

MEMORANDUM TO THE COMMISSION

9/2/54

Subject: Proposed Revision of Corporations Code §§ 3901 and 2201.

I received a telephone call today from Mr. David Samuels, an attorney in Palo Alto, in which he called my attention to a problem in the Corporations Code which might be of interest to the Commission.

Mr. Samuels reported that §3901 of the Corporations Code authorizes the directors to sell all or substantially all of the assets of a corporation with the consent of a majority of the shareholders. He says that this section does not mention any <sup>No</sup> meeting to be called for this purpose or <sup>No</sup> any notice to be given to minority shareholders of the proposed sale.

Mr. Samuels says that §2201 of the Corporations Code, on the other hand, which deals with annual meetings of stockholders provides that no action looking to the sale of all or substantially all of the assets of the corporation may be taken unless notice of this proposed action is given in the notice of meeting.

Mr. Samuels said he discussed this sometime ago with Professor Orschel who was then a member of the Stanford Law School faculty and that Professor Orschel expressed the opinion that notice was intended in a sale under §3901. He said that Professor Orschel subsequently discussed the matter with Professor Jennings of Boalt Hall, however, and that Jennings took the opposite view stating that the notion of notice to minority stockholders is old-fashioned and that the Legislature would have explicitly required notice had it been intended. Apparently, the latter view can be buttressed to some extent by reference to §4107 of the Corporations Code which expressly provides

that when a merger or consolidation is contemplated notice must be given to minority stockholders; this arguably makes the omission of a similar requirement in §3901 more significant.

Mr. Samuels says that he has no particular view about what the law ought to be with respect to this matter, but that he does think that the law should be clear. He says that the problem has arisen with some frequency in his practice.

John R. McDonough, Jr.  
Executive Secretary

Mr. David Samuels, an attorney in Palo Alto, reports that the Corporations Code is unclear with respect to whether a meeting must be called or notice given minority share-holders before the directors of a corporation can dispose of all of or substantially all of the assets of the corporation, pursuant to Section 3901 of the Corporations Code. Mr. Samuels suggests that clarification of the law on this matter may be an appropriate undertaking for the Commission.

Section 3901 of the Corporations Code provides:

A Corporation shall not sell, lease, convey, exchange, transfer, or otherwise dispose of all or substantially all of its property and assets except in accordance with one of the following subdivisions:

(a) Under Section 3900. [This authorizes the board of directors to hypothecate all or part of corporate property for the purpose of securing the payment or performance of any contract, note, bond, or obligation. Unless the articles otherwise provide, no vote or consent of share-holders is necessary.]

(b) Under authority of a resolution of its board of directors and with the approval of the principal terms of the transaction and the nature and amount of the consideration by vote or written consent of shareholders entitled to exercise a majority of the voting power of the corporation.

However, the articles, may require for such approval the vote or consent of a larger proportion of the shareholders or the separate vote of a majority or a larger proportion of any class or classes of shareholders.

Section 2201 of the Corporations Code provides:

At the annual meeting directors shall be elected, reports of the affairs of the corporation shall be considered, and any other business may be transacted which is within the powers of the shareholders, except that action shall not be taken on any of the following proposals unless written notice of the general nature of the business or proposal has been given as in case of a special meeting, even though notice of regular or annual meetings is otherwise dispensed with:

(a) A proposal to sell, lease, convey, exchange, transfer, or otherwise dispose of all or substantially all of the property or assets of the corporation except under Section 3900 . . . .

*See Section 3900  
regarding  
shareholders' vote*

It seems somewhat anomalous that notice to stockholders should be required under Section 2201 but not under Section 3901 when both deal with the same subject matter. One problem presented is whether a notice requirement is to be read into Section 3901 in light of Section 2201 and general considerations of fairness.

No cases have been found which discuss the question whether notice is required under Section 3901. In both Barber v. Lewis and Kaufman, 269 P.2d 929 (D.C.A. 1954) and Jeppi v. Brockman Holding Co., 206 P.2d 847 (Sup. Ct. 1949) <sup>sect. not applicable to winding assets corp. - i.e. 2 sell prop. - Prof. 125 CA 95 34 C2 11 149</sup> the opinions indicate that notice of the meeting was not given but the opinions do not discuss the matter. Ballantine and Sterling in California Corporation Laws (1949 Edition, p. 299) state that many state statutes similar to Section 3901 provide for notice in case of a disposition of the corporation's entire assets; they imply that notice is not required under Section 3901.

Mr. Samuels suggests that Section 4107 of the Corporations Code may be relevant to the question whether a requirement of notice is to be read into Section 3901. Section 4107 provides:

The agreement ~~to~~ <sup>to merge or consolidate</sup> shall be approved by the vote of the holders of not less than two-thirds of the issued and outstanding shares of each class; regardless of limitations or restrictions on the voting power thereof, of each of constituent corporations, at a meeting duly called upon notice of the time, place, and purpose thereof, duly given to each shareholder at least twenty days prior to the date of the meeting, except that notice of the time, place and purpose of any such meeting may be waived as provided in Section 22091. Unless the notice be waived, there shall be mailed with the notice of the meeting a statement of the general terms of the proposed agreement. Different series of the same class of shares shall not constitute different classes of shares for the purpose of voting by classes.

Mr. Samuels says that it might be argued that since in the analagous situation covered by Section 4107 notice is explicitly required, its omission in Section 3901 is significant under the rule inclusio unius est exclusio alterius. On the other hand, ~~might~~ it not be argued that a merger is a kind of transfer of all of the assets of a corporation and that the express requirement of notice

therein, as well as in Section 2201, indicates that such a requirement should be read into Section 3901?

The purpose of such statutory provision as contained in Section 3901 is to make possible the sale of a corporation's entire assets without unanimous consent while affording the shareholders a chance to have a vote on a transfer which may terminate the business. Such provisions are liberally construed; short of fraud, the sale is valid whether or not a majority of the shareholders have approved. Barber v. Lewis and Kaufman, supra; Jeppi v. Brockman Holding Co., supra.

A notice provision would not preclude sale over the minority shareholders' protests but it would give them an opportunity to present arguments against the contemplated action and to resort to the courts for protection in the event of fraud. This safeguard may not be of sufficient practical importance, however, to outweigh the inconvenience to the corporation in giving notice.

Mr. Samuel's point that the law of California on this matter is not clear seems to be well taken. What form clarification of the law should take is less clear.

Robert Harmon