PERSONAL JURISDICTION OVER CORPORATE OFFICERS AND DIRECTORS: RECENT DEVELOPMENTS

BY JACK B. JACOBS*

MR. JACOBS: I'm in somewhat of an unenviable position today for I'm the only speaker who stands between you and lunch. I must also confess to you right now that unlike Mike Goldman who made a very excellent presentation filled with humor, nothing I am going to say about my topic will be humorous.

The reason for that, in my own self-defense, is not that I'm prudish or incapable of a good laugh every now and then, but because after plowing through the literature in this area (constitutional jurisdiction), I found it is excelled in its use of metaphysical terminology and Latinate words only by the law of real property. I concluded reluctantly that this is a subject totally devoid of humor, probably because the judges who wrote the landmark decisions decided that that's the way it ought to be.

But what I do have to say is that this topic, constitutional jurisdiction, particularly as it affects corporate lawyers and particularly litigators, is highly important, and its importance has been highlighted ever since the 1977 Supreme Court decision in *Shaffer v. Heitner*.[1]

As you can imagine, it is important for a number of reasons. The enforcement of the substantive law governing the fiduciary duties of corporate officers and directors resides largely in the province of the state courts. Indeed the state courts made that clear in *Cort v. Ash*,[2] decided in 1975, and in the *Sante Fe*[3] case, which was decided not too long afterwards; the proposition being that the regulatory function of enforcing corporate fiduciary duties belonged to the state courts except where there is a clear supervening federal interest.

The foundation for the state court enforcement of shareholder's rights, which is the general topic that Mike Goldman and I are here to discuss, is that body of constitutional law governing the assertion of state courts of jurisdiction over persons. The body of corporate law in the fiduciary area rests upon that constitutional foundation.

That, of course, is why the topic is being discussed under the rubric of shareholder rights. It should be obvious that if one changes

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1. Shaffer v. Heitner, 433 U.S. 186 (1977).
2. Cort v. Ash, 422 U.S. 66 (1975).
3. Santa Fe v. Green, 430 U.S. 462 (1977).

the foundation, the result is to change the legal superstructure that rests upon it. *Shaffer* did precisely that. It shifted the jurisdictional foundation and forced corporate law to make new accommodations to changing jurisdictional requirements.

The impact of *Shaffer* on the practice of lawyers and upon the concerns of judges has been nationwide. It has affected us here in Delaware, where, of course, *Shaffer* originated. To appreciate the impact of the *Shaffer* decision on Delaware corporate practice, I think it useful to review the jurisdictional landscape as it existed before 1977, and with your permission, I will briefly do that.

The constitutional problem underlying state court jurisdiction over corporate officers and directors is based on the circumstance that as corporations grew larger and as their operations extended across the nation—and in many cases across the world—the officers and directors of those corporations tended not to reside in the state of incorporation. As far as Delaware corporations are concerned, the basic truth is that most of the officers and directors of those corporations do not reside here, and in the great number of instances, those corporations do not physically have or conduct any business office or operations here. For that reason the directors and officers of those types of corporations cannot physically be served in person in Delaware.

However, there did develop a constitutional structure which permitted state courts, including those of Delaware, to assert personal jurisdiction over nonresident corporate management. There evolved over the 100 year period, beginning with *Pennoyer v. Neff*[4] in 1877 and concluding with *Shaffer* in 1977, an entire body of law concerning jurisdiction over nonresidents, which evolved in two separate directions at the same time during that period.

Under the rule of *Pennoyer,* a state could constitutionally assert power over persons or interests in property so long as either were located within the borders of the state. On the other hand, the rule of *International Shoe,*[5] decided in 1945, was that a state could assert jurisdiction over nonresident persons so long as their contacts with the foreign state were sufficient in quantity and quality to assure that it was fundamentally fair to require those persons to defend in a foreign state.

