IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

IN AND FOR NEW CASTLE COUNTY

STATE OF WISCONSIN INVESTMENT BOARD,	)	
Plaintiff,	)	
v.	)	Civil Action No. 17637
PEERLESS SYSTEMS CORPORATION and EDWARD A. GAVALDON,	)	
Defendants.	)	

MEMORANDUM OPINION

Date Submitted: September 27, 2000
Date Decided: December 4, 2000

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CHANDLER, Chancellor

This lawsuit involves a challenge to the adjournment of the June 17, 1999 annual shareholders meeting (the "Annual Meeting") of Peerless Systems Corporation ("Peerless" or the "Company"). The adjournment, called by Peerless's Chairman, Chief Executive Officer ("CEO") and President, Edward A. Galvadon, postponed the closing of the polls on a proposal ("Proposal 2") to add 1,000,000 shares to the Peerless stock option plan. At the time of the Annual Meeting, Proposal 2 would have been defeated. Thirty days later, Peerless reconvened the Annual Meeting, Galvadon closed the polls on Proposal 2, and Proposal 2 passed by a slim margin. Peerless and Galvadon are the defendants in this action.

Plaintiff, the State of Wisconsin Investment Board ("SWIB"), asserts that the defendants inequitably, and in breach of their fiduciary duties, interfered with and manipulated the voting at the Annual Meeting and deprived Peerless' shareholders of their voting rights. SWIB asserts three claims: (i) the defendants breached their fiduciary duties to all shareholders by exercising corporate power to manipulate and to interfere with a shareholder vote ("claim I"); (ii) Galvadon breached his fiduciary duty to shareholders when he, as a director, adjourned the Annual Meeting on Proposal 2 in connection with a corporate transaction in which he had a personal financial interest ("claim II"); and (iii) the defendants omitted

material information and made false and misleading statements of material fact about the adjournment ("claim III").

SWIB moves for summary judgment on all three claims and seeks an order nullifying the amendment to the option plan. Defendants have cross-moved for summary judgment on all three claims as well.

I. FACTUAL BACKGROUND

A. The Parties

Plaintiff SWIB is an agency of the State of Wisconsin that invests the assets of the Wisconsin.Retirement System, the State Investment Fund., and several smaller trust funds established by the State of Wisconsin. In managing the assets of the Wisconsin public pension system, SWIB is entrusted to protect and invest the pension benefits of over 450,000 current and former state and local government employees. As of December 3 1, 1999, SWIB had assets under management of approximately $70 billion. During the relevant time period, SWIB was the beneficial owner of 985,000 shares of Peerless con-u-non stock, representing between 7 percent to 9 percent of the total outstanding shares of Peerless. SWIB continues to be a Peerless common shareholder.

Peerless is a Delaware corporation with its principle place of business in El Segundo, California. It provides software-based embedded imaging

systems to original equipment manufacturers of digital document products such as printers, copiers, fax machines, and scanners. Peerless has a market capitalization of approximately $30 million.

In 1999, the Peerless board of directors consisted of four directors: Galvadon, Robert G. Barrett, Robert L. North, and Robert V. Adams. Three of the directors, Barrett, North, and Adams (the "outside directors"), were all non-employee outside directors. As part of their compensation, the outside directors received stock options according to a fixed formula. The fourth director, Edward A. Galvadon, was the President, CEO, and Chairman of the Peerless Board during the relevant time period. Galvadon's compensation consisted of both a salary and stock options. Galvadon resigned from his position with Peerless, effective April 13, 2000. Galvadon is a resident of California.

B. Peerless Issues a Proxy Statement

Shortly after May 20, 1999, in connection with its Annual Meeting, Peerless issued a proxy statement explaining three proposals and recommending that Peerless shareholders vote to approve each proposal. The first proposal ("Proposal 1") sought to re-elect each of the four members of the Peerless Board. Proposal 2 sought to increase by 1,000,000 the number of Peerless shares available for issuance through the Company's

existing option plan. The third proposal ("Proposal 3") sought to ratify the Peerless Board's selection of the accounting firm of PricewatershouseCoopers LLP as the Company's auditors.

In addition to the proxy statement and accompanying proxy card, Peerless also sent to its shareholders a "Notice of Annual Meeting of Shareholders to be Held on June 17, 1999" (the "meeting notice"). The proxy statement made one reference to the possibility of adjournment: "[t]he enclosed proxy is solicited on behalf of the Board of Directors of Peerless ... for use at the Annual Meeting of Stockholders to be held on June 17, 1999 at 2:00 p.m. local time (the 'Annual Meeting'), or at any adjournment or postponement thereof. . . ."[1] The proxy card and the meeting notice made similar references to the possibility of adjournment.

C. *SWIB Reacts to the Proxy Statement*

After receiving the proxy statement, SWIB quickly reacted in opposition to Proposal 2. On May 25, 1999, Reid Pearson of Institutional Shareholder Services ("ISS"), a division of the Thompson Financial Network providing certain information and other services to institutional shareholders, alerted Sandra K. Nicolai, the Proxy Administrator of SWIB, that Proposal 2, if enacted, would exceed ISS's recommended equity

[1] Pl.'s Ex. 11.

dilution guidelines. In a phone call on or around May 27, 1999, between Ms. Nicolai, Galvadon, and Peerless Chief Financial Officer, Carolyn M. Maduza, Ms. Nicolai informed Peerless that SWIB would not support Proposal 2. In late May 1999, SWIB retained George Garland of Garland & Associates to solicit against Proposal 2.

On June 1, 1999, SWIB sent a letter to each Peerless shareholder asking them to vote against Proposal 2 (the "June 1 Letter"). Among the reasons for its opposition to Proposal 2, SWIB noted that the amendment to the option plan would increase the total potential dilution from Peerless's option programs to more than 33 percent of the current number of outstanding shares, the Peerless Board would be able to reprice the additional options without shareholder approval, and the Peerless Board would be able to grant options at less than fair market value.[2]

D. Peerless Holds a Special Shareholders Meeting

Just prior to the Annual Meeting, Peerless held a special shareholders meeting on June 10, 1999, to consider a proposed acquisition of Auco, Inc. As of the May 11, 1999, record date for the Special Meeting, there were 11,286,967 shares of Peerless outstanding. At the special meeting, the shareholders approved the merger by a vote of 5,697,037 for, and 352,539

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[2] Pl.'s Ex. 13.

against, with 9,600 abstentions. The total number of shares that voted at the special meeting equaled 6,059,176, representing approximately 54 percent of the outstanding shares on the record date. Additionally, the number of shares approving of the merger as a percentage of the total outstanding shares as of the record date equaled 50.47 percent.

E. The Period Between the Special Meeting and the Annual Meeting

On June 11, 1999, Peerless issued a press release announcing the approval of the merger by Peerless and Auco shareholders. In connection with the merger, Peerless issued an additional 2,500,000 shares of common stock.

