

Date of Meeting: September 5-6, 1958  
Date of Memo: September 2, 1958

Memorandum No. 9

Subject: Study No. 11 - Sale of Corporate Assets

At the July meeting the Commission instructed the staff to obtain the views of Professors Jennings (California) and Scott (Stanford) and Mr. Graham Sterling on this matter. A copy of my letter to Professor Jennings and a copy of his reply to me are enclosed. I sent an identical letter to Mr. Sterling and a copy of his reply is also enclosed. I had planned to discuss the matter orally with Professor Scott this week but find that he is on vacation so we do not have the benefit of his views.

Drawing upon the information obtained from Professor Jennings and Mr. Sterling we have rewritten pages 8 et seq of the staff study and have drafted a new proposed Recommendation of the Commission for consideration at the September meeting. A copy of each is enclosed.

The policy questions for determination at the September meeting are:

- 1.. Shall the Commission recommend the enactment of a requirement that notice be given to all shareholders when a sale of corporate assets is to be approved by written consent?

The draft Recommendation answers this question in the negative. Neither Professor Jennings nor Mr. Sterling would favor this and the Commission has not heretofore been inclined to favor it. (Mr. Sterling believes that if anything along this line were done a statute of general application would be preferable to one limited to sales of corporate assets.)

2. If the answer to the first question is in the negative should Section 3901 of the Corporations Code be revised to codify this view (and the present law)? The draft Recommendation answers this question in the affirmative. Professor Jennings did not express an opinion on this directly but presumably would not favor it since he did not recommend it. Mr. Sterling disfavors it.

3. Shall the Commission recommend that a person soliciting a proxy to approve a sale of corporate assets by vote or written consent be required to so inform the shareholder from whom the proxy is solicited? Professor Jennings proposed this and submitted a draft statute. Mr. Sterling expressed doubt, being concerned that the statute proposed by Professor Jennings would be interpreted as requiring that all stockholders be given notice whenever action is to be taken by written consent. The draft Recommendation includes a proposal that a statute along the lines of that proposed by Professor Jennings (but somewhat different in detail) be enacted. I assume that Mr. Sterling would think that if such a provision

were to be enacted at all it should be made one of general application (i.e., made applicable to all cases in which a proxy is to be used to give written consent to corporate action requiring such consent) rather than being limited to situations involving a sale of all or substantially all of the corporate assets.

4. Shall the Jeppi decision be codified? The draft Recommendation answers this question in the affirmative.

Professor Jennings sees no objection to this; Mr. Sterling did not comment on it.

5. If the answer to the last question is in the affirmative, shall Section 3904 of the Corporations Code be amended to provide for a certification to this effect to protect bona fide purchasers of corporate assets? The draft Recommendation answers this question in the affirmative.

Respectfully submitted,

John R. McDonough, Jr.  
Executive Secretary

July 22, 1958

Professor Richard W. Jennings  
School of Law  
University of California  
Berkeley, California

Dear Dick:

The California Law Revision Commission has asked me to write you concerning one of the studies on its agenda. The Commission believes that you are probably familiar with the factual and legislative background of this problem and that, in any event, your views on the policy questions presented would be most helpful to the Commission in formulating a sound recommendation to the Legislature.

Some time ago the Law Revision Commission was authorized to make a study to determine whether Sections 2201 and 3901 of the Corporations Code should be made uniform with respect to notice to stockholders relating to the sale of all or substantially all of the assets of a corporation. I enclose a copy of a staff study on the subject which was recently completed. The study reports that it is clear from the legislative history of Section 3901 that notice to stockholders is not necessary when approval of a sale of corporate assets is obtained by written consent of those having a majority of the voting power. The study then analyzes some of the policy questions presented and suggests various alternatives for consideration by the Commission.

At its June, 1958 meeting the Law Revision Commission determined to recommend no change with respect to Section 2201 other than to incorporate therein the substance of the rule of Jeppi v. Brockman Holding Company, that Section 3901 does not apply to a sale of all or substantially all of a corporation's assets which is made in the usual and regular course of its business. The Commission also determined to recommend that the Jeppi limitation be written into Section 3901 and that a related amendment be made to Section 3904. The Commission decided to recommend that Section 3901 not be amended to require that notice be given to all stockholders when a sale of corporate assets is to be approved by the written consent of a majority. The retention of a notice requirement in Section 2201 as respects approval

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by vote while not writing it into Section 3901 as respects approval by written consent was thought to be justified because of the practice of voting by proxy at shareholders' meetings; since one is not required under California law to disclose upon what issues or how a proxy will be voted, a sale of corporate assets could be approved at a stockholders' meeting even though the holders of a substantial proportion of the shares voted in favor of the proposal by proxies were not aware that such action would be taken up at the meeting.

