

*Memo as req. of
Commission*

Date of Meeting: March 13-14, 1959
Date of Memo: March 4, 1959

Memorandum No. 4

SUBJECT: Study #11 - Corporations Code

Attached is a memorandum prepared by Mr. Stephens relating to the Commission's proposal (A. B. 403) to codify the decision of the Jeppi case, that Section 3901 of the California Corporations Code does not require the consent of shareholders to a sale of all or substantially all of the assets of a corporation when the sale is made in the usual and regular course of the corporation's business.

In a covering memorandum to me Mr. Stephens states that the memorandum attached is "based on a research of the cases cited in the staff study, a review of the statutes of all other states, Shepardization of the Jeppi case, a review of texts cited in the staff study and a search through the American Digest System back to 1906."

It is recommended that this memorandum be used as the basis for further negotiations with the State Bar Committee on Corporations and that the Commission decide at the March meeting to adhere to its recommendation on this subject even if this should mean active opposition from the State Bar before the legislative committees.

Respectfully submitted,

John R. McDonough, Jr.
Executive Secretary

MEMORANDUM

Section 3901 of the California Corporations Code provides, generally, that a corporation may not sell or otherwise dispose of all or substantially all of its property except under authority of a resolution of its board of directors and with the approval by vote or written consent of shareholders entitled to exercise a majority of the voting power of the corporation. The California Law Revision Commission has recommended that this section be amended so as to make it inapplicable to sales by a corporation "where made in the usual and regular course of its business." This recommendation is based upon the following considerations:

1. It is now the law in California. This was decided by the California Supreme Court in Jeppi v. Brockman Holding Company¹ which involved the question whether failure to obtain the consent of the majority of stockholders to a contract to sell substantially all of the corporation's property invalidated the contract of sale. The court held that Section 3901 was not applicable and that the transaction was not ultra vires because the sale was one made in the furtherance of the business for which the corporation was organized. The court stated:

The provisions of the statute should not be applied solely upon the basis of the quantity of the property; the test which determines the question of the necessity for consent of the stockholders is, "whether the sale is in the regular course of the business of the corporation and in furtherance of the express objects of its existence, or something outside the normal and regular course of the business..."²

2. It is in conformity with the common law. At common law a solvent corporation could not sell all or substantially all of its

assets without the unanimous consent of the stockholders, since this was considered to be a step towards dissolution.³ This doctrine evolved on the theory that there is an implied contract among the stockholders of the corporation that it will continue to exist and to carry out the business purposes as set forth in the corporate charter.⁴ The courts created an exception to this rule, however, where the very purpose of the corporation was to sell such assets--e.g., a corporation created to buy and sell land.⁵ A distinction was taken between a sale of corporate assets which was made in the usual and regular course of the corporate business and one which was not. In the case of the former, consent of the stockholders was not required.⁶ In California and in most other states, statutes such as Corporations Code Section 3901 have been enacted for the purpose of relaxing the strict common law rule requiring unanimous stockholder consent to a sale of all or substantially all of the assets of a solvent corporation.⁷ It is reasonable to conclude, in conformity with the Jeppi case, that the Legislature did not intend by this statute to add restrictive requirements in situations where they did not exist at common law in the first place.

3. It is in general conformity with the express statutory provisions of nine other states. Six of these, Illinois,⁸ North Carolina,⁹ Oklahoma,¹⁰ Pennsylvania,¹¹ Wisconsin,¹² and Virginia¹³ expressly state that no consent is needed for such sales; the other three jurisdictions, Missouri,¹⁴ Maine,¹⁵ and Ohio,¹⁶ accomplish the same result by providing that the specified consent is required for sales "other than in the usual course of business."

4. It is consistent with the judicial construction of statutes similar to Corporations Code Section 3901 in other states. So far as we have been able to determine, in states having statutes analogous in this respect to California's, such statutes have been construed as not applying to sales in the usual course of business.¹⁷ We have found no contrary authority.

