IN THE SUPERIOR COURT OF BALTIMORE CITY

RAWSON G. LIZARS,
Plaintiff

v.

BROR DAHLBERG, HECTOR J. DOWD, ARTHUR O. GRAVES, JAMES L. WATSON, FREDERICK H. PAYNE, HORACE G. ROBERTS, LEO J. SHERIDAN, R. P. ULM, THOMAS F. PETERSON, JR., AND CERTAIN-TEED PRODUCTS CORPORATION,
Defendants.

BRIEF OF THE SECURITIES AND EXCHANGE COMMISSION AS AMICUS CURIAE

1. Nature of the proceeding and interest of the Securities and Exchange Commission

A stockholder of Certain-teed Products Corporation (hereinafter referred to as Certain-teed), a Maryland corporation, is seeking a writ of mandamus to compel presentation of proxies solicited by and on behalf of the management for the purpose of making a quorum at the annual meeting for the election of directors. The action is founded exclusively upon state law and invokes the jurisdiction of this Court to require the discharge of their official duties by officers of a Maryland corporation.

The common stock and the 6% cumulative prior preference stock of Certain-teed are registered with the Securities and Exchange Commission as listed on the New York Stock Exchange thereby making applicable Sections 14 (a) and 23 (a) of the Securities Exchange Act (15 U. S. C. §§ 78 n and w) and the rules of the Commission thereunder which govern the solicitation of proxies for a company whose securities are so listed. These rules are in general designed to require fair and adequate disclosures in connection with such solicitation.

The Commission having reason to believe that certain of the defendants in the state action had violated and were violating its proxy rules in connection with the current annual meeting for Certain-teed, has filed a complaint in the United States District Court for the District of Maryland based solely on federal grounds as to which Section 27 of the Act (15 U. S. C. §§ 78aa) gives the federal courts "exclusive jurisdiction." A copy of that complaint is attached as an appendix to this memorandum. That complaint seeks relief which in one respect is identical with the relief which the plaintiff in this action is seeking from this Court, i. e., a direction to the management to present its proxies at the meeting.

The similarity in the relief sought in the two actions does not, however, indicate any inconsistency in the independent prosecution of both suits. One is based exclusively on federal law and brought by the Commission as the Agency charged with responsibility for the enforcement of the statute, and the other is brought by a stockholder and is based

exclusively on state law. There is no question of conflict between state and federal law involved. In fact, Section 28 of the Act (15 U. S. C. §§ 78bb) expressly provides that "the rights and remedies provided by this title shall be in addition to any and all other rights and remedies that may exist at law or in equity."

The Commission desires to present its views amicus curiae on the principal issue of state law involved in this suit because of the prior pendancy of this suit and because a judgment for the plaintiff in this action would substantially narrow the issues remaining in the federal suit and possibly make unnecessary the further prosecution of the federal action. In addition, the Commission believes that the issues of state law involved in this case are of vital importance to the discharge of its federal statutory duties for the protection of investors. Our whole system of regulation of the disclosures to be required in connection with proxy solicitations presupposed that persons who solicit specific authority will be required to execute the authorization so obtained, and particularly that corporate managements who use corporate funds in aid of their solicitation will be held to a high standard of fiduciary responsibility in connection with such activity. The regard of the corporate bar for the Maryland statutes of incorporation and the fact that many corporations of national scope are incorporated in Maryland adds to the importance of the issue.

The Commission has no interest in the incidental questions of state law involved in the proceeding, such as whether the management proxies were in fact legally presented.

FACTS

For purposes of this memorandum we advert only to the following among the facts shown in the Petition. Section 16 of Article 23 of the Code of Public General Laws of Maryland provides:

"Every corporation . . . shall hold annually a stated or regular meeting for the election of directors and for the transaction of general business . . ." (Ann. Code of Md. (Flack, 1939) Art. 23, § 16.)

And the Company's Certificate of Incorporation provides that annual stockholders' meetings shall be held on the second Wednesday of April each year.

This year the meeting was scheduled to be held on April 12, 1944. Prior to that date the management solicited and obtained proxies from stockholders of the Company which by their terms expressly "direct" the defendants, Payne, Roberts and Sheridan "to attend the Annual Meeting of Stockholders and said Corporation called to be held . . . on Wednesday, April 12, 1944 . . . and any adjournment or adjournments thereof" and to vote such proxies for the election of nine directors. Defendants Frederick H. Payne, Horace G. Roberts and Leo J. Sheridan, who are directors of Certain-teed, are named as the agents, attorneys and proxies to act in that capacity for stockholders executing such proxies. The proxy statement filed with the Commission indicates that proxies are being

solicited on behalf of the management and at corporate expense. The post card form of proxy so solicited is addressed to the secretary of the corporation.