Also on June 11, ISS issued an alert updating its recommendation on Proposal 2 (the "ISS Alert"). The ISS Alert explained that although it still recommended a vote against Proposal 2, it was revising its estimate of the total potential dilution of Peerless shares down to 22.21 percent. The revision was based on the additional shares issued as a result of the Auco merger and the Company's promise to use only 10,000 restricted shares of stock as employee rewards.

F. The Annual Meeting and the Adjournment

As scheduled, the Annual Meeting commenced on June 17, 1999 with Galvadon presiding as Chairman. SWIB was not in attendance. In fact,

very few shareholders actually attended the Annual Meeting. According to Maduza, there were between 75 and 90 people in the room, but many were Peerless employees.[3] The sign-up attendance sheet for non-employee shareholders after the meeting included only three names.

During the Annual Meeting, Galvadon ordered the polls closed on Proposals 1 and 3. The polls closed with both measures passing quite easily. On Proposal 1, each director received at least 9,300,000 votes and no more than 209,983 votes were withheld for any of the four directors. Proposal 3 received 9,480,908 votes for, 30,821 against, and 3,400 abstentions.

Galvadon adjourned the Annual Meeting for 30 days without closing the polls on Proposal 2. The adjournment was not made pursuant to any formal Peerless Board action, but rather was made by Galvadon as Chairman of the meeting. It does appear, however, that Galvadon discussed the possibility of the adjournment with the other members of the Peerless Board sometime before the Annual Meeting.[4] No one present at the Annual Meeting voiced any objection to the Chairman's motion for an adjournment and the motion was therefore granted. This procedure is in keeping with § 9 of the Company's Amended and Restated By-Laws, which states:

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[3] Pl.'s Ex. 5, 181.
[4] Pl.'s Ex. 4, 151.

> ADJOURNMENT AND NOTICE OF ADJOURNED MEETINGS. Any meeting of stockholders, whether annual or special, may be adjourned from time to time either by the chairman of the meeting or by the vote of a majority of the shares casting votes, excluding abstentions. When a meeting is adjourned to another time or place, notice need not be given of the adjourned meeting if the time and place thereof are announced at the meeting at which the adjournment is taken. At the adjourned meeting, the corporation may transact any business which might have been transacted at the original meeting. If the adjournment is for more than thirty (30) days or if after the adjournment a new record date is fixed for the adjourned meeting, a notice of the adjourned meeting shall be given to each stockholder of record entitled to vote at the meeting.'

If the polls had been closed on Proposal 2 at the Annual Meeting, Proposal 2 would have been defeated by 684,266 votes; 2,920,925 shares voted for Proposal 2 (25.88 percent of shares outstanding as of the record date), 3,605,191 shares voted against (3 1.94 percent of shares outstanding as of the record date), and 7,000 shares abstained. Just as in the case of the special meeting, the record date for the Annual Meeting was May 11, 1999 and, therefore, the number of shares of common stock outstanding on that date was also 11,286,967. The total number of shares cast on Proposal 2 up to the adjournment equaled 6,533,116, or 57.88 percent of the shares outstanding as of the record date.

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[5] Pl.'s Ex. 45.

G. Reasons for the Adjournment

Peerless asserts that the primary reason for the adjournment was the low voter turnout on Proposal 2 in contrast to Proposals 1 and 3. There is one predominant reason why the number of votes cast on Proposal 2 is significantly lower than the number of votes cast on Proposals 1 and 3. Under the rules of the New York Stock Exchange ("NYSE"), brokers and other agents of shareholders can vote on routine matters without instructions from the beneficial owners of the shares in question? On non-routine matters, the vote of the beneficial *owners* is required.[7] Generally, this

[6] NYSE Rule 452. Generally speaking, a member organization of the NYSE may give a proxy to vote stock without customer instructions provided that: (1) it has transmitted proxy soliciting material to the beneficial owner of stock or to the beneficial owner's designated investment adviser in accordance with Rule 45 1; (2) it has not received voting instructions from the beneficial owner or from the beneficial owner's designated investment adviser, by the date specified in the statement accompanying such material; and, (3) the person in the member organization giving or authorizing the giving of the proxy has no knowledge of any contest as to the action to be taken at the meeting and provided such action is adequately disclosed to stockholders and does not include authorization for a merger, consolidation or any matter that may affect substantially the rights or privileges of such stock.

[7] NYSE Rule 452. According to the NYSE Rules,, a member organization may not give a proxy to vote without instructions from beneficial owners when the matter to be voted upon: (1) is not submitted to stockholders by means of a proxy statement comparable to that specified in Schedule 14-A of the Securities and Exchange Commission; (2) is the subject of a counter-solicitation, or is part of a proposal made by a stockholder which is being opposed by management (i.e., a contest); (3) relates to a merger or consolidation (except when the company's proposal is to merge with its own wholly owned subsidiary, provided its shareholders dissenting thereto do not have rights of appraisal); (4) involves right of appraisal; (5) authorizes mortgaging of property; (6) authorizes or creates indebtedness or increases the authorized amount of indebtedness; (7) authorizes or creates a preferred stock or increases the authorized amount of an existing preferred stock, (8) alters the terms or conditions of existing stock or indebtedness; (9) involves waiver or modification of preemptive rights (except when the company's proposal is to waive such rights with respect to shares being offered pursuant to stock option or

difference often accounts for a higher number of votes on routine matters than on non-routine matters. Proposals 1 and 3 were routine matters and Proposal 2, like the vote on the Auco merger, was not.

The need of beneficial owners to vote is particularly important here because over 2,000,000 common shares of Peerless, or about 17.7 percent of the outstanding shares entitled to vote, were held by foreign investors. Evidently, many of these European investors experienced certain difficulties in voting because their agents were not familiar with American voting procedures. At the time of the adjournment, only one

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purchase plans involving the additional issuance of not more than 5% of the company's outstanding common shares (see Item 12)); (10) changes existing quorum requirements with respect to stock-holder meetings; (11) alters voting provisions or the proportionate voting power of a stock, or the number of its votes per share (except where cumulative voting provisions govern the number of votes per share for election of directors and the company's proposal involves a change in the number of its directors by not more than 10% or not more than one); (12) authorizes issuance of stock, or options to purchase stock, to directors, officers, or employees in an amount which exceeds 5% of the total amount of the class outstanding; (13) authorizes either a new profit-sharing or special remuneration plan, or a new retirement plan, the annual cost of which will amount to more than 10% of average annual income before taxes for the preceding five years, or the amendment of an existing plan which would bring its cost above 10% of such average annual income before taxes; (14) changes the purposes or powers of a company to an extent which would permit it to change to a materially different line of business and it is the company's stated intention to make such a change; (15) authorizes the acquisition of property, assets, or a company, where the consideration to be given has a fair value approximating 20% or more of the market value of the previously outstanding shares; (16) authorizes the sale or other disposition of assets or earning power approximating 20% or more of those existing prior to the transaction; (17) authorizes a transaction not in the ordinary course of business in which an officer, director or substantial security holder has a direct or indirect interest; (18) reduces earned surplus by 51% or more, or reduces earned surplus to an amount less than the aggregate of three years' common stock dividends computed at the current dividend rate.