5. It is a reasonable exception to the general rule. In a vast majority of cases the sale of all or substantially all the assets of a corporation represents so drastic a change in the operations of the corporation that it is reasonable to require the consent of the shareholders. However, in the relatively unusual situation where the very purpose of the corporation is to sell such property, the need for such consent disappears and such matters fall properly within the discretion of management; a requirement that a majority of shareholders must consent to such sales would be anomalous.

If the basic desirability of such an exception is granted it is difficult to follow any objection based on the ground that it might "lead to abuses." Neither cases nor writers reveal evidence of such "abuses" in states which now have statutes expressly providing for this exception. Nor, as a general matter, do we feel that the Legislature should refrain from enacting reasonable exceptions to the rules it has promulgated for fear that unscrupulous persons might improperly try to come within such exceptions. It is the very purpose of our courts to prevent this from occurring. So long as the language used is capable of reasonable interpretation, we must rest our confidence in their competence and intelligence; we cannot assume that they would permit the torturing of such language beyond its reasonable meaning.

Footnotes

1. 34 Cal.2d 11, 206 P.2d 847 (1949); see also *Keck Enterprises v. Braunschweizer*, 108 F.Supp. 925 (1952).
2. *Id.* at 16, 206 P.2d at 850.
3. Ballantine, Corporations § 281 (rev. ed. 1946); 4 Thompson, Corporations § 2501 (3d ed. 1927); 3 Cook, Corporations § 670 (8th ed. 1923).
4. *Lake Ontario Bank v. Onondaga Bank*, 7 Hun (N.Y.) 549 (1876); *Town v. Bank of River Raisin*, 2 Doug. (Mich.) 530, 546 (1847); *Revere v. Boston Copper Co.*, 15 Pick. (Mass.) 351 (1834); Ballantine, Corporations § 281 (rev. ed. 1946); 3 Cook, Corporations § 669 (8th ed.) (1923).
5. *Hendren v. Neeper*, 279 Mo. 125, 213 S.W. 839, 5 A.L.R. 927 (1919).
6. See *Miners' Ditch Co. v. Zellerbach*, 37 Cal. 543, 592 (1869) (dictum); see also Ballantine, Corporations § 42 (rev. ed. 1946); 2 Fletcher, *Cyclopedia Corporations* § 518 (perm. ed. 1950); Annot., Corporations - Sale of Property, 5 A.L.R. 930 (1920)
7. Ballantine, Corporations 668 (rev. ed. 1946).
8. Ill. Ann. Stat. ch. 32, § 157.71. (1954).
9. N.C. Gen. Stat. § 55-26 (1950).
10. Okla. Stat. tit. 18, § 31.163 (1951).
11. Pa. Stat. Ann. tit. 15, § 2852-311 (1958).
12. Wis. Stat. § 180.70 (1957).
13. Va. Code Ann. § 13.1, 77 (1950).
14. Mo. Rev. Stat. § 351.400 (1949).
15. Me. Rev. Stat. ch. 53, § 84 (1954).

16. Ohio Rev. Code Ann. § 1701.76 (Supp. 1958).
17. Thayer v. Valley Bank, 35 Ariz. 238, 276 Pac. 526 (1929); In re. Miglieta, 287 N.Y. 246, 39 N.E.2d 224, rehearing denied, 288 N.Y. 661, 42 N.E.2d 749 (1942); Greenpoint Coal Docks v. Newton Creek Realty Corp., 5 Misc.2d 812, 912 N.Y.S.2d 466 (1949); Continental Bank & Trust Co. of N.Y. v. W.A.R. Realty Corp., 270 App. Div. 577, 61 N.Y.S.2d 273, affirmed, 295 N.Y. 877, 67 N.E.2d 517 (1946); Painter v. Brainard - Cedar Realty Corp., 29 Ohio App. 123, 163 N.E. 57 (1928); Fontaine v. Brown County Motors Co., 251 Wis. 433, 29 N.W.2d 744 (1947); Annot., Sale of Corporate assets, 9 A.L.R.2d 1306 (1950).