So a double standard emerged. Jurisdiction over *persons* required, under the constitution, a showing of minimum contacts, but jurisdiction over *property* did not. Based upon this dichotomized state of the law, the various states developed several jurisdictional

4. Pennoyer v. Neff, 95 U.S. 714 (1877).
5. International Shoe Co. v. Washington, 326 U.S. 310 (1945).

mechanisms to reach nonresidents; Delaware's mechanism was possibly the most innovative, at least from a conceptual point of view.

I have in mind three types of jurisdictional devices: The general long-arm statute, the director's consent statute, and attachment or sequestration.

General long-arm statutes, the first of the three mechanisms, were generally not addressed specifically to corporation officers and directors, but were applicable by their terms to any nonresident whose contacts with the state involved certain statutorily prescribed in-state activities, any or all of which met the *International Shoe* requirement. The general long-arm statute was useful as a device to obtain service over some directors, but was not very useful in corporate cases in a state like Delaware where the directors of its corporations generally performed no activities within the state. Indeed, Delaware did not even have a general long-arm statute until the summer of this year when the first such statute was ever enacted.[6]

The second device took the form of the director's consent statute. A few states (not all of them) did adopt statutes which provided essentially that acceptance of a directorship in a corporation chartered in that state would constitute consent to be served in the courts of that state upon a cause of action arising out of the performance of the duties of these persons as directors. These types of statutes are generally predicated upon two separate constitutional rationales, which have tended to become somewhat confused. One of these rationales is "consent", and the other is "minimum contacts".

The third jurisdictional device—and this was Delaware's chosen mechanism—was attachment or sequestration, a mechanism based exclusively on the *Pennoyer* notion that the state can exercise power over property within the state. That concept was the basis for the body of jurisdictional law denominated as *in rem* and *quasi in rem,* which evolved over the last century.

The conceptual "innovation" which Delaware adopted, arose from the fact that most officers and directors in Delaware corporations own stock in that corporation or in some other Delaware corporation. However, stock is an intangible and the problem became: Where is the stock located for purposes of fixing jurisdiction?

As I'm sure you know, the UCC, the Uniform Commercial Code, in all states except Delaware, provides that the situs—that is, the location of corporate stock—was wherever the certificates representing that stock were physically located. However, in Delaware our statute decreed that the situs of stock of all Delaware corporations would be

6. DEL. CODE ANN. tit. 10, § 3104 (1975).

the state of incorporation, namely Delaware.[7] And as a result the stock of Delaware corporations was, for state court jurisdictional purposes, located in Delaware and was, therefore, property "located in Delaware" over which our courts could quite properly assert jurisdiction under *Pennoyer v. Neff*.

This was the constitutional rule for the Delaware sequestration procedure. That procedure enabled plaintiffs in a Delaware court to compel nonresident directors to enter a general appearance or risk having their property sold and the proceeds forfeited under this *quasi in rem* rationale.

Now it is correct that this procedure did force nonresident directors to litigate here in Delaware, even though they had no contact with Delaware other than having a directorship in a Delaware corporation, and other than owning stock in a Delaware corporation. The sequestration procedure did permit that result, and it was for that reason, among others, that the sequestration procedure was eventually invalidated in the *Shaffer* decision.

But one of the important beneficial results of the Delaware sequestration procedure was that it centered corporate litigation in the forum whose substantive law was applicable to the fiduciary rights and obligations sought to be enforced. It also resulted in involving most, if not all, of the management of the corporation charged with the responsibility for wrongdoing into the Delaware litigation.

I say that result was beneficial, because in matters of this sort, it is desirable that there be at least one state forum where jurisdiction over all directors can be obtained. In that regard, Delaware fulfilled that function quite well under the jurisdictional landscape that existed at that time, and has continued to do so.

Now *Shaffer,* as we all know, did change the rules and it upset the jurisdictional structure that I have tried to describe. As you know, *Shaffer* held two things (it may have held a lot more; there is a great deal of debate about it), but it did at least hold that the minimum contact requirement of *International Shoe* would be applied to all assertions of state court jurisdiction whether *in personam, in rem* or *quasi in rem.*

Shaffer also held that holding a directorship in Delaware corporations and owning stock in a Delaware corporation, are insufficient minimum contacts, because such contacts did not give rise to a reasonable expectation on the part of nonresident directors that they would be sued in Delaware on account of their serving as directors.