At the June meeting the Commission also considered whether Section 3901 should be amended to state explicitly what the research study had shown the law to be -- i.e., that notice need not be given to all stockholders when approval of a sale of corporate assets is to be obtained by written consent of a majority. It was feared by some members of the Commission that if Section 3901 were thus amended it might raise an inference that such notice is required in the case of other sections of the Code which authorize corporate action to be taken with the written consent of a stated proportion of the voting shares and which are, as Section 3901 presently is, silent as to whether notice need be given to all shareholders when such action is contemplated. No decision was reached on this question at the June meeting.

In preparation for the July meeting of the Commission which was held last week, the staff prepared a draft recommendation to the Legislature on this subject which included a draft of proposed legislative changes. A covering memorandum presented information relating to various sections in the Corporations Code which authorize action to be taken with the approval of a stated proportion of shareholders, manifested by vote or written consent. A copy of each of these documents is enclosed. As you will see, the draft recommendation contained some statements and proposed legislation which had not yet been approved by the Commission.

At the July meeting the Commission reaffirmed its determination to codify the Jeppi decision in Sections 2201 and 3901 and to amend Section 3904 concomitantly. In the course of rediscussing the June decisions with respect to notice to shareholders of a sale of corporate assets, however, one of the members of the Commission called attention to Section 2217 of the Corporations Code which provides that the holder of a proxy may give

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written consent to transactions requiring the consent of shareholders. This would appear to invalidate the distinction which the Commission had thought existed and justified the disparity between Section 2201 and Section 3901. In addition, the Commission found itself in doubt as to whether Section 3901 should be amended to state expressly that notice to all stockholders is not required when a sale of assets is approved by written consent, assuming that no substantive change is made therein.

At this point in the discussion it was suggested that I write you and ask whether you might be able to give some thought to and let the Commission have the benefit of your views on the following questions:

1. Should Section 2201 be revised to eliminate the special notice provision in respect of a sale of corporate assets?
2. Conversely, should Section 3901 be revised to require that notice be given to all stockholders when a transaction is to be approved by the written consent of a majority?
3. If the answers to both questions 1 and 2 are in the negative, how may the difference be justified?
4. If it is determined to leave Section 3901 unchanged substantively should it be amended to state explicitly that notice to all stockholders is not required when a sale of corporate assets is approved by written consent of a majority? Is it likely that a court would infer from such an amendment that notice to all stockholders is required in the case of other provisions of the code authorizing action to be taken with the written consent of a stated proportion of the voting stock and which are silent as to whether such notice need be given?
5. If it should be deemed desirable to amend Section 3901 to make it clear that notice to all stockholders is not required when action is taken with written consent, would it follow that the same would be true in all other cases in which corporate action must be approved by a stated proportion of stockholders? If so, would it be desirable to enact a general provision to this effect rather than amending Section 3901?

Professor Richard W. Jennings

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While this is a rather discursive letter, I hope that it will be more meaningful than I suspect it is at this point when you have had opportunity to go over the enclosed material. We would like to consider this matter further at the September meeting of the Commission which is now scheduled for September 5 and 6, and would appreciate it very much if you could let us have your views on the questions we have posed by around the 20th of August so that I can get them out to the Commissioners in advance of the meeting.

If you have any questions, please call me.

Sincerely yours,

John R. McDonough, Jr.  
Executive Secretary

JRM:imh  
Enclosures

UNIVERSITY OF CALIFORNIA

School of Law  
Berkeley 4, California

August 18, 1958

John R. McDonough, Jr. Esq.,  
Executive Secretary  
School of Law  
Stanford, California.

Dear John:

I have your letter of July 22 in which you ask me to comment upon Law Revision Commission studies to determine whether amendments should be made to Cal. Corp. Code §§ 2201 and 3901. I appreciate the opportunity which you and the Commission have given to me to express my views on this subject.

I have no special knowledge of the factual and legislative background on the problem. The Commission study seems accurately to set forth the background of the existing legislation. I should like, however, to make some general comments upon these sections.