European investor was known to have voted all of its shares. Peerless specifically describes the experience of one major European investor, Lombard Odier, a European investment bank holding in excess of 400,000 shares, as representing the problems encountered by many of its European shareholders.' Apparently, although Lombard Odier believed all of its shares had been voted in 'favor of Proposal 2, one of Lombard Odier's custodial banks did not follow the proper voting procedures, thereby preventing all but 8,800 shares from being voted on time.

There are also other possible explanations for the low vote count on Proposal 2 in comparison to Proposals 1 and 3. Several shareholders may have discarded their proxy materials without reading them, believing that they had received a duplicate mailing of the proxy statement for the special meeting. Peerless management also devoted a significant amount of time soliciting in favor of the Auco merger at the expense of any efforts they may have made to solicit for Proposal 2.

G. The *Adjournment Period*

Except for statements made at the Annual Meeting, Peerless did not make any public disclosures to its shareholders generally about the status of Proposal 2. It did not issue a press release or send supplementary proxy

[8] Peerless Op. Br. in Support of Summary Judgment, at 11-12.

materials informing shareholders that it closed the polls on Proposal 1 and 3 but had adjourned the meeting without closing the polls on Proposal 2. Peerless also did not inform shareholders that Proposal 2 would have been defeated if the polls had been closed at the Annual Meeting, why the Annual Meeting was adjourned, or that Peerless planned to continue its efforts at soliciting the votes of certain shareholders.

Nevertheless, Peerless continued to solicit votes on Proposal 2, but only from selected shareholders. The Company asserts that the purpose of these efforts was simply "to get [the shareholders] to vote" in order to increase voter participation on Proposal 2.[9] The Company claims that it did not ask these shareholders to vote in favor of Proposal 2, although Peerless does admit that it devoted more time to contacting shareholders who were more likely to support management and vote in favor of Proposal 2.[10] Peerless also contacted several large European investors who had not voted in order to assist them in the process as well as certain significant domestic investors who had not voted on Proposal 2.[11] Peerless also contacted shareholders who had voted against Proposal 2 to determine if altering the

[9] Pl.'s Ex. 5, 194.
[10] Peerless Op. Br. in Support of Summary Judgment, at 15; Pl.'s Ex. 5, 194,201.
[11] *Id.*

proposal might change their vote.[12] These initiatives would seem to belie the Company's professed neutrality with regard to the passage of Proposal 2.

On June 24, 1999, Peerless informed SWIB that the Annual Meeting was adjourned with the polls still open on Proposal 2. Additionally, Peerless also informed SWIB that there had been no disclosure of the vote total on Proposal 2. In response, SWIB sent a second solicitation letter to all Peerless shareholders dated July 1, 1999 (the "July 1 Letter"). This letter questioned the propriety of the adjournment and urged shareholders to vote against Proposal 2. The letter states that the total potential dilution to shareholders remained at 33 percent of the then outstanding shares.

H. The Annual Meeting is Reconvened

On July 16, 1999, thirty days after the adjournment, the reconvened meeting (the "Reconvened Meeting") was held at Peerless's offices in El Segundo, California. Again, SWIB did not attend. Galvadon ordered the polls closed on Proposal 2 which passed by a vote of 3874,380 for (representing 34.33 percent of shares outstanding as of the record date) and 3,653,3 10 against (representing 32.37 percent of shares outstanding as of the record date). This represents a difference of 221,070 votes, or just 1.96 percent of the shares outstanding as of the record date. The total number of

[12] Pl.'s Ex. 5, 211-12.

votes cast on Proposal 2 equaled 7,527,690, or 66.69 percent of the shares outstanding as of the record date. In comparison to the vote count at the time of the adjournment, 953,455 additional shares voted for Proposal 2 and 48,119 additional shares voted against Proposal 2. The total number of votes cast as of the Reconvened Meeting was still well below the vote totals for Proposals 1 and 3.

SWIB filed its complaint in this Court on December 7, 1999, approximately four months and three weeks after the Reconvened Meeting.

I. ANALYSIS

A. The Legal Standard on Cross-Motions for Summary Judgment

Both SWIB and Peerless have moved for summary judgment on each of the three claims. Summary judgment will only be granted where the moving party demonstrates the absence of genuine issues of material fact and that it is entitled to judgment as a matter of law.[13] If the movant puts in the record facts that, if undenied, entitle her to summary judgment, the burden then shifts to the defending party to dispute the facts by affidavit or proof of similar weight.[14] On any application for summary judgment, the

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[13] Ch. Ct. R. 56(c); *Gilbert v. El Paso Co.*, Del. Supr., 575 A.2d 1131, 1142 (1990).

[14] Ct. of Ch. R. 56(e); *Hurtt v. Goleburn*, Del. Supr., 330 A.2d 134 (1974). Rule 56(e) states in relevant part:

> ... When a motion for summary judgment is made and supported as provided in this rule, an adverse party may not rest upon the mere allegations or denials of the adverse party's pleading, but the adverse

Court must view all of the evidence in the light most favorable to the non-moving party. [15] The party opposing summary judgment, however, may not merely deny the factual allegations adduced by the movant.[16] The fact that the parties have filed cross motions does not alter the applicable standard.[17] The Court retains the discretion to deny both motions if it decides that the record requires a more thorough development to clarify the law or its application to the case.'*

B. Does SWIB Have Standing to Bring This Claim?

Peerless asserts that SWIB has no standing to bring this lawsuit because SWIB chose not to attend either the Annual Meeting or the Reconvened Meeting, did not object to the adjournment at either meeting, and did not exercise "reasonable diligence" to preserve its rights to challenge Galvadon's ruling as the Chairman of the meeting. Besides the fact that SWIB clearly expressed its displeasure with the adjournment by continuing to solicit against Proposal 2 with the July 1 Letter, the Court is aware of no

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party's response, by affidavits or as otherwise provided in this rule, must set forth specific facts showing that there is a genuine issue for trial. If the adverse party does not so respond, summary judgment, if appropriate, shall be entered against the adverse party.

[15] *Brown v. Ocean Drilling & Exploration Co.,* Del. Supr., 403 A.2d 1114, 1115 (1979).
[16] *Tanzer v. International General Industries, Inc.,* Del. Ch., 402 A.2d 382,385 (1979).
[17] *Bethany Village Owners Ass 'n, Inc. v. Fontana,* Del. Ch., C.A. No. 15539, at 12, Chandler, C. (Jan. 10, 2000).
[18] See *Alexander Indus., Inc. v. Hill,* Del. Supr., 212 A.2d 917, 918-19 (1965).

Delaware case or statute that holds that a shareholder must attend a shareholders meeting and record an objection or lose its ability to challenge the propriety of a shareholder vote.

