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CORPORATIONS--CORPORATE POLICY, THE "CURE-ALL" FOR PROXY SOLICITATION AILMENTS

David M. Michaelson S. Ed.
University of Michigan Law School

CORPORATIONS—CORPORATE POLICY, THE "CURE-ALL" FOR PROXY SOLICITATION AILMENTS?—All too often lawyers and students of law are inclined to asume that some principle or formula has become so

deeply rooted in the law that it has acquired a sanctity which gives it an all-embracive effect, a "cure-all," as it were, for legal ailments. This has been the usual approach when the question has arisen of the propriety of spending corporate funds to solicit proxies. The ever-faithful panacea has been to say, quite automatically, that where the intra-corporate contest is concerned with matters of policy as distinguished from personnel of management, then corporate funds may be used to inform the stockholders of the policy issues and to secure their support of the views advocated by the management.[1] While there has been an occasional case which would seem to reject this approach,[2] the "policy" formula as a justification for corporate expenditures has enjoyed some popularity. A statement of the Delaware court indicates that the formula may have even grown beyond the point of being a judicial "cure" accepted primarily because of its supposed virtues. The Delaware court has said, "Moreover, for good or evil, the incumbent board of directors of a Delaware corporation may look to the corporation for payment of expenses incurred by them in soliciting proxies where a question of policy is involved."[3]

[1] Peel v. London and North Western Railway Company, [1907] 1 Ch. Div. 5. "I gather the principle from these authorities to be that where reasonable expenditures are in the interest of an intelligent exercise of judgment on the part of the stockholders upon the policies to be pursued, the expenditures are proper; but where the expenditures are solely in the personal interest of the directors to maintain themselves in office, expenditures made in their campaign for proxies are not proper." Hall v. Trans-Lux Daylight Picture Screen Corp., 20 Del Ch. 78 at 84, 171 A. 226 (1934). ". . . where stockholders are called on to decide controversies over substantial questions of policy as distinguished from inconsequential matters and personnel of management, directors may make such expenditures from corporate funds as are reasonably necessary to inform stockholders of considerations in support of the policy advocated by directors under attack, and in such communications directors may solicit proxies in their favor." Hand v. Missouri-Kansas Pipe Line Co., (D.C. Del. 1944) 54 F. Supp. 649 at 650; Steinberg v. Adams, (D.C. N.Y. 1950) 90 F. Supp. 604.

[2] The opinion of the court in The Lawyers' Advertising Company v. Consolidated Railway Lighting and Refrigerating Co., 187 N.Y. 395, 80 N.E. 199 (1907), seems to suggest that the court would go only so far as to permit corporations to mail proxies to their respective stockholders "accompanied by a brief circular of directions" in order to encourage voting, but that corporate funds could never be used to solicit proxies in favor of one faction to a contest. However, this point is not fully developed, and it may be that the court accepts the "policy formula" and would have permitted the solicitation of proxies in favor of the management if it felt that more was involved than merely "perpetuation of their offices and control."

[3] Empire Southern Gas Co. v. Gray, (Del. Ch. 1946) 46 A. (2d) 741 at 744. Rascovor v. American Linseed Co., (2d Cir. 1905) 135 F. 341, dealt with a problem closely related to the use of corporate funds for the solicitation of proxies. The directors of a corporation in carrying out a proposed scheme for an exchange of stock with a rival corporation sought to obtain the cooperation of the shareholders by encouraging, through newspaper advertisements, the prompt deposit of their stock. The court held that the directors of a corporation have authority to incur expenses in notifying the stockholders of a proposed scheme for exchanging the stock of the corporation for that of another, and the manner of giving such notice and the expenses to be incurred is a matter within their discretion.

