxy materials cleared by the SEC. The court noted this but didn't have a great deal of sympathy for that problem, and despite the fact that the management was waiting for SEC clearance on its proxy, the court directed the parties to hold a meeting. Now, in the opinion, the court hinted that counsel should try to work out a date. I assume the court was trying to suggest that there might be a date which would be compatible with the SEC clearance. It is not clear from the opinion whether a date without regard to the SEC proxy clearance was directed, and incidentally Mike Goldman was involved in that case and perhaps he can tell us what the practical outcome was. But I mention those two cases because they are illustrative of the summary nature of the section 211 proceeding.

With respect to the special meetings, I have indicated the statutory requirements, briefly noted the type of considerations to be

10. Coaxial Communications v. CNA Financial Corp., 367 A.2d 994 (Del. 1976).

11. Tweedy, Browne & Knapp v. Cambridge Fund, Inc., 318 A.2d 635 (Del. Ch.), *aff'd.*, No. 63, 1974 (Del. April 2, 1974).

taken up at special meetings, and I have referred to the *Gimbel v. Signal Companies*[12] case. I have mentioned this case somewhat as an aside because it illustrates that whatever liberal interpretation the court may be inclined to take regarding corporate democracy, it will not ignore the clear statutory directive. In this case, among other things, the shareholders were trying to obtain a decision by the court that a sale of assets was subject to section 271[13] involving a sale of all or substantially all the assets. Despite the fact that this particular transaction involved figures in the magnitude of $480 million, the court was compelled to follow the mandate of the statute and ruled that it was not subject to section 271. I mention this case as an aside because, despite what equitable parameters the court may feel it is entitled to extend to, there are certain statutory mandates and limitations that simply will not be ignored.

In connection with the notice of the meeting and the content of the notice, I want to direct your attention to the decision mentioned on page [354] of my outline [in Appendix D] under the caption "Contents of Notice." Before doing that, at the top of page [354] with respect to notice of the meeting, you will see that the time limitations of ten days and sixty days are specified there. There is another section of the statute, namely section 262,[14] relating to appraisal rights, where the time limitation is different, so you don't want to be caught on that one. The notice cannot be less than twenty days rather than the ten days mentioned in section 222.[15] With respect to the contents of the notice, let me point out the 1968 amendment which revised section 211(b) which contained a provision for limiting consideration at the meeting, matters in the notice. In 1968, that was amended to say "any other proper business." I don't want this point to be misleading, and let me clarify it by this. The language which was amended in 1968 was actually put in in 1967. The 1967 language was new at that time, the limitation in the 1967 language lasted only for a year. The 1968 amendment was a technical correction.

In connection with the notice, your attention is directed to the decision of *Liese v. Jupiter Corporation.*[16] In this case, there was an annual meeting called but there was some debate as to whether preferred shareholders, who at that time were entitled to elect a minority to the board, were now entitled to elect a majority of the board by reason of the passage of a specified number of preferred

12. 316 A.2d 599 (Del. Ch.), *aff'd per curiam*, 316 A.2d 619 (Del. 1974).
13. DEL. CODE ANN. tit. 8, § 271 (1974).
14. *Id.* § 262 (1976).
15. *Id.* § 222 (1976).
16. 241 A.2d 492 (Del. Ch. 1968).