More importantly, very strong policy rationales underlie why this attendance and objection requirement simply cannot be the law of Delaware. First, I note that the proxy solicitation system as it exists in the United States works in large part because shareholders are not required to attend meetings to protect their rights.[19] Instead, the system values the widespread ownership and distribution of corporate securities that is enabled by the proxy instrument.[20] Second, I note that the proxy system helps both the large investor who is spared the impracticalities and costs of attending all of the shareholder meetings of companies held in a heavily diversified portfolio as well as the small investor who may not have the time, money, or other resources necessary to attend the shareholder meetings of the companies in which that individual chooses to invest. Neither the large nor the small investor should have to sacrifice its rights to challenge improper actions by

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[19] Time will tell whether the level of interaction between shareholders and management, and the level of shareholder attendance, will be improved as a result of the recent amendment to the Delaware General Corporation Law that permits a company to hold its stockholder meetings at a virtual location, such as a website. See Britton, *Electronic Stockholders' Meetings—Delaware Begins the Next Chapter, 8* Corporate Governance Advisor, No. 5 (Sept./Oct. 2000).

[20] See *generally* Louis Loss & Joel Seligman, Fundamentals of Securities Regulation Ch. 6C, 437 (3d ed. 1995).

directors and officers simply because they have not attended a shareholders meeting. Third, where there is fraud, abuse, or some other inequitable conduct affecting the propriety of a shareholder vote, if the improper act or the effects of that act are not exposed until after the shareholders meeting, shareholders would effectively lose their right to seek redress. This rule of attendance and objection, as Peerless advanced, would bar shareholders from having the ability to challenge improprieties that they could not have possibly known about at the time of the shareholders meeting. The attendance and objection requirement urged by Peerless is not the law of Delaware. Thus, SWIB has standing to challenge the adjournment.

C. *Is Peerless a Proper Defendant to this Action?*

The defendants contend that Peerless owes no fiduciary duty directly to SWIB and therefore is not a proper defendant to this action because only the directors and officers of Peerless act as fiduciaries to the corporation and its shareholders.[21] While it is true that the Company per se does not owe fiduciary duties to its shareholders and that there was no formal board action approving the adjournment, it is undisputed that Peerless took action through its CEO, director, and co-defendant, Galvadon. Further, the decision to

[21] ***See, e.g., Arnold v. Societyfor Sav. Bancorp,*** Del. Ch., C.A. No. ***12883,*** slip op. at 17, Chandler, V.C. (June **15, 1995), *aff'd,*** Del. Supr., 678 **A.2d** 533 (1996).

adjourn was only made after consultation with, and approval by, the other Peerless directors.[22]

To this point, the Court also adds that Galvadon clearly acted in a capacity that gave rise to fiduciary duties even though he called for the adjournment while wearing the title of Chairman of the meeting. Galvadon's concurrent roles as CEO and director, as well as his attempt to incorporate the other directors into the decision to call for the adjournment, confirm why the acceptance of this temporary designation in no way extinguished or deferred his continuing fiduciary obligations to the Peerless shareholders during the Annual Meeting. Defendants' arguments on this question are beside the point. My analysis of claims I, II, and III follows.

D. Have Peerless and Galvadon Breached the Fiduciary Duty of Loyalty By Adjourning the Annual Meeting Without Closing the Polls on Proposal 2

1. The Shareholder Franchise

Before moving to a discussion of the specific claims of the parties, I take this opportunity to reaffirm the fundamental importance of the voting rights of shareholders in Delaware law. No one should doubt that "[t]here exists in Delaware a general policy against disenfranchisement" as "[t]he shareholder franchise is the ideological underpinning upon which the

[22] Peerless Op. Br. in Support of Summary Judgment, at 1.

legitimacy of directorial power rests."[23] The right to vote one's shares is a fundamental aspect of stock ownership governed and protected by 8 ***Del C.*** § 15 l(a). In the context of takeover defenses, the Delaware courts have forcefully written that board actions that affect the rights of shareholders to vote are deeply suspect.[24]

In *Blasius*, the Court of Chancery contemplated whether the shareholder franchise deserves unique treatment under Delaware, law.[25] Chancellor Allen discussed two reasons that distinguish the sanctity of the shareholder vote from the handling of other corporate actions. First, he pointed to the question of where and how a board of directors derives its power:

> it is clear that [the shareholder franchise] is critical to the theory that legitimates the exercise of power by some (directors and officers) over vast aggregations of property that they do not own. Thus, when viewed from a broad, institutional perspective, it can be seen that matters involving the integrity of the shareholder voting process involve consideration@] not present in any other context in which directors exercise delegated power.[26]

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[23] *Blasius Indus. v. Atlas Corp.*, Del. Ch., 564 A.2d 651, 659, 669 (1988).
[24] See, e.g., *Unitrin, Inc. v. American General Corp.,* Del. Supr., 651 A.2d 1361, 1378 (1995) ("This Court has been and *remains* assiduous in its concern about defensive actions designed to thwart the essence of corporate democracy by disenfranchising stockholders"); *Paramount Communications, Inc. v. QVC Network, Inc.,* Del. Supr. 637 A.2d 34, 42 (1994) ('Because of the overriding importance of voting rights, this Court and the Court of Chancery have consistently acted to protect shareholders from unwarranted interference with such rights.").
[25] *Blasius, 564* A.2d at 65 1.
[26] ***Blasius,*** *564* A.2d at 659.

Second, he identified the issue of the proper allocation of power between shareholders and directors. He noted,

> a decision by the board to act for the primary purpose of preventing the effectiveness of a shareholder vote inevitably involves the question who, as between the principal and the agent, has authority with respect to a matter of internal corporate governance.[27]

Although interference with the operation of a shareholder vote is not a *per* se violation of Delaware law, the concerns identified by Chancellor. Allen remain fundamental tenets which guide this Court in any dispute concerning the shareholder franchise;

2. *The Blasius Standard Versus Business Judgment Review*

Given this Court's historical role as a protector of the shareholder franchise, I must first determine the applicable standard for analyzing the claims in this matter. As has often been noted before, the choice of the applicable test to judge director action often determines the outcome of the case.[28] That is particularly true in this case involving a shareholder vote because the two possible tests provide for vastly different levels of review. On the one hand, SWIB asks the Court to apply the *Blasius* standard. This test potentially presents the defendants with the "quite onerous" burden of

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[27] *Blasius, 564* A.2d at 659-60 (citations omitted).
[28] *Stroud v. Grace,* Del. Supr., 606 A.2d 75, 90 (1992)(hereinafter "*Stroud II*").

demonstrating a compelling justification for their actions.[29] On the other hand, the defendants urge the Court to apply deferential business judgment review and examine the adjournment under the rubric of entire fairness. When the more deferential review is applied, "an attack on a fully informed majority decision to ratify a disputed action or transaction 'normally must fail. '"[30]

Blasius sets forth a relatively simple, yet extremely powerful, two-part test based on the duty of loyalty. Under that test, first the plaintiff must establish that the board acted for the primary purpose of thwarting the exercise of a shareholder vote.[31] Second, the board has the burden to demonstrate a compelling justification for its actions.[32] Under this second prong, even where the Court finds that the action taken by the board was made in good faith, it may still constitute a violation of the duty of loyalty.[33]