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7. DEL. CODE ANN. tit. 8, § 169 (1975), DEL. CODE ANN. tit. 10, § 366 (1975).

But the court did suggest, in its opinion, that the result might be different had Delaware enacted a statute which created an expectation on the part of directors that acceptance of a directorship in a Delaware corporation would constitute consent to being served and sued in Delaware.

As you know, after *Shaffer* was decided in late June of 1977, Delaware was left totally without any mechanism for serving nonresident directors. What was worse, at that particular time, the legislative session was due to expire in one week. Therefore, something had to be done and done quickly to fill the jurisdictional vacuum. The answer clearly appeared to be some sort of director consent statute as suggested by Justice Marshall in the *Shaffer* court opinion.

Therefore, a committee of lawyers knowledgeable in this area was quickly assembled, and in a series of very intensive but thorough drafting sessions, they were able to draft the Directors-Consent-To-Serve Statute, which the legislature did adopt during the then current legislative session. That statute is now codified within the Delaware Code as DEL. CODE ANN. tit. 10, § 3114 and has been in effect since September of 1977. One might expect that with *Shaffer* changing all the rules and Delaware enacting a statute to substitute for the invalidated sequestration that those two events would have solved all of the jurisdictional problems. But it should come as no surprise that that was not the result. Indeed, although *Shaffer* did solve some old problems, it created a bunch of new ones in its wake, and those problems have been winding their way through the Delaware courts ever since. Some of the questions prompted by *Shaffer* have been answered; many have not been.

In the few minutes remaining to me I would like to talk a little bit about these new problems, because these are the "recent developments" which I have been asked to talk about today.

One issue which arose almost instantly after *Shaffer* was decided was whether *Shaffer* could be applied retroactively to cases which had been filed under the Sequestration Statute before *Shaffer,* where the defendant directors or officers had entered a general appearance in response to the sequestration. After *Shaffer* was decided, a number of cases of that sort had been filed and were then pending in the chancery court, and in fact, a number of them had gone quite far along in pretrial discovery.

Nonetheless, attempts were made by the defendants in those cases to quash service on *Shaffer* grounds, and that issue was litigated in a series of decisions, which are cited on page 10 of my outline. The answer which developed from those cases is that, yes, it is permissible

to retroactively raise a *Shaffer* argument against the constitutionality of pre-*Shaffer* sequestration service. However, any defendant who does this has the burden of establishing that the entry of his general appearance, and his consent to the general jurisdiction of the court, was compelled by the sequestration, and not by some other circumstances.

Another problem which arose was whether *Shaffer* outlawed the use of the sequestration procedure altogether or whether it outlawed sequestration only in *Shaffer*-type cases. Delaware courts interpreted *Shaffer* as invalidating sequestration only on the facts of that case and appear to have held that sequestration retains viability in other circumstances. The question is, in what types of cases would it be viable? Quite frankly, my experience has been that sequestration has been used very little, if at all, in post-*Shaffer* corporate litigation because it is difficult to imagine a typical corporate case where "minimum contacts," as described by the Supreme Court, would likely be found to exist over nonresident directors.

However, there are some cases where conceivably sequestration might be useful, for example, in situations where the defendant has some minimum contacts with Delaware and is an officer but not a director of the corporation. In such a case our director's consent statute does not apply. Also there might arise situations where by its terms the general long-arm statute might not specifically apply.

Another problem raised by *Shaffer* and litigated in the Delaware courts is to what extent *in rem* actions, instituted under section 365 of the Delaware Code, still remain viable. As you may know, section 365 is our general *in rem* statute. It is utilized generally for *in rem* jurisdiction over propery claimed by nonresidents typically to establish ownership rights or to remove a cloud upon title.