dividends. The management notice of the meeting was unclear as to whether there would be an issue of separate common and preferred elections, and it did not properly inform the preferred shareholders that if it was determined that the dividends were in arrears that the preferred was entitled to elect a majority to the board. On the basis of that ambiguous notice, the court invalidated the action which took place at the meeting and this case is cited for the proposition that the notice must be adequate to inform what is to take place. I think that case was a close one because there was some hint in the notice that there might be some question about the entitlement of preferred shareholders to elect a majority as opposed to a minority. The court simply said that it was not clear enough and invalidated the action taken. In connection with the notice, I again direct your attention to section 262, the appraisal rights. In addition to the notice minimum period being longer, section 262 has very detailed specifications with respect to what has to be in the notice and proxy material, including a verbatim statement of section 262. In connection with that section, I want to direct your attention to the case of *Raab v. Villager.*[17] This case involved the situation where the supreme court was called upon to resolve a number of very technical disputes regarding the rights of certain claimants to an appraisal following a merger. The disputes involved the question of whether jointly-owned shares had to be signed by both parties, it involved questions of record ownership, etc. After ferreting out all of the disputes, the court, in an unusual statement in my opinion, at the end of its opinion, said that it wanted to make a policy pronouncement, and this policy pronouncement obviously has put us all on notice. The policy pronouncement, in effect, says that the management has an obligation to inform shareholders in the proxy material very specifically and unambiguously regarding their rights under section 262. If they don't, if there are any disputes, then any resolution with respect to these disputes will be decided in favor of the shareholders, and the court does not want to entertain hypertechnical objections to shareholder procedures respecting appraisal rights.

You will note on page [355] of my outline, I have a topic captioned "State 'Proxy Rules'." Now, obviously, the State of Delaware does not have proxy rules, but I captioned this discussion for the purpose of highlighting what I think the cases cited in that discussion suggest, namely, that there is a very fundamental body of law in Delaware which indicates that Delaware courts are disposed to developing a body of law quite similar to the body of law which has developed in the federal area with respect to compliance with

17. Raab v. Villager Indus., 355 A.2d 288 (Del. 1976).

SEC proxy rules. Note first the *Investment Associates*[18] decision. In this case, the court was called upon to consider the applicability of the federal proxy rules in a state proceeding. Obviously, as you know, section 27 of the Exchange Act[19] says that proceedings under the '34 Act are the exclusive jurisdiction of the federal courts. The state court in this case said that's obviously correct. But then, Vice Chancellor Seitz made this following observation:

> I think it should be made clear that some acts which constitute violations of the Securities Exchange Act and the rules and regulations formulated thereunder may also be cognizable in a Section 31 [now section 225] proceeding as independent wrongs for which this court would grant a remedy, even if the Securities Exchange Act had never been passed.[20]

I think that the language of this case, together with some language in the *Empire Southern*[21] case, which I will refer to in a minute, suggests that the state courts indeed are empowered and are in a position to establish a body of law similar to the body of law which has developed under the federal securities laws with respect to the solicitation of proxies. Referring to the *Empire Southern* case, the court was called upon to enjoin the solicitation of proxies which were allegedly misleading. In this case, the court analyzed the issue and expressed its opinion in language which, in my view, is strikingly similar to the type of language you will find in the federal decisions which are addressing themselves to the disputes arising under the SEC proxy rules. The court had this to say with respect to the issue: "I believe both precedent and practice support the right of this court to interfere prior to a shareholder's meeting to prevent fraud in the solicitation of proxies, and to enjoin the voting of proxies so obtained."[22] Now, that's obviously a basic proposition of equity but certainly not a position which can be found in section 225[23] of our corporation law. The court went on to further espouse the following proposition which I think, if you didn't know where the quotation came from, it could easily be attributed to any federal decision under the proxy rules.

> Would a stockholder reading the notice, the proxy statement and the proxy be likely to obtain the impression that the proxy

18. Investment Assoc. v. Standard Power & Light Corp., 29 Del. Ch. 225, 48 A.2d 501 (Ch. 1946), *aff'd.*, 29 Del. Ch. 593, 51 A.2d 572 (Sup. Ct. 1947).
19. Securities Exchange Act of 1934, § 27, 15 U.S.C. § 78AA (1970).
20. 29 Del. Ch. at 242, 48 A.2d at 510.
21. Empire Southern Gas Co. v. Gray, 29 Del. Ch. 95, 46 A.2d 741 (Ch. 1946).
22. *Id.* at 99, 46 A.2d at 743.
23. DEL. CODE ANN. tit. 8, § 225 (1974).

