

Date of Meeting: July 18-19, 1958

Date of Memo: July 9, 1958

Memorandum No. 2

Subject: Study No. 11 - Sale of Corporate Assets.

Attached is a draft of the Commission's recommendation to the Legislature and its proposed legislation on this subject, for consideration at the July meeting.

The proposed amendment of Section 2201 and the first proposed amendment of Section 3901 are designed to codify the Jeppi decision, that consent of shareholders is not necessary when a sale of corporate assets is made in the ordinary course of the particular corporation's business. A study of the statutes of other states which have legislated on this subject shows that the phraseology typically used for this purpose is "usual and regular course of business." A related amendment of Section 3904 is also proposed.

The Commission has not yet approved the other proposed amendment of Section 3901, stating that notice to shareholders is not necessary when a sale of corporate assets is made with the written consent of shareholders. The purpose of this amendment would be simply to codify the existing law as set forth in the Staff report, thus eliminating the alleged ambiguity which prompted the suggestion which led to this study. At the June meeting the question was raised whether such an amendment of Section 3901 might give rise

to the inference that such notice is necessary in the case of various other sections of the code which are similar to Section 3901 in that they both authorize action to be taken by written consent of shareholders and do not specify whether or not notice of the contemplated sale must be given to all of the shareholders. The thought was expressed that this problem might be particularly acute in the case of the several kinds of corporate action covered by Section 2201 which requires that special notice be given if approval of such action is to be voted upon at a stockholders' meeting. The staff was asked to provide some additional information relating to this matter; what we have found may be summarized as follows:

1. Cases falling under Section 2201. There are five types of corporate action which may be approved by either vote or written consent of a specified proportion of shareholders and of which special notice must be given under Section 2201 if the matter is to be voted on at a shareholders' meeting.* In the case of three of these written notice must be given to all shareholders if the action is approved by written consent of shareholders:

a. A proposal to amend the articles of incorporation.

Section 3637 requires that when written consent of shareholders is solicited the corporation shall mail notice of the proposed amendment to each shareholder of record but that failure to do so does not invalidate the amendment.

b. A proposal to wind up and dissolve the corporation.

Section 4605 requires written notice to be sent to all

*A proposal to merge or consolidate with another corporation, covered by Section 2201, can only be approved by a vote of two-thirds of the shareholders.

shareholders when a voluntary proceeding for dissolution is commenced.

- c. A proposal to adopt a plan of distribution of shares, securities, or any consideration other than money in the process of winding up. Section 5006 provides that notice of such a plan must be sent to all shareholders having a liquidation preference within twenty days after adoption of the plan.

In the case of the other two the Corporations Code is silent as to whether notice must be given to all shareholders if the action is approved by written consent of shareholders:

- d. A proposal to sell, etc. all or substantially all of the property or assets of the corporation except under Section 3900.
- e. A proposal to reduce the stated capital of the corporation. However, Section 1910 provides that when the corporation applies any surplus created by reduction of stated capital to the reduction of any deficit arising from losses in the value of corporate assets the corporation shall include a statement concerning such action in its annual report.

2. Cases not falling under Section 2201. Below are listed five types of corporate action which can be taken only with the consent of a stated proportion of shareholders, given either by vote or written consent, but

which are not listed in Section 2201 and hence presumably can be acted upon at a shareholders' meeting even though special notice thereof is not given to the shareholders prior to the meeting. In the case of all of these the Corporations Code is silent as to whether notice must be given to all shareholders when the action authorized is taken with the written consent of the specified proportion of shareholders:

- a. Section 122 provides that the vote or written consent of a majority of shareholders is required to approve an election to continue existence under the Corporations Code of a corporation existing on January 1873.
- b. Section 500 provides that the vote or written consent of a majority of shareholders is required to adopt, amend or repeal by-laws.
- c. Section 819 provides that the vote or written consent of a majority of shareholders is required to remove a provisional director.
- d. Section 823 provides that the vote or written consent of two-thirds of the shareholders is required to authorize the corporation to make a loan of money or property to or guarantee the obligation of any director or officer of the corporation or any person.
- e. Section 1108 provides that the vote or written consent of two-thirds of the shareholders is required to issue or sell stock subject to preemptive rights without first offering it to shareholders entitled to preemptive rights.

Respectfully submitted,

John R. McDonough, Jr.
Executive Secretary

RECOMMENDATION OF CALIFORNIA LAW REVISION
COMMISSION

Relating to Notice to Stockholders of Sale of
All or Substantially All Corporate Assets

Section 3901 of the California Corporations Code permits the board of directors of a corporation to sell, lease, convey, exchange, transfer or otherwise dispose of all or substantially all of the corporation's property and assets "with the approval of the principal terms of the transactions and the nature and amount of the consideration by the vote or written consent of shareholders entitled to exercise a majority of the voting power of the corporation." Section 2201 of the Corporations Code provides that when such a transaction is to be voted upon at a shareholders' meeting all shareholders must be given written notice thereof even though routine notice of meetings has been dispensed with. The Corporations Code contains no express provision, however, as to whether all shareholders must be notified when a sale of all or substantially all of the corporate assets is made with the written consent of a majority of the voting shares.