But section 365 has also been used in corporate litigation as well. There is a case called *Arden-Mayfair, Inc. v. Louart Corp.*[8] cited in the outline which involved a suit under section 365 brought by a corporation for a declaratory judgment as to whether stock in a Delaware corporation would have cumulative voting rights. This action took the form of a typical *in rem* action to determine rights concerning property. It was not an action for a personal judgment against the named defendants.

Nonetheless, Vice Chancellor Brown held that that procedure was jurisdictionally impermissible under *Shaffer,* since the sole contacts of the defendants were ownership of stock in a Delaware corpora-

8. Arden-Mayfair, Inc. v. Louart Corp., 385 A.2d 3 (Del. Ch. 1978).

tion. These were held not sufficient, even though there was no effort being made in that case to obtain a personal judgment against the individual defendants.

Shortly thereafter there was a decision in *Bolger v. Northern Lumber*[9] where Vice Chancellor Brown's reasoning in *Arden-Mayfair* was applied, to dismiss a lawsuit brought both under sections 365 and 366 (section 366 was the sequestration statute) to cancel corporate stock which it was claimed had been illegally issued. That decision which invalidated the attempted jurisdiction under both statutes might be explained as an impermissible effort to obtain a personal judgment over the nonresident defendants to whom the stock had been issued. However, in that case, as well as *Arden-Mayfair,* no personal judgment was sought.

A pressing problem, I should say an immediate problem, which has been created by *Shaffer* and which is still in the courts of Delaware, is whether *Shaffer* itself invalidates the new Director's Consent Statute. There are several cases in which the constitutionality of the Director's Consent Statute has been placed in issue. The issue has been briefed in a couple of those cases, but has not yet been decided. Because some of those cases have been settled, I don't know whether at this point the constitutionality challenge is in fact sub judice before the chancery court. But the mere fact of those challenges has created some uncertainty regarding the statute's constitutionality.

The argument against the constitutionality of the statute, if I express it correctly, would be as follows: minimum contacts means, in fact, that there must be actual minimum contacts. You can't create minimum contacts where they don't otherwise exist by implying a fiction of "consent." If a director's only contact with Delaware is holding a directorship in a Delaware corporation, *Shaffer* held that that is not good enough and creating a statutory fiction won't improve the absence of jurisdictional facts.

As I understand the counter arguments, there are several. The first is that consent is, and always has been, regarded as in independent basis for asserting state court jurisdiction. There is no difference between having a director sign a piece of paper in which he actually consents in writing to service of process as the result of being a director, and his accepting a directorship in a Delaware corporation with knowledge that the consequences of accepting service would be inability to sue in Delaware.

Second, in terms of minimum contacts, the new statute, the Director's Consent Statute, was designed to meet the requirement of

9. Bolger v. Northern Lumber Co., C.A. 5328 (Del. Ch. 1978).

Shaffer that the cause of action be related to the status of the defendant as a director of the corporation. The statute applies only to causes of action involving claims that the director has not fulfilled his duties to the corporation.

Thirdly, the statute expresses Delaware's interest in defining and enforcing fiduciary obligations owed by directors to Delaware corporations, and fourthly, it creates the expectation on the part of the directors of a Delaware corporation of being sued in the state, all of which are requirements which the Supreme Court indicated were necessary to fulfill the minmium contacts requirements.

Finally, the Supreme Court left open in its *Shaffer* decision the possibility that jurisdiction over nonresident directors would be sustained in cases where there was no other forum available to the plaintiff in which all the directors could be served. I think a good argument could be made that Delaware does appear to be, at least in many cases where the directors of a corporation reside throughout the country, the only state forum where jurisdiction could be obtained over all of them in an action to enforce directors' fiduciary duties.

I don't know what the outcome of the controversy over the statute will be, except that it is clear that if the statute were to be invalidated, it would certainly throw into doubt whether state courts will even be able to fulfill their function—as decreed by the United States Supreme Court [10]—of enforcing the fiduciary duties owed by directors under state corporation law.