Nevertheless, *Blasius* does not apply in all cases where a board of directors has interfered with a shareholder vote. Many cases are instructive on this point. The most recent Delaware Supreme Court opinion validating

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[29] *Williams v. Geier,* Del. Supr., 671 A.2d 1368, 1376 (1996).
[30] *Stroud II,* 606 A.2d at 90 (quoting *Gerlach v. Gillam,* Del. Ch., 139 A.2d 591, 593 (1958)).
[31] *Blasius, 564* A.2d at 662. *Blasius* also refers to the subject of this first prong as whether the board exercised power "for the primary purpose of foreclosing effective shareholder action." *Blasius, 564* A.2d at 663.
[32] *Blasius, 564* A.2d at 662.
[33] *Blasius, 564* A.2d at 663.

the *Blasius* framework, *Williams* **v. *Geier,*** analyzed whether the board of directors of Cincinnati Milacron ("Milacron") could validly implement a recapitalization plan that provided for a form of "tenure voting." [34] In that plan, holders of common stock on the record date would receive ten votes per share, but upon sale or other transfer, each share would have only one vote until that share was held by its owner for three years.[35] Just before its finding that the *Blasius* standard did not apply to the facts of ***Williams,*** the Supreme Court noted that

> the application of the 'compelling justification' standard set forth in *Blasius* is appropriate only where the 'primary purpose of the board's action [is] to interfere with or impede exercise of the shareholder franchise,' and the stockholders are not given a 'full and fair opportunity to vote.'[36]

The Supreme Court concluded: "[w]e can find no evidence to support Williams' claim that the Defendants' primary purpose in adopting the Recapitalization was a desire to impede the Milacron stockholders' vote."[37] Inparticular, the Supreme Court observed that beyond any desire to obstruct the shareholders' voting rights, among the goals of the Recapitalization were the promotion of long-term value by the enhancement of voting rights of long-term shareholders, the ability to issue additional shares of common

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[34] *Williams, 671* A.2d at *1368.*
[35] *Id.*
[36] *Williams, 671* A.2d at *1376* (quoting *Stroud II, 606* A.2d at 92).
[37] *Williams, 671* A.2d at 1376.

stock for financing or other purposes with minimal dilution of voting rights of long-term shareholders, and the discouragement of hostile takeovers.[38] Therefore, the Court found *Blasius* inapplicable and reverted to a business judgment analysis in upholding the Milacron recapitalization.

In ***Stroud II,*** another highly informative case on the subject of the *Blasius* applicability to certain board actions, minority shareholders of Milliken Enterprises, Inc. ("Milliken") brought an action against the Milliken board of directors challenging the validity of the notice given for an annual meeting, and the validity of charter amendments and a bylaw adopted at that meeting by a majority of Milliken shareholders.[39] The controversy over the amendments specifically centered around a proposal that the Milliken shareholders should enter into a General Option Agreement ("GOA") that gave the Milliken family and then Milliken itself, a right of first refusal to purchase any Milliken shares offered to unrelated persons. The Supreme Court noted that members of the Milliken family who already owned a majority interest in the corporation supported the adoption of the proposal and that most other Miliken shareholders had also approved and executed the GOA.[40] Therefore "it cannot be said that the 'primary purpose'

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[38] *Id.*
[39] *Stroud II, 606* A.2d at 75.
[40] *Stroud II, 606* A.2d at 92.

of the [Milliken] board's action was to interfere with or impede exercise of the shareholder franchise" and, therefore, a *Blasius* analysis in connection with the validity of the amendments and the by-law was inappropriate.[41]

Similarly, when faced with a situation where a board unintentionally did not fulfill its statutory duty to seek shareholder ratification of an asset sale, I recently concluded that a board's unintentional failure to fulfill its statutory obligations, while perhaps constituting a breach of the fiduciary, duty of care, does not ordinarily trigger *Blasius* review as long as the 'primary purpose' of the board's action was not to interfere with or impede exercise of the shareholder franchise.[42]

In the absence of a finding that the primary purpose of the board's action was to interfere with or impede exercise of the shareholder franchise, the business judgment rule presumption applies.[43] That is, the plaintiff has the burden to rebut the presumption that the Peerless Board acted independently, with due care, in good faith, and in the honest belief that its actions were in the stockholders' best interests.* In the absence of a breach of a fiduciary duty in connection with the shareholder vote, when coupled

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[41] *Stroud II,* 606 A.2d at 92.
[42] *Apple Computer, Inc. v. Exponential Tech., Inc.,* Del. Ch., C.A. No. 163 15, mem. op. at 12 n.20, Chandler, C. (Jan. 21, 1999).
[43] *Williams, 671* A.2d at 1376.
[44] *Aronson v. Lewis,* Del. Supr., 473 A.2d 805,812 (1984).

with a fully informed shareholder approval of the proposal in question, the burden of proof remains squarely with the plaintiff to prove that the action taken by the board was unfair.[45] To sustain this burden, the plaintiff must prove that the board action was not properly taken or that the action was the product of fraud, manipulation, or other inequitable conduct.[46]

3. *Did the Peerless Board and Galvadon Act with the Primary Purpose of Frustrating the Shareholder Franchise?*

As is made clear by the two most recent Supreme Court decisions concerning the applicability of the stringent *Blasius* review, before moving on to the second step of the analysis involving a compelling justification, this Court must find that the primary purpose of the adjournment was "to interfere with or impede exercise of the shareholder franchise."[47] As explained above, for the sake of determining whether SWIB has satisfied the initial hurdle of the *Blasius* test on its motion for summary judgment, the Court will view all of the evidence in the light most favorable to the defendants.[48]

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[45] *Stroud II, 606* A.2d at 90. See *also Bershad v. Curtiss- Wright Corp.,* Del. Supr. 535 A.2d 840, 846 (1987); *Smith v. Van Gorkom,* Del. Supr., 488 A.2d 858, 890 (1985); *Weinberger v. UOP, Inc.,* Del. Supr., 457 A.2d 701, 703 (1983); *Michelson v. Duncan,* Del. Supr., 407 A.2d 211,224 (1979).
[46] *Stroud II, 606* A.2d at 93.
[47] *Stroud II,* 606 A.2d at 92; *Williams, 671* A.2d at 1376.
[48] *Brown v. Ocean Drilling & Exploration Co.,* Del. Supr., 403 A.2d 1114, 1115 (1979).

From this point forward in the analysis, I think it is necessary to summarize the evidence presented thus far pertaining to the inquiry into the primary purpose of Galvadon and Peerless in calling for the adjournment. For purposes of the following discussion, I assume that all of the facts relating to the troubles of the European stockholders are valid and true, and that if properly voted, these votes could have made the difference in passing Proposal 2. In connection with the defendants' argument concerning the low vote count as of the adjournment (and the corresponding need for a clearer statement of the will of the Peerless shareholders), I note that the total vote count at the Special Meeting (the Auco merger), 6,059,176, was smaller than the total vote count on Proposal 2 at the time of the adjournment, 6,533,116. Nevertheless, while the margin of victory of the Auco merger proposal was 5,344,498 votes, the margin of difference on Proposal 2 at the time of the adjournment was only 684,266 votes. Ultimately, the margin of victory for Proposal 2 at the Reconvened Meeting was only 221,070 votes. Moreover, the total number of votes on Proposal 2 was still considerably smaller than the total number of votes on Proposals 1 and 3, a significant percentage of Peerless shareholders still had not voted on Proposal 2 as of the Reconvened Meeting, and almost every share voted between the adjournment and the

closing of the polls at the Reconvened Meeting voted along with the Peerless management.