A meeting was held on April 12 but was adjourned to May 3, 1944 because of the pendancy of an action instituted by the management in the Circuit Court of Baltimore City seeking to enjoin the use of proxies obtained by Rawson G. Lizars, et al. (referred to herein as the "opposition group"). On April 27, 1944, Judge Henderson sustained a demurrer to the complaint in that action and dissolved the injunction theretofore granted.

On May 3, 1944, the adjourned meeting was held but the management refused to return their proxies to the inspectors of election for counting with the result that a quorum was not present and the election of a Board of Directors could not proceed. 1/ Consequently, the annual meeting was further adjourned until May 12, 1944. We understand that there has been a further adjournment until May 17, 1944.

ARGUMENT

It is the Commission's position that the defendants as officers and directors of Certain-teed have a duty to hold an annual meeting as directed by Section 16 of Article 23 of the Code. It is in direct conflict with that duty for them to endeavor to withhold proxies within their control with a view to defeating a quorum and thereby continuing themselves in office without a vote of the stockholders. In soliciting proxies they necessarily represented that they would present those proxies in accordance with the express direction of the proxy. In soliciting at the corporate expense they were necessarily acting in their capacity as corporate officers and not as individuals. Accordingly, the proxies in their possession are held by them subject to their fiduciary duties as corporate officers and cannot be withheld to promote their selfish interest in the retention of office.

It is scarcely necessary to cite authority for the proposition that corporate officers and directors are fiduciaries and cannot use their powers to promote their selfish interest to the detriment of their trust. The following are typical statements of this elementary proposition:

"They [officers and directors] stand in a fiduciary relationship both to the corporation and to the stockholders . . . and may not under any circumstances use the power entrusted to them to promote their personal interests at the expense of the stockholders . . ."

Coffman v. Maryland Pub. Co., 167 Md. 275, 173A. Atl. 248, 254, (1934).

"It is now well settled that directors and managers of corporations, and other companies, are equally within the rule which guards and restrains the dealings and transactions between trustee and cestui que trust, and agent and his principal . . .

"The affairs of the corporations are generally entrusted to the exclusive management and control of the board of directors, and there is an inherent obligation, implied in the acceptance of such trust, not only that they will use their best efforts to promote the

interest of the stockholders, but that they will in no manner use their positions to advance their own individual interest as distinguished from that of the corporation, or acquire interests that may conflict with the fair and proper 'discharge of their duty.'"

Cumberland Coal & Iron Co. v. Parish, 42 Md. 598, 605-06 (1875).

Also see Hoffman Steam Coal Company v. Cumberland Coal & Iron Company, 16 Md. 456, 464, 507 (1860); Macgill v. Macgill, 135 Md. 384, 109 Atl. 72 (1919).

That a corporate, not an individual purpose, is here involved is emphasized by the fact that the proxies in question were solicited at corporate expense. The use of corporate funds for solicitation of proxies is lawful only where used in furtherance of a corporate purpose, rather than in support of the selfish desire of a management to retain itself in office. See Hall v. Trans-Lux Daylight Picture Screen Corp., 171 Atl. 226 (Ch. Del. 1934). In considering an injunction to prevent the use of corporate funds by the management in connection with a contest for proxies to be used at the annual meeting of stockholders, the Court stated the rule as follows:

"Where the controversy is concerned with a question of policy as distinguished from personnel of management and the stockholders are called upon to decide it, it would seem quite clear that the incumbent directors may with perfect propriety make such expenditures from the corporate treasury as are reasonably necessary to inform the stockholders of the considerations which the directors deem sufficient to support the wisdom of the policy advocated by them and under attack; and in the same communications which the directors address to the stockholders in support of their policy they may solicit proxies in its favor." (171 Atl. at 227)

The Court went on to state that:

"Where the expenditures are solely in the personal interest of the directors to maintain themselves in office, expenditures in their campaign for proxies are not proper." (171 Atl. at 228)

And further that:

" . . . if all that is at stake is the ambition of the 'ins' to stay in, the corporation should not be called upon to pay for the expense of their campaign to persuade the voting stockholders to rally to their support . . . The nature of the contest must be looked at to see if it is one where it can be said that only the selfish desires of incumbent directors to hold on to their positions are at stake. If so, the persons who seek simply to procure their own re-election should pay the bills contracted in such a purely personal enterprise." (171 Atl. at 229)

See also Lawyers' Advertising Co. v. Consolidated Railway Co., 187 N. Y. 395, 80 N. E. 199 (1907); Pell v. London & North Western Ry. Co., [1907] 1 Ch Div., 5, 21 (opinion of Buckley, L. J.).