The pertinent parts of Section 2201 concern the notice of the annual meeting. It specifies, among other things, that action shall not be taken at an annual meeting on a proposal to sell all assets, except under Section 3900, unless written notice of the general nature of the proposal has been given as in the case of a special meeting. In the absence of this provision, it would be possible for the management to solicit proxies (not consents) for use at an annual meeting and comply with Section 3901 without the shareholder whose proxy was solicited having had advance notice of the principal terms of the transaction. All Section 3901 requires is that the principal terms be approved by vote or written consents of shareholders. The approval by vote could be accomplished at a meeting by the management voting the proxies.

Furthermore, shareholders should have specific notice of extraordinary matters to determine whether or not to attend the meeting, irrespective of proxy solicitation. Thus, the notice requirement should be retained in Section 2201.

If action under Section 3901 is to be taken by written consent of shareholders, without a meeting, the consent would have to be given to the principal terms of the transaction and the nature and amount of the consideration. Accordingly, in the usual case, consenting shareholders will have had full information at the time of executing the consent.



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A possible loophole exists, however, by virtue of Section 2217, which authorizes the giving of a proxy with authority in the proxyholder to execute written consents. In theory, at least, the corporation or management could solicit proxies giving power to execute written consents to sell the assets, without advance notice of the terms of the transaction. Furthermore, where action is to be taken at an annual or special meeting, the solicitation of proxies may be made before or after notice of the meeting, so that the proxy solicitation material, as well as notice of the meeting, should describe the terms of the sale. To close this avenue, I would propose that a new section be added and numbered section 3901.1 with language substantially ;in the following form:

3901.1 If proxies are solicited by the corporation or by or on behalf of its management, authorizing the holder thereof to give approval by vote or written consent to any such transfer or disposition, the corporation shall mail to each shareholder from whom proxies or consents are solicited at his address appearing on the books of the corporation, or given by him to the corporation for the purpose of notice, or if no such address appears or is given, at the place where the principal office of the corporation is located, a statement of the principal terms of the transaction and the nature and amount of the consideration. However, failure to give such notice or the giving of a defective notice does not invalidate the transfer or disposition.

This proposed change would preserve the present substance of Sections 2201 and 3901. It would give adequate notice to all shareholders if action is to be taken at an annual or special meeting or to the extent that proxies or consents are solicited. If a majority acts by written consent, there is still no necessity to notify shareholders who have not been solicited. Such notice could easily be provided for, however, by broadening the notice provision in the new section 3901.1. I do not suggest this in view of the statutory history and the position taken by the Commission. Furthermore, my proposed solution would eliminate any inference that notice of the transaction must be given to nonconsenting shareholders if such were ever justified. I have tried to demonstrate that even now there is no conflict between the notice provision in Section 2201 and the failure to require notice to nonconsenting shareholders in Section 3901.

I note that the Commission has also reaffirmed its determination to codify the Jeppi decision in Sections 2201 and 3901 and to amend Section 3904 concomitantly. I see no objection to this proposal.

In the past Messrs. Graham L. Sterling, Jr., of Los Angeles and Stacy H. Aspey, Counsel for the Secretary of State, have followed

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closely technical changes in the Corporations Code, and we have regularly exchanged views on technical amendments to the Code. I am therefore taking the liberty of sending a copy of your letter to them, together with my response. It is possible that you have already contacted Messrs. Sterling and Aspey, but I should like to have them double-check my proposal for possible "bugs", and they may wish to offer further or alternative suggestions, which I assume would be permissible and proper.

I shall be away from Berkeley from August 21 to September 2. If you have any further questions concerning this matter, please let me know.

Kindest regards.

Very truly yours,

/s/ Richard W. Jennings

Richard W. Jennings

RWJ:jlh

cc Graham Sterling, Esq.  
433 South Spring Street  
Los Angeles 13, California

cc Stacy H. Aspey, Esq.,  
Senior Counsel and Deputy,  
Office of the Secretary of State,  
Sacramento 14, California

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O'Melveny & Myers  
433 South Spring Street  
Los Angeles 13

Refer to S-1737-10

August 29th, 1958

John R. McDonough, Jr., Esq.,  
Executive Secretary,  
California Law Revision Commission,  
School of Law,  
Stanford, California.