Beyond the evidence that can be gleaned simply from the numbers, the record contains some rather enlightening affidavit testimony that speaks directly to the reasons behind the adjournment. In response to a question asking "[w]ho decided to adjourn the [Annual Meeting]," Galvadon stated that the Board decided to adjourn the Annual Meeting if "as I said earlier, proposal No. 2 was behind and we didn't have enough votes cast."[49] Ms. Maduza's affidavit included the following exchange:

> Q: Am I right in understanding that if there were sufficient votes to pass [proposal 2], the company would not adjourn the meeting?
> A: Correct?'
> ...
> Q: Did the company make any efforts to inform all shareholders that they could still vote or change their vote during the adjournment period?
> A: No.[51]

Ms. Fabiola Vasquez, the administrative assistant to Ms. Maduza, also testified on the reasons behind the adjournment:

> Q: What was your understanding of the reasons for the adjournment?
> A: [Peerless] [r]eceived [a] quorum, but the proposal No. 2 did not look like it was doing too well, so we had it

[49] Pl.'s Ex. 3, 65.
[50] Pl.'s Ex. 5,168.
[51] Pl.'s Ex. 5, 181.

extended so that possibly within that time frame we would receive more yes votes.

Q: Where did you gain that understanding of the reason for the adjournment or how did you gain it?

A: It wasn't told to me directly. But, I mean, I don't want to insult you, but, you know, come on.

...

Q: You think it's clear that because there did not appear to be a number of votes to pass proposal 2 that that's the reason for the adjournment?

A: Correct.

...

. . . [The reason for the adjournment] was just common sense to me. And it was kind of what everyone thought -- felt as well.

Q: Can you explain what was common sense to you and what it was that everyone else felt as well?

A: The reason for the adjournment was to, hopefully, by the time of the next meeting, whenever, you know, they decided that was going to be, we would get enough yes votes to pass the proposal.[52]

In addition, the absence of any evidence of certain disclosures by Peerless during the adjournment period is highly probative in analyzing the intentions of the Company in calling for the adjournment. If the purpose of the adjournment was merely to increase shareholder participation on a very close vote so that the Company could abide by "the will of a majority of the

[52] Pl.'s Ex. 6, 46-48. I realize that the testimony of Ms. Vasquez is not based on firsthand knowledge of the decision to adjourn the meeting. I also recognize, however, that I am in no better position to consider the facts surrounding the Adjournment than Ms. Vasquez, an administrative assistant to one of the key figures in the dispute. The parties do not dispute that Ms. Vasquez witnessed and, to a certain extent, participated in many of the events in question. The Court, therefore, considers Ms. Vasquez's testimony highly relevant, albeit not necessarily conclusive.

shareholders,"[53] it makes absolutely no sense that Peerless did not inform all of its shareholders that it had called the adjournment, that shareholders could continue to vote on Proposal 2, and that the Company encouraged all of its shareholders to vote on Proposal 2 because the vote was very close. The fact that the final vote as tallied at the Reconvened Meeting was so much closer than the vote at the moment of the adjournment suggests that these disclosures would have been important if the Company truly wanted to obtain as clear a mandate as possible on Proposal 2.

Unfortunately, the factual record as it appears before me at this moment remains quite muddled on the specific events surrounding the adjournment. Yet, a simple distinction seems quite important in sorting through all the facts and testimony; inquiries into *purpose as* opposed to *justification are two* separate analyses that must remain distinct. The question of *purpose* asks for what ultimate ends were the acts committed. Purpose is defined as "[a]n objective, goal, or end."[54] The concept of *justification* concerns the rationale behind the search for that end. *Justification* is defined as "[a] lawful or sufficient reason for one's acts or omissions."[55]

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[53] Peerless Reply Br. in Support of Summary Judgment, at 8.
[54] ***Black's Law Dictionary 1250 (7th ed.*** 1999).
[55] ***Black's Law Dictionary 870-71 (7th ed.*** 1999).

Here, the primary purpose behind the adjournment was to ensure the passage of Proposal 2 by interfering with the shareholder vote and allowing Proposal 2 to have more time to gain votes. By its own concession, Peerless admitted at oral argument that it strongly preferred avoiding the time delay and extra expenses involved in admitting defeat and calling for another shareholder vote. There is no material factual dispute here that-regardless of the vote count or the turnout of European shareholders-if Proposal 2 had had enough votes to pass as of the Annual Meeting, there would have been no decision to adjourn.

I base this conclusion on (1) the inconsistent actions of the Peerless Board in deciding to close the polls at the Special Meeting and at the Reconvened Meeting in contrast to their decision to adjourn the Annual Meeting, (2) the uncontroverted affidavit testimony given by three Peerless employees, two of whom directly participated in the decision to call for the adjournment, and (3) the lack of any formal disclosures by the Company aimed at increasing overall voter turnout. All of the evidence concerning the low vote count and the problems of European shareholders, however, is highly relevant in determining whether the Peerless Board was *justified* in its decision to adjourn the Annual Meeting. But the simple truth is that the

adjournment only occurred because Proposal 2 did not have enough votes to pass on the date of the Annual Meeting.

This finding that the primary purpose of the adjournment was to interfere with the shareholder vote on Proposal 2 in no way indicates that the defendants acted in bad faith in calling for the adjournment. Even in the worst case scenario, it appears only that the defendants misapprehended an admittedly difficult legal principle. In short, I assume that the defendants acted in good faith at all times. Nevertheless, I may still find that the defendants violated the fiduciary duty of loyalty. *Blasius* is highly instructive on this point, as Chancellor Allen held that "even finding the action taken was in good faith, it constituted an unintended violation of the duty of loyalty that the board owed to the shareholders."[56]

4. *Have the Defendants Demonstrated a Compelling Justification For Interfering With the Shareholder Vote on Proposal 2?*

After concluding, as a matter of law based on the undisputed facts, that the Peerless Board acted for the primary purpose of interfering with the shareholder vote, the next step in the *Blasius* analysis is clear. As the

[56] *Blasius*, 564 A.2d at 663.

Supreme Court noted in ***Williams, "the*** board [now] bears the heavy burden of demonstrating a compelling justification for such action."[57]

The defendants offer a plethora of justifications for their decision to adjourn the meeting. I will review each in turn and consider their persuasiveness both individually and collectively.