The Law Revision Commission was authorized by the 1955 Session of the Legislature to make a study to determine (1) whether a requirement that all shareholders must be given notice before such a transaction is approved by written consent might be implied from the provisions of the Corporations Code or has been established by court decision and (2) if not, whether there is adequate reason for having a requirement that notice be given to all of the shareholders when a sale of corporate assets is approved at a shareholders' meeting but not when it is approved by written consent of the requisite number of shareholders.

As the Commission's staff study, infra, shows, it is clear from the legislative history of Section 3901 that notice need not be given to all shareholders when a sale of corporate assets is approved by written consent of a majority. A provision requiring such notice to be given was enacted in 1931 but was repealed in 1933. The Commission believes that the present law is sound. The self-interest of the majority shareholders and their fiduciary duty to the minority provide reasonably adequate protection for the interests of the latter. Moreover, a requirement of giving formal notice to all shareholders might, because of the delay or publicity involved, seriously handicap a corporation in effectuating such a transaction. Yet in many cases a sale of all or substantially all of its assets may be the only way either to save a corporation from disaster or to realize upon its assets for the greatest benefit of all of its shareholders. The Commission recommends, therefore, that no substantive change be made in this respect in the Corporations Code.

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[However, to avoid any future ambiguity on the matter, the Commission recommends that Section 3901 be amended to state that notice to all of the shareholders is not necessary when corporate assets are sold with the written consent of those shareholders having a majority of the voting power.]

On the other hand, the Commission does not believe that the present requirement of Section 2201 that all shareholders be notified when a sale of corporate assets is to be voted upon at a shareholders' meeting should be repealed. The reason is that insofar as the law of this State is concerned shareholders' proxies may be solicited without informing the shareholder of the matters to be voted upon at the meeting. Thus, a majority vote approving such a transaction might be cast at a share-

holders' meeting even though the holders of some of the shares voted in favor of the proposal had not actually known about or approved the proposed transaction. Section 2201 is a desirable safeguard against this contingency.

While the Commission recommends that no substantive change be made in the law of this State relating to notice to shareholders of the sale of all or substantially all of the assets of a corporation, one matter warranting legislative action has come to its attention in the course of making this study. As the staff study, infra, shows, a recent California decision adopted the widely-accepted view that common law and statutory rules prohibiting or regulating the sale of all or substantially all of a corporation's assets are not applicable to a corporation the very purpose of which is to sell such assets -- e.g., a corporation organized to buy and sell real property. In the case of such a corporation a sale of all or substantially all of the corporate assets is a sale in the ordinary course of business and hence within the discretion of management. Yet neither Section 2201 nor Section 3901 of the Corporations Code provides expressly for this situation. It is recommended, therefore, that both sections be amended to except from their provisions a sale of all or substantially all of a corporation's assets made in the usual and regular course of business. [If this is done it will be necessary or at least desirable to amend Section 3904 to provide that the certificate of the secretary or assistant secretary of the corporation that a sale of corporate assets is made in the usual and regular course of business shall be prima facie evidence of that fact and conclusive evidence thereof in favor of any innocent purchaser or encum-

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The Commission's recommendation would be effectuated by the enactment of the following measure:

An act to amend Sections 2201 and 3901 of the Corporations Code, relating to the sale of all or substantially all of the property and assets of a corporation.

The people of the State of California do enact as follows:

SECTION 1. Section 2201 of the Corporations Code is amended to read:

2201. 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 in the usual and regular course of its business or under Section 3900.

(b) A proposal to merge or consolidate with another corporation,

domestic or foreign.

(c) A proposal to reduce the stated capital of the corporation.

(d) A proposal to amend the articles, except to extend the term of the corporate existence.

(e) A proposal to wind up and dissolve the corporation.

(f) A proposal to adopt a plan of distribution of shares, securities, or any consideration other than money in the process of winding up.

SEC. 2. Section 3901 of the Corporations Code is amended to read:

3901. 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.

(b) In the usual and regular course of its business.

(c) Under authority of a resolution of its board of directors and

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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. When action is proposed to be taken with the written consent of shareholders it is not necessary to give all of the shareholders notice thereof.

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.

SEC. 3. Section 3904 of the Corporations Code is amended to read:

3904. Any deed or instrument conveying or otherwise transferring

any assets of a corporation may have annexed to it the certificate of the secretary or an assistant secretary of the corporation, setting forth the resolution of the board of directors and (a) stating that the property described in said deed, instrument or conveyance is less than substantially all of the assets of the corporation, if such be the case, or (b) stating that the conveyance or transfer is made in the usual and regular course of business, if such be the case, or (c) if such property constitutes all or substantially all of the assets of the corporation and the conveyance or transfer is not made in the usual and regular course of business, stating the fact of approval thereof by the vote or written consent of the shareholders pursuant to this article. Such certificate is prima facie evidence of the existence of the facts authorizing such conveyance or other transfer of the assets and conclusive evidence in favor of any innocent purchaser or encumbrancer for value.