The seeming devotion of the courts to a judicial formula as revealed by their pious reiteration of a set form of words is not in itself sufficient to make it a useful legal tool for the lawyer. An apparent method of solution will not facilitate the efficient preparation of a case unless it is an accurate guide to the judicial processes underlying the opinion of the court. This raises, directly, the problem of this comment. Is the "policy formula" the real basis for decision? Or, does the formula like so many legal generalizations merely camouflage the judicial thinking, concealing the fundamental elements behind the decision? The recent case of *Steinberg v. Adams*[4] indicates, in a striking manner, that the answer to this question is of great, practical importance. The *Steinberg* case involved the propriety of payments made by a corporation to defray expenses incurred by contesting parties in connection with an election of directors. The parties were in agreement that the "ins" could spend corporate funds in a corporate election where there was a controversy over policy. The issue arose whether corporate funds could also be used to reimburse the "outs" if they won. The court, after an investigation of prior judicial decisions, reasoned: "None of these cases authorizes reimbursement of the successful insurgents. All were concerned with expenditures authorized and incurred by the incumbent board. No case has been called to my attention which, in a 'policy' controversy, either allowed or disallowed the reimbursement of an insurgent group for the expenses incurred by it in bringing about a change of management. My own choice is to draw no distinction between the 'ins' and the successful 'outs.' I see no reason why the stockholders should not be free to reimburse those whose expenditures succeeded in ridding a corporation of a policy frowned upon by a majority of the stockholders. Once we assert that incumbent directors may employ corporate funds in policy contests to advocate their views to the stockholders even if the stockholders ultimately reject their views, it seems permissible to me that those who advocate a contrary policy and succeed in securing approval from the stockholders should be able to receive reimbursement, at least where there is approval by both the board of directors and a majority of the stockholders."[5] The *Steinberg* opinion is keyed primarily to the "policy formula." While the broadened application of the formula in the *Steinberg* case may be justified as a logical extension, nevertheless, the problem facing the lawyer is sharply revealed. Is the finding that the issue in a corporate election concerns corporate policy the determinative element justifying corporate expenditures to solicit

[4] (D.C. N.Y. 1950) 90 F. Supp. 604.
[5] Id. at 607, 608.

proxies? An analysis of the decisions reveals that, for all its appealing simplicity, the "policy formula" is a deceptive guide. The decisions are actually decided with regard to three factors: 1. The primary purpose of the corporate expenditures; 2. The means employed to solicit the proxies; 3. The amount of expenditures incurred.

A. The Primary Purpose of the Corporate Expenditures

When the question of the propriety of payments has arisen, assuming the means used and the expense incurred were not objectionable, the courts have recognized two purposes as justifying the spending of corporate funds to solicit proxies. First, if the principal object of the expenditures was to disseminate information concerning corporate policies sought to be pursued, so that the shareholders might make an intelligent choice, then the disbursement of corporate funds in soliciting proxies has been upheld.[6] The second judicially sanctioned purpose for corporate expenditures has been found where the solicitation of proxies was primarily intended to encourage voting by the shareholders, thereby insuring a quorum.[7] The initial impetus toward the courts' approbation of these two objectives probably resulted from a feeling that they were socially desirable.[8]

Individual conduct is not prompted by any single, easily distinguishable purpose but is the resultant of a composition of forces. This is all the more so when dealing with an aggregate of individuals, a board of

[6] Peel v. London and North Western Railway Company, [1907] 1 Ch. Div. 5; Hall v. Trans-Lux Daylight Picture Screen Corp., 20 Del. Ch. 78, 171 A. 226 (1934); Hand v. Missouri-Kansas Pipe Line Co., (D.C. Del. 1944) 54 F. Supp. 649. The "policy formula" evolved from the recognition of this objective as a legitimate purpose for which the corporation could incur solicitation expenses. The difficulty with the formula is that it merely emphasizes this one consideration and to a large extent ignores the other factors which often play a vital part in influencing the courts' decisions.

[7] "The custom has become common upon the part of corporations to mail proxies to their respective stockholders often accompanied by a brief circular of directions, and such custom when accompanied by no unreasonable expenditure is not without merit in so far as it encourages voting by stockholders through making it convenient and ready at hand." The Lawyers' Advertising Company v. Consolidated Railway Lighting and Refrigerating Co., 187 N.Y. 395 at 399, 80 N.E. 199 (1907). "It unquestionably has been the custom for many years for corporate management to solicit proxies for candidates proposed by the board of directors. There is nothing illegal or wrong in such solicitation. Without it, it would often be difficult to secure a quorum." In re Zickl et al., 73 N.Y.S. (2d)181 at 185 (1947). "No deception was practiced in securing proxies—everyone was given an opportunity to vote for anyone he chose to represent him in the meeting, and it seems to us that this manner of proceeding was fair, and insured practically a fuller meeting of stockholders than otherwise. The expense for printing the extra slips [proxies] and sending them with the regular notices was but a trifle and should not be considered." Bounds et al. v. Stephenson et al. (Tex. Civ. App. 1916) 187 S.W. 1031 at 1034.