First, the defendants argue that there is no duty of loyalty issue here and, therefore, ***Blasius'*** heightened standard should not apply. On this issue, the facts of this case are quite different from the typical ***Blasius*** case that involves entrenchment or control issues in which a clear conflict exists between the board and the shareholders. In ***Blasius,*** the incumbent board attempted to appoint new members at the eleventh hour to preclude shareholders from filling those seats by electing a hostile acquirer's candidates.'* The Board's appointments were enjoined because they prevented shareholders from electing a majority of dissident directors at the upcoming election?' Similarly, in ***Aprahamian v. HBO & Co., the*** board delayed a shareholder meeting to prevent the incumbent directors' electoral defeat.[60] The board was enjoined from delaying the director election and the

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[57] ***Williams, 671*** A.2d at 1376 (quoting ***Blasius, 564*** A.2d at 661).
[58] ***Blasius, 564*** A.2d at 65 1.
[59] *Id.*
[60] Del. Ch., 531 A.2d 1204 **(1987).**

inevitable defeat of the incumbents by a dissident slate.[61] I too have written that ***"Blasius*** and similar cases involve tactical maneuvers by incumbent boards seeking to ward off hostile acquirers and defeat dissident slates."[62] That may be the more typical example, but it is not the case here. This fact alone makes it more problematic to subject the adjournment to heightened ***Blasius scrutiny.***

As the earlier discussion of shareholder vote sanctity attempted to demonstrate, *Blasius* does not only apply in cases involving hostile acquirers or directors wishing to retain their position against the will of the shareholders. The derivation of board power from shareholders, as well as the allocation of power with respect to governance of the corporation, are broad structural concerns within the corporate form that are present in any shareholder vote. The fiduciary duty of loyalty between a board of directors and the shareholders of a corporation is always implicated where the board seeks to thwart the action of the company's shareholders. Nonetheless, that principle, admittedly wrapped in lofty idealism, is often difficult to apply to the practicalities of corporate governance. *Blasius* and its progeny attest to that fact.

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[61] *Id.*

[62] *Apple Computer,* C.A. No. 16315, mem. op. at 10.

Still, SWIB argues that the Peerless Board, and Galvadon in particular, had personal financial interests in the decision to adjourn the vote on Proposal 2 and, therefore, directly violated their fiduciary duties. No one disputes that Galvadon received a substantial portion of his compensation from Peerless in the form of stock options. Moreover, Galvadon testified he was aware that he could receive options from the 1,000,000 shares that were the subject of Proposal 2.[63] Additionally, the Peerless Board discussed and approved this increase in the number of shares in the option plan in conjunction with the Board's request that Maduza prepare an overall program to compensate management, including Galvadon?

In arguing that Galvadon had no direct, financial interest in Proposal 2, defendants point out that Proposal 2 does not grant options to any director, officer, or employee of Peerless; nor does Proposal 2 vary the terms on which any options are granted pursuant to the Company's existing option plan. Further, defendants maintain that any interest created by the directors' status as potential recipients of options in the normal course of business is too remote and attenuated to pose a conflict of interest under these circumstances, the outside directors received all their options according to a

[63] Pl.'s Ex. 3, 18-19.
[64] Pl.'s Ex. 5, 33-34, 36-37, 62-63.

pre-existing fixed formula, and that any option grant made to Galvadon would first have to be approved by a committee of outside directors. In the midst of these contentions, I note that some evidence exists that the 1,000,000 options had three primary uses (at least as presented to the Peerless Board): (i) to retain and further recruit for the Peerless engineering base; (ii) to retain Auco employees post-acquisition; and (iii) to grant to Peerless executives?

At this point in time, the factual record on this issue is insufficiently developed to enable me to come to any clear conclusions. Mindful of these facts, however, I will proceed with the compelling justification analysis, viewing all the evidence in the light most favorable to the non-moving party.

Second, Peerless argues that no act of disenfranchisement occurred here. Specifically, the defendants contend that the directors and officers of Peerless owe fiduciary duties not only to the opponents of Proposal 2, but to all Peerless shareholders. Therefore, because Proposal 2 passed at the Reconvened Meeting after additional shareholders had the opportunity to vote, Peerless asserts that to act otherwise would have denied its shareholders "a full and fair opportunity to vote" as required by *Stroud II*?

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[65] Pl.'s Ex. 5, 172.
[66] *Stroud* II, 606 A.2d at 92.

As it stands, because Proposal 2 ultimately passed at the Reconvened Meeting, albeit with the support of less than a majority of outstanding Peerless shares, Peerless concludes that the adjournment allowed for the expression of a *greater number* of shareholders and concurrently effectuated the true, overall will of the Peerless shareholders.

In this justification, Peerless essentially argues that the post-adjournment ratification of Proposal 2 moots SWIB's claims. In reviewing issues of ratification, Delaware law divides improper acts by the board into two separate categories, void acts and voidable acts.[67] Void acts include those that are *ultra vires*, fraudulent, gifts or waste, and are legal nullities incapable of cure.[68] Voidable acts are performed in the interest of the company, but beyond the authority of management, and are also cause for relief.[69] If the shareholders ratify the voidable act after the fact, as opposed to the void act, the ratification cures the defect and relates back to moot all claims provided that the ratification was "fairly accomplished."[70]

Here, even if I assume that the adjournment was made in the interests of the Company and therefore was a voidable act that may be cured, it is far

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[67] For a discussion of ratification issues under Delaware law, see ***In re Wheelabrator Tech., Inc. Shareholder Litig.***, Del. Ch., 663 A.2d 1194 (1995).
[68] ***Apple Computer,*** C.A. No. 163 15, mem. op. at 15.
[69] ***Id.***
[70] ***Michelson v. Duncan,*** Del. Supr., 407 A.2d 2 11, 2 18-2 19 (1979).

from clear whether the ratification was "fairly effected and intrinsically valid."[71] The parties hotly dispute whether the defendants directly solicited votes in favor of Proposal 2 during the adjournment or rather simply solicited votes without illustrating a bias either way. This question affects the ability of the ratification to cure the act, and requires further factual development before I can determine the fairness of Proposal 2's final vote. Although the later shareholder vote approving Proposal 2 weighs. in the favor of defendants, lingering questions prevent the vote from being dispositive of this matter,

Third, Peerless points to the low vote count on Proposal 2 at the moment of the adjournment and argues that a need for a higher vote count justified the adjournment. I know of no Delaware case or statute that supports this rationale where a quorum is present. Absent a legal reason to support this argument, one is hard pressed to understand why this particular low vote count required adjoumment, while other similarly low vote counts do not. As discussed above, I also find this argument unpersuasive based on the lower number of votes at the special meeting as well as the closer vote at the Reconvened Meeting-but the lack of adjournment in those two instances. The lack of any informational disclosures aimed at increasing the

[71] *Id.*

vote count, together with the affidavit testimony, further attest to the unimportance of this factor.