> was being solicited by authority of the board of directors of the complainant company? I believe that he would so conclude, unless it is to be implied that the law will assume each stockholder will read and examine the various documents through the eyes of one who is placed on guard as to the possible existence of misleading statements. To expect or to require such a procedure of stockholders would remove the law beyond reason or reality. The accepted and desirable tendency has been to place the burden of candor upon those who would communicate with stockholders rather than to require the stockholders to be eternally vigilant.[24]

I submit that that is language from the intent and purpose of the federal securities laws. I submit that it indicates the disposition of the state courts to take an equally vigorous position in protecting the rights of shareholders with respect to proxies either not subject to federal jurisdiction or where litigants would feel inclined to proceed in the state court under state law rather than in the federal court under the federal securities law.

I wanted to mention one other item in this stockholder area. On page [356] of my outline, there is a reference of voting under section 212[25] and there is the proposition stated that the court need not look beyond the registered owner for purposes of determining who is entitled to vote. That general proposition is subject to the limitation noted in the *Norton v. Digital*[26] case. There, the court was called upon to examine whether the registered owner, the only statutory requirement, was entitled to cast his vote. The court held that in addition to looking at the question of registration, it had to look at the question of the legal right of the owner to vote his shares. That case involved earn-out shares where the shareholder received stock both in escrow and personally, which were subject to an earn-out provision of a merger transaction. The court held that since the shares were subject to a condition subsequent and since the consideration for the issuance of the shares had not yet been realized, namely, the earnings of the new subsidiary, the shareholder in this case did not have legal ownership, that is, he did not have the legal right to vote the shares despite the fact that the shares were registered in his name.

Let me mention one other case under shareholder rights, under voting rights, and the question recently addressed by our supreme court as to whether shareholders of a particular class could be given

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24. 29 Del. Ch. at 105, 46 A.2d at 746.
25. DEL. CODE ANN. tit. 8, § 212 (1974).
26. Norton v. Digital Applications, Inc., 305 A.2d 656 (Del. Ch. 1973).

unequal voting rights. This is the *Baker v. Providence*[27] case, recently decided by our supreme court, where the court below held that a certificate of incorporation provision which limited the number of votes based upon the number of shares held (in this case, there was one vote for each fifty shares, and then one vote for every twenty shares over the fifty) was a violation of section 151 of the corporation law.[28] The supreme court reversed and said that section 151 talked about a classification of shares, but you had to look at section 212 which states that a corporation can vary the one share-one vote rule of common law. Therefore, the supreme court held that section 151 neither said you could nor could not do this, section 212 by implication said you could vary the vote with individuals and the certificate of incorporation provision was upheld under section 212.

I'm running overtime, I don't want to cut off Mike Goldman, but let me just briefly refer you to the directors meeting section,[29] and let me respond to a question which was posed in that connection. Someone has raised the question as to whether in a shareholders meeting it is permissible under Delaware law to entertain a resolution from the floor by a shareholder where there has been no previous notice with respect to that resolution. Typically, in publicly-owned corporations, whatever is intended to be covered at the meeting is in the proxy statement and the question arises as to whether a shareholder who shows up and presents a proposition not otherwise noticed should be entertained. Well, first of all, I think it should be clear that that resolution should be entertained only if it would have been a proper resolution for a shareholder to request the management to put in the management proxy under the proxy rules of the SEC. Assuming that it is a proper resolution for a shareholder to propose, I am not aware of any Delaware case law, obviously no statutes, on the subject. But it seems to me that in view of the fact that the proxy material is the communication from management to the shareholders, there is really no effective communication of shareholders *inter se* preceding the meeting, and I think that if the shareholders meeting has any democratic basis to it, then a proper resolution should be entertained. I think management would be running a greater risk by not entertaining that resolution than by entertaining it. Now, obviously, if you let all shareholders make these kinds of proposals, you are going to run into a timing problem. I think that, however, can be handled as a matter of procedure and if proper resolutions become excessive in number, then I think they

27. Providence & Worchester Co. v. Baker, 378 A.2d 121 (Del. 1977).
28. DEL. CODE ANN. tit. 8, § 151 (1974).
29. *Id.* § 141 (1976).

can be appropriately cut off. Based upon my discussion with Mike Goldman, I think I have exceeded my time, but I will be happy to entertain any questions following Mike's discussion, if that be the disposition of the Chair.