10. Curtis Publishing Co. v. Butts, 388 U.S. 130 (1967).

SHAREHOLDER MEETINGS, VOTING RIGHTS AND PROXY SOLICITATION

BY CHARLES S. CROMPTON, JR.*

MR. CROMPTON: I really want to emphasize some of the basic rules that are represented by what I would call a "bare bones" codification of some objective standards for meetings, notices, elections and voting rules. Professor Loss says he thinks that *ad hoc* judicial determination is preferable in most cases to codification, but he has produced a statute consisting of a thousand or so pages.

The Delaware statute,[1] insofar as it relates to this topic, is a very brief and very flexible statute with only a few minimums or guidelines, and which permits a corporation to tailor-make, in its own charter and bylaws, subject only to these guidelines, the rules it wants to follow in this regard.

That philosophy is subject to criticism by Ralph Nader and others who are pushing for some federal regulations which they say are needed to insure and improve a corporate shareholder democracy. They point to some admittedly telling statistics which show, I think, a rather low participation by shareholders in most questions presented to them. But I don't think that's because of any lack of a system, or a lack of rules designed to guarantee such participation. I think it is because shareholders mostly don't want to make those decisions. They want their businesses to be run by professional managers. They don't want to be consulted on every item of business or policy, but just to decide whether to buy a stock, or to hold, or to sell it, and to trust the business judgment of their professional managers for business decisions.

In any event, when there is some highly contested issues, or when there is a battle over control of management, or some great policy issue presented, I think there are clear and definitive standards under the state and federal partnership of regulations that has grown up to assure that the battle will be fair, that each side will get a shot at being held, and that the shareholders will have a fair opportunity to express themselves when they want to.

Again, this is not something you can prove by examples, because, at least until very recently, in the last twenty years there really hasn't been any sizeable number of proxy battles. The method most used

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1. DEL. CODE ANN. tit. 8, § 109(b) (1974).

to effect management changes recently has been more in the form of a merger or a tender offer than a proxy battle. Maybe we are going to see a shift back to the proxy contest with the Kennecott Copper battle that's been around for a year or so, and there are now threats to have a similar fight in the McGraw-Hill take-over attempt. Maybe we will see some new move back to proxy battles that really will determine whether we've got an adequate system to govern them and to insure that the shareholders get a fair opportunity to express themselves on at least basic questions such as management changes.

Let me talk about two or three of the basic policies that I think lie behind the scheme, or system, that the Delaware statute provides in this area. The first principle I would suggest is that it is recognized that shareholders can, and do, vote in their own self-interest. They may vote out of whim or caprice or they can vote for something that's particularly good for them, even knowing all the while that it's not going to be particularly good for the corporation overall.

That, of course, is subject to the fiduciary standards that apply if the shareholder is a controlling shareholder, but unlike a director who must vote in the best interests of the corporation and cannot vote in his own self-interest, a shareholder may. The statutory scheme and the cases that talk about shareholders are, I think, based on that basic principle of self-interest.

The other policy was underlined very forcefully by the Supreme Court recently in the *Chris-Craft*[2] case. That is that while the statute does prescribe certain rules, and they are objective rules—a ten day to sixty day notice period, for example—and while they are clear and not very complex, you still can't use those rules even if you fall exactly within them, for an improper or inequitable purpose.

Again, I think that points out the real strength of the Delaware system, that despite a statutory scheme and objective standard of conduct, we are still going to follow a common law system of *ad hoc* determination in a court of equity as to whether any transaction, even those falling within the exact letter of the statute, is fair.

The Supreme Court phrased in the *Chris-Craft* case what I think is a basic premise to this statutory scheme, and that is that an inequitable act does not become permissible merely because it is legally possible.[3] That, I think, is a parallel concept to the one the Court has recently emphasized again in the freeze-out merger case, *Singer v. Magnavox*.[4] The objection to that kind of equitable *ad hoc* principle

2. Schnell v. Chris-Craft Indus., Inc., 285 A.2d 437 (Del. 1971), *rev'g* 285 A.2d 430 (Del. Ch. 1971).

3. *Id.* at 439.