Fourth, Peerless describes the troubles of their European shareholders in unsuccessfully attempting to vote their proxies. I also find this argument unpersuasive for several reasons. Although corporate governance of a Delaware corporation is largely left in the hands of directors and officers, there are certain responsibilities that come with being a shareholder as well. Under Delaware law, a stockholder has the final decision whether or not to vote his shares.[72] A stockholder also has the right not to attend a meeting and be represented at that meeting by giving a general or lirnited proxy to vote those shares.[73] Generally, this Court is very lenient in enabling shareholders to vote by proxy as "[w]hatever reasonably purports to be a proxy of a shareholder entitled to vote at an election is entitled to a prima facie presumption of validity."[74] Further, this Court has also written that "the use of proxies in corporate elections should not be hedged about by restrictions which, because of practical considerations, are almost prohibitive."[75] That is not to say, however, that the company or the other

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[72] ***Berlin v. Emerald Partners,*** Del. Supr., 552 A.2d 482,493 (1989).
[73] 8 Del. C. $212; ***Berlin v. Emerald Partners, 552*** A.2d at 493.
[74] ***Standard Power & Light Corp. v. Investment Assocs.,*** Del. Supr., 51 A.2d 572,580 (1947).
[75] ***Atterbury v. Consolidated Copper-mines Corp.,*** Del. Ch., 20 A.2d 743,747 (1941)

shareholders become in any way responsible for enabling the proxy agent to properly vote those shares where the company has given proper notice and ample time for the proxy agent to complete his duties and has in no way acted to impede, prevent, frustrate, or interfere with the shareholder's ability to vote by proxy. The proxy relationship is "a particular sort of agency" where the stockholder is the principal and the proxy agent is just that, the agent to vote the shares.[76] Ultimately, the European shareholders, not Peerless, must bear responsibility for entering into the proxy relationship, choosing their own custodial bankers, and making sure their chosen agent is competent enough to vote these proxies on time. These requirements represent the absolute bare minimum expected of shareholders who choose not to attend a shareholder meeting and vote by proxy.

Perhaps I would be slightly more sympathetic to the European shareholders' plight if the circumstances were different. By all accounts, however, we are dealing here with sophisticated investors who presumably control equity holdings in many countries, as well as proxy agents and custodial banks who likewise must have some familiarity with various proxy procedures around the world. For the sake of argument, even

[76] *Duffy v. Loft,* Inc., Del. Ch., 151 A. 223, 227 (1930), *aff'd,* Del. Supr., 152 A. 849 (1930).

at the outermost boundary of accommodation, the Company might believe it has some responsibility to help sophisticated European investors properly vote their shares in compliance with the governing voting procedures. But Peerless asks this Court, in effect, to make the shareholders who voted on time bear responsibility for the inability of other shareholders and the chosen agents of those shareholders to properly file their proxies on time. This, to my mind, is inappropriate.

Fifth, Peerless argues that the adjournment was lawfully consistent with its by-laws and was made without objection from any shareholder present at the Annual Meeting. This argument ignores the clear rule that "inequitable action does not become permissible simply because it is legally possible."[77] As I observed earlier, I am unmoved by an argument based on the lack of an objection to the motion for adjournment at the Annual Meeting.

Sixth, defendants also insisted at oral argument that the alternative to adjourning the Annual Meeting would have been to admit defeat on Proposal 2 and resubmit the proposal for a new vote at a subsequent shareholders meeting. They argued that that course of conduct entails substantial cost and some delay. Although I am not blind to the practicalities of shareholder

[77] *Schnell v. Chris-Craft Industries, Inc.*, Del. Supr., 285 A.2d 437,439 (1971).

votes, this justification, perhaps vitally important in the minds of management in terms of cost and efficiency analyses, is not a compelling reason to forego the legally required procedures.[78]

Individually, I have noted possible objections to each of Peerless's justifications. Considering them together, it is doubtful that at the end of the day, based on the factual record presently before me, the defendants will have provided a compelling justification for their actions. Nevertheless, I confess discomfort, at the summary judgment stage, in deciding whether the defendants had a compelling justification when calling for the adjoumment. The justifications offered by Peerless *collectively* provide some hope or reasonable possibility for satisfying the onerous compelling justification burden. As a result, although I am convinced, as a legal matter, that defendants acted with the primary purpose of interfering with the shareholder vote on Proposal 2 (and therefore *Blasius* does apply), I leave

[78] Given the conclusions reached in this decision, the continuing costs of engaging in this litigation, and the time it will take for the Court to ultimately render a decision on the merits, one would think the management of Peerless might well reconsider its decision not to call another special shareholders meeting and hold a new vote.

The Court recognizes the Company's pressing need to use the option shares to attract and retain key personnel. The pendency of this lawsuit, of course, places a cloud over the Company's ability to make option g-rants from the 1,000,000 share pool that Proposal 2 authorized. If the Company chooses to issue options before final resolution of this action, it must inform the option recipients fully of the legal uncertainty surrounding the stock in question. Although scheduling a new vote at a special meeting would likely cost less than a full trial, and possible appeal, of this matter, the Court is prepared to schedule a trial in a reasonably prompt fashion if that is the parties' request.

for another day the question whether defendants acted with a compelling justification. This issue requires further argument and factual development. Accordingly, I deny both the plaintiffs and the defendants' motions for summary judgment on claim I.

E. Did Galvadon, Specifically, Breach His Fiduciary Duty of Loyalty?

In claim II, SWIB accuses Galvadon of a breach of his duty of loyalty when he adjourned the Annual Meeting on Proposal 2 knowing that he had a direct, personal financial interest in the outcome of that vote. SWIB insists that Galvadon engaged in self-interested conduct that was not entirely fair to the shareholders or the Company. Under longstanding Delaware precedent, director action that is self-interested or for selfish reasons is a breach of the fiduciary duty of loyalty.[79] When a director uses his office to promote, advance, or effectuate a transaction that is in the personal financial interest of the director, the director has the burden of establishing good faith as well as the "most scrupulous inherent fairness" of the transaction.[80] When faced with this question of divided loyalties, the director has the burden of

[79] *Guth v. Loft*, Del. Supr., 5 A.2d 503,510 (1939).
[80] *Mills Acquisition Co. v. MacMillan Inc.*, Del. Supr., 559 A.2d 1261, 1280 (1989).

establishing the entire fairness of the transaction to survive careful judicial scrutiny!

As discussed above, the record is not developed sufficiently to make the necessary factual conclusions concerning this claim. If claim II is to proceed, I will require, in particular, a stronger development of the record as to Galvadon's potential to receive options issued as a result of Proposal 2, as well as Galvadon's personal knowledge of these facts at the time. of the adjournment. At this juncture, I find too many questions left unanswered to reach a judgment *on* claim II for either party. Accordingly, I deny both motions for summary judgment on this claim as well.

F. Did the Defendants Omit Material Information and Make False and Misleading Statements of Material Facts About the Adjournment?

In Claim III, SWIB argues that the defendants failed to adequately disclose all material information about the adjournment to the Peerless shareholders. In particular, SWIB contends that before the Annual Meeting, the defendants failed to fully and fairly give notice that they planned to adjourn the Annual Meeting and seek additional votes in favor of Proposal 2 if two conditions were met, namely that Proposal 2 was losing and enough shareholders had not voted so that the Company had a prospect of passing

[81] *Id.*

Proposal 2 with further