[8] Peel v. London and North Western Railway Company, [1907] 1 Ch. Div. 5; Hall v. Trans-Lux Daylight Picture Screen Corp., 20 Del. Ch. 78, 171 A. 226 (1934).

directors, where any analysis of what purposes determined a particular course of action must be made in terms of collective behavior. Thus, even to speak of a dominant purpose may, in the usual situation, be an unrealistic, perhaps fanciful, approach toward the solution of any problem. On the other hand, the circumstances giving rise to the controversy may occasionally be such that one can readily discern the principal consideration which induced the board's choice in making corporate expenditures. Then an evaluation of the purpose, in the light of what the court considers to be legitimate, can be a very useful factor in shaping the court's decision.[9]

B. The Means Employed to Solicit the Proxies

Though both the primary purpose of the corporate expenditures and the amount of expense incurred receive the approval of the court, there still remains the question of whether authorized methods were resorted to in solicitation of the proxies. Obviously, the possible methods of solicitation are as manifold as the available means of public communication. However, the proxy solicitation controversies which have been made the subject of litigation fall into three categories. The first and largest category embraces those controversies where the mails have been utilized in proxy solicitation. This method of solicitation has been regarded with favor by the courts.[10] The next classification involves solicitation by advertising in newspapers. There is less agreement by the courts as to the propriety of imposing the expense of this means of solicitation upon the corporation.[11] The third category comprehends those

[9] A primary purpose to inform shareholders of the policy issues having received judicial approval as one factor in favor of corporate expenditures for solicitation, the difficult question arises as to what is an issue of intracorporate policy. The following quotation illustrates the inherent confusion: "It is impossible in many cases of intracorporate contests over directors, to sever questions of policy from those of persons. The two are often inextricably blended. What difference in principle can it make between laying before stockholders reasons for answering a referendum in the abstract upon whether a certain policy shall be pursued, and asking them to vote for one set of persons who stand for a certain policy and will promote it, and against another set who are opposed to the policy and will defeat it? I can see none." Hall v. Trans-Lux Daylight Picture Screen Corp., 20 Del. Ch. 78 at 85, 171 A. 226 (1934).

[10] Peel v. London and North Western Railway Company, [1907] 1 Ch. Div. 5; The Lawyers' Advertising Company v. Consolidated Railway Lighting and Refrigerating Co., 187 N. Y. 395, 80 N.E. 199 (1907); Bounds et al. v. Stephenson et al. (Tex. Civ. App. 1916) 187 S.W. 1031; Hall v. Trans-Lux Daylight Picture Screen Corp., 20 Del. Ch. 78, 171 A. 226 (1934); Hand v. Missouri-Kansas Pipe Line Co., (D.C. Del. 1944) 54 F. Supp. 649; also see Steinberg v. Adams et al., (D.C. N.Y. 1950) 90 F. Supp. 604.

[11] The court in The Lawyers' Advertising Company v. Consolidated Railway Lighting and Refrigerating Company, 187 N.Y. 395, 80 N.E. 199 (1907), held that there was no authority for imposing advertising expenses on the corporation. Cf. Rascover v. American Linseed Company, (2d Cir. 1905) 135 F. 341 at 344, where the court held in regard to soliciting the cooperation of the shareholders in a proposed scheme for exchanging stock:

cases involving the use of professional proxy solicitors. There is considerable difference in the results reached by the various courts when professional proxy solicitors have been employed.[12]

The differences in the decisions are possibly due to the interjection of the chancellor's personal feelings of what constitutes fair play in a corporate contest. Moreover, consideration of the third factor, i.e., the amount of expenditures incurred, exerts a powerful restraining influence, and may have led some courts to strike down solicitation methods which tend to impose substantial expenses upon the corporation.