Dear John:

I was on vacation the last two weeks of July when your letter of July 22 arrived concerning Sections 2201 and 3901 of the Corporations Code. It seems hard to believe, but a combination of unusually heavy office work, State Bar work and ABA activities prevented my getting around to answering your letter until just now. Meantime Dick Jennings has sent me a copy of his letter of August 18 to you on the same subject:

Answering specifically the questions in your letter of July 22:

1. No.
2. I don't think such an amendment to Section 3901 is necessary, but see discussion below.
3. I think Dick Jennings has answered this question satisfactorily. Furthermore, in view of the requirements of Section 3901, no careful lawyer would fail to advise stockholders of the principal terms of the proposed sale, etc., even though Section 2201 in the case of an annual meeting and Section 2207 in the case of a special meeting might appear to be literally complied with by a notice stating merely that one of the purposes of the meeting is to act upon a proposal to dispose of all or substantially all of the properties of the corporation.
4. I would answer the first question under this number in the negative. As to the second question under this number, anyone's guess is as good as mine but I would be afraid that a court might draw such an inference.

5. I would answer the first question under this number in the affirmative and also the second question under this number.

In practice I have often considered the question as to whether notice of any corporate action which is to be taken by written consent of the majority should be given to all stockholders. I agree with your report that the policy behind the present law which does not require notice in such instances is that notice to all serves no useful purpose when the action is to be taken upon the written consent of the majority. In the case of a closely held corporation with few stockholders, it seems to me there is perhaps more justification for this policy than in the case of a corporation a majority of whose shares is held by a few stockholders and the balance of whose shares is widely held. I suppose the principal justification for the policy is that although there is a strong principle of corporation law in favor of discussion of corporate action at a directors' meeting, there is no such principle (at least so far as I know) in favor of discussion of corporate action at a stockholders' meeting, and since by hypothesis at least under our statute the majority stock has the power to approve the action, there is no reason for notice in advance to the minority stockholders. Furthermore, financing time schedules may be facilitated by the absence of a notice requirement where it is feasible quickly to obtain the written consent of a majority.

I don't think the loophole which Dick Jennings points out is serious. It is difficult for me to imagine that stockholders would give a "blind" proxy to management to approve important corporate changes by written consent. Furthermore, I would not approve corporate action taken in reliance on written consents executed pursuant to any such blind proxies. However, what disturbs me most about Dick's suggested addition of a new Section 3901.1 is that it would not be generally understood and would probably have the effect of a requirement of notice to all stockholders whenever action is to be taken by written consent.

In summary, I am satisfied with the statute as it is on these points. If, however, a change in policy is thought desirable, I would prefer a general provision to the effect that notice to all stockholders is required when action is to be taken by written consent, but I think any such general provision should call for a relatively short notice, say at least five days, and should state

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that failure to give the notice or the giving of a defective notice would not invalidate the transaction.

Incidentally, my compliments on the staff's study which seems to me to be an excellent job.

Sincerely yours,

Graham L. Sterling, Jr.

GLS: zp

CC: Professor Jennings  
Mr. Aspey

RECOMMENDATION OF CALIFORNIA LAW REVISION  
COMMISSION

Relating to Notice to Shareholders of  
Sale of 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 transaction 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 requirement that such notice be given to shareholders when a sale of 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 a sale of corporate assets 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 the 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 shareholders generally when a sale of corporate assets is approved by the written consent of a majority. A provision requiring such notice was enacted in 1931 but was repealed in 1933. Professor Henry W. Ballantine who worked with the State Bar Committee which proposed the 1933 amendment states that the requirement raised a question as to the validity of the sale if the prescribed notices were not given and that the requirement did not seem to be necessary.

The Commission believes that a requirement that notice be given to all shareholders before all or substantially all of a corporation's assets are sold or otherwise disposed of with the written consent of the majority shareholders should not be enacted. The self-interest of the majority and their fiduciary duty to the minority provide reasonably adequate protection for the interests of the latter. Moreover, a requirement that all shareholders be given formal notice might in some cases seriously handicap a corporation in effecting such a transaction because of the delay or publicity involved. Yet 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 change be made in this respect in the Corporations Code.

One matter warranting legislative action has come to the attention of the Commission 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 should not be applied 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 Section 3904 should be amended 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 encumbrancer for value.



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

An act to amend Sections 2201, 3901 and 3904 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 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.

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.