The fact that it is sometimes a difficult task for a court to distinguish between a proper corporate purpose and the selfish interests of the management cannot avail the defendants here. After availing themselves of corporate funds 2/ and acting ostensibly in furtherance of their corporate duty to see that an annual meeting is held, they cannot be heard to say that they were acting in an unofficial capacity so as to escape the jurisdiction of this Court to compel them to discharge their corporate duties in using the proxies so presented.

The vital importance of a statutory provision for the holding of annual meetings has been recognized by decisions refusing to countenance devices of the parties in power to maintain themselves in office by preventing a quorum.

In Sylvania & G. R. Co. v. Hoge, 129 Ga. 734, 59 S.E. 806 (1907), the Court compelled the directors to call a meeting of the stockholders for the purpose of electing a board of directors, at the instance of a stockholder. The Court held that the fact that a majority of the stockholders was not present at the meeting could not under Georgia law prohibit the conduct of business and the election of a board of directors by those present.

In Lutz v. Webster, 249 Pa. 226, 94 Atl. 834 (1915), the Court held to be invalid a by-law requiring four-fifths of the stock to be represented to constitute a quorum. In that case two stockholders held more than a fifth of the stock and prevented a meeting by absenting themselves from the meeting. The Court held that the by-law contravened the purpose of the law to have annual elections. The Court said:

". . . Our conclusion is that the by-law which requires four-fifths of the stock to be represented in order to constitute a quorum must be determined to be subordinate to the statute which provides for the annual election of directors and that it cannot be used to defeat the plain intent of the legislature as declared in the Acts of Assembly."

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"The jurisdiction of the court to grant the relief prayed for is challenged, but we agree with the views of the learned chancellor and approved by the court in banc that, under the exceptional facts of this case, the court had power to determine whether the by-law was inconsistent with the law of the state, and, if found to be so, to decree that an election be held at which a majority of the stock shall constitute a quorum. The appellant Webster has prevented the holding of an annual election for two years by refusing to attend a meeting called for this purpose, and certainly it is within the spirit and reason of our own cases for the court to order an election to be held in an orderly and lawful manner under such circumstances.

"It is in the interest of the corporation, and of the stockholders, and of all other interested parties, that proper officers be elected to conduct the corporate business. To accomplish this result it is necessary to elect a board of directors, and the decree of the court simply orders that to be done which the facts plainly show should be done."

In Darrin v. Hoff, 99 Md. 491, 58 Atl. 196 (1904), the court held that, in the absence of specific statutory permission, a by-law providing merely that a majority of the stock should constitute a quorum was invalid since it permitted a large stockholder to take advantage of the by-law to prevent an election. As in the Lutz case the by-law was held invalid because it was in derogation of the statutory mandate that a meeting be held annually.

The contention on the part of the management that the proxies held by the opposition group are invalid is entirely irrelevant to this proceeding and affords no justification for the action of the management in failing to present the proxies which the management itself had solicited. If invalidity of the opposition proxies can be established in an appropriate judicial proceeding, the votes pursuant to those proxies can be set aside. The management is now seeking such a determination in its appeal from Judge Henderson's order of April 27 sustaining the demurrer to their bill of complaint in the Circuit Court. Failing such a judicial determination, the management cannot take the law into their own hands.

In conclusion we wish to emphasize that the Commission has no interest in which of the contending groups shall be elected to corporate office. It has, however, a vital interest in the integrity of the election process for corporations whose securities are listed on a national securities exchange. Accordingly we urge that the writ should issue for the purpose of enabling an election to be held, leaving to future determination any question that may arise as to the validity of particular votes that may be cast.

Respectfully submitted,

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Milton V. Freeman, Assistant Solicitor
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Attorneys for the Securities and Exchange Commission

May 12, 1944