C. *The Amount of Expenditures Incurred*

This factor plays an important part in the shaping of every court's decision where the propriety of burdening the corporation with the cost of solicitation expenses is at issue.[13] As suggested in the prior discussion regarding methods of solicitation, the fact that the amount of expenditures incurred had offended the sensibilities of the chancellor may have been the critical factor leading to the rejection of the proposition that the expenses were a proper corporate responsibility. No precise rule can be set down whereby one may say with confidence that, "this is the limit, any expenditures beyond this point are unauthorized." The most that can be done in the way of asserting a principle is to take sanctuary behind the time-worn generalization that such expenditures as are *reasonably* necessary will be upheld.

It has been the purpose of this comment to indicate that the "policy formula" is, at best, simply an inaccurate shorthand form which to some

"Whether the notice shall be long or short, in what form of words it shall be couched, whether it shall be sent by mail or advertised in newspapers are matters of detail, which should be left to the directors." In Steinberg v. Adams et al., (D.C. N.Y. 1950) 90 F. Supp. 604 at 606, "The contest was conducted by printed appeals for proxies addressed to the stockholders, and employment of proxy solicitors and other devices not unusual in such campaigns." The court there suggests that the corporate funds could be used to defray expenditures incurred in solicitation unless the expenses were unreasonable.

[12] The Lawyers' Advertising Company v. Consolidated Railway Lighting and Refrigerating Co., 187 N.Y. 395, 80 N.E. 199 (1907) (held, could not dispatch "special messengers for the purpose of procuring proxies in their behalf"); Hand v. Missouri-Kansas Pipe Line Co., (D.C. Del. 1944) 54 F. Supp. 649, court's footnote at page 650: "The Hall case does not, however, decide whether the employment of professional proxy solicitors is a proper method to inform stockholders of considerations in support of the policy advocated by management. In fact, a search discloses no authority in Delaware on the question." In re Zickl et al., 73 N.Y.S. (2d) 181 at 185 (1947) (held, follow-up solicitation by proxy solicitors proper); *Contra,* Pittsburgh Steel Co., v. Walker et al., 92 P.L.J. 464 (1944); Steinberg v. Adams et al., (D.C. N.Y. 1950) 90 F. Supp. 604, (proper to use corporate funds to employ proxy solicitors).

[13] See quotations in footnotes 1 and 7 supra.

degree, perhaps, reflects the end result of the courts' consideration of the purpose and means of solicitation and the amount of expenditures incurred. Careful attention to all three of these factors is therefore essential in the proper presentation of an argument before a court which adheres to the "policy formula."[14]

David M. Michaelson, S. Ed.

[14] With regard to securities listed and registered on a national securities exchange, attentive respect must be paid to Regulation X-14 under the Securities Exchange Act of 1934. This regulation sets forth detailed requirements as to the form of the proxy and the information to be furnished to security holders. It is interesting to note that recourse to methods of solicitation other than the use of the mails, including employment of professional proxy solicitors, is contemplated by the Regulation: "If the solicitation is made otherwise than by use of the mails, state the methods used. If the solicitation is made by specially engaged employees of the issuer or other paid solicitors, state (1) the material features of any contract or arrangement for such solicitation, (2) the cost or anticipated cost thereof, and (3) the approximate number of specially engaged employees of the issuer or employees of any other person (naming such other person) who will solicit proxies," 17 CFR Schedule 14A, Item 3(d) at 232 (1949).

While there is no express provision restricting the amount of expenses incurred for employment of professional proxy solicitors, one should carefully consider the possible implications of the requirement of disclosure of the "cost or anticipated cost thereof" as suggesting a policy of limiting the expenditures. Proxy Rule U-65 under the Public Utility Holding Company Act of 1935 clearly reveals a policy of placing a ceiling on the expenditure of corporate funds for proxy solicitation: "Except . . . pursuant to the order of the Commission . . . no registered holding company or subsidiary thereof shall expend any money or other consideration in connection with the solicitation of any proxy, consent, or authorization regarding any security of such company. (b) *Exceptions.* This section shall not apply to: (1) Ordinary expenditures in connection with preparing, assembling, and mailing proxies, proxy statements, and accompanying data; or (2) Other expenditures not in excess of $1,000 during any one calendar year." 17 CFR 250.65 (1949).