4. 380 A.2d 969 (Del. Ch. 1977).

is that it makes it more difficult, or even impossible, to predict what's going to happen in a specific situation and leaves everything subject to challenge as being unfair, which is sort of a difficult concept to define or to predict a result on.

But in my view, that's still preferable to trying to set down in a statute or regulation every possible concept or a comprehensive list of what's right and what's wrong. Leave it to that kind of judicial determination to meet each developing situation within a broad statutory framework of basic rules.

One other thing that's important with respect to this kind of policy which Delaware follows in this area is that we do provide a prompt and summary procedure in a court of expert ability to determine the rights of all parties in specific situations of corporate law. You are not going to be left for two or three years while a matter grinds through a crowded court. You can resolve those judicial questions promptly and with expertise based on a broad array of precedent.

Let me mention one basic right that is guaranteed by the statutory scheme and I guess it is the basic right of a shareholder—the right to have an annual meeting in which directors are going to be elected. There was a serious effort some years ago to have that statutory requirement abolished. Proponents of repeal cited with some force the circus atmosphere that pervaded a lot of meetings where professional gadflies or others just try to grab a headline and try to get their picture in the paper. But I think a public corporation and its management should be prepared at least once a year to face that kind of public scrutiny, and it does give some shareholder relief value to allow them to air legitimate problems or questions. The proposed repeal was defeated and the annual meetings requirement was retained.

The problem in a smaller corporation, of course, or in one in which there is a majority control in a parent, can be avoided by written consent in lieu of meeting when you have the votes.

Up until a few years ago there was some question about whether that written consent provision could be used entirely to replace the annual meeting requirement, but in *Everett v. Transnation*[5] and the other cases that permitted a director to be removed by written consent, those doubts were settled. There is a question still about whether you might have some due process or similar right to a hearing or notice of some kind before your directors could be removed by written consent, but I don't believe the *Everett* case leaves much hope for that argument.

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5. Everett v. Transnation Dev. Corp., 267 A.2d 627 (Del. Ch. 1970).

What happens if management neglects or consciously refuses to call a meeting? Suppose it knows it's going to lose the vote and wants to stay in office. There is a prompt and summary proceeding provided for a shareholder to compel the call of an annual meeting, and, if he can show that it's likely that management will not fairly conduct the meeting, the court will appoint a master to control it.

Sometimes, again, you yearn for the old days when those kinds of proxy battles and court-ordered meetings were more prevalent, and you hear some of the older lawyers talking about fighting all day about who puts what ballot where, and sitting up all night watching your ballots to make sure the other side doesn't grab your proxies.

There is one terrific reported case where the chancellor notes that after he appointed a master to hold a meeting, he couldn't hold a valid meeting because the president's faction started a riot and scared off enough shareholders so that a quorum couldn't be called. Somehow in the middle of the meeting the president assaulted the master. The chancellor didn't hold him in contempt, but I certainly hope he gave consideration to that when he set the fee for the master.

If the growing regulation of tender offers continues, maybe we'll develop some kind of a new proxy contest trend if the McGraw-Hill battle goes forward and if it gets too difficult to make tender offers. Maybe we will get back to the old proxy fight attempts to change control of management.

I am not going to talk about the necessary disclosures in a proxy and how Delaware is now enforcing full disclosure on a common law basis with about the same standards as the federal courts have developed under the federal securities laws. Don Pease is going to cover that I think in another paper.

I want to leave the subject, though, again with a defense of the Delaware policy of limiting the codification, limiting the black and white statutory rules, to those that are really the basic minimum, and letting adversaries litigate a dispute in an *ad hoc* situation in a forum that's available and expert to develop these principles on a case-by-case basis.

I think if we wanted to we could probably write a 500 page statute that would summarize the existing Delaware law, statutory and judicial, but then on the next day it would be outdated, and we would start again with just as many disputes over new developments as we have now. I perfer to leave the statute in which I would call a constitutional breadth framework and let individual cases decide individual questions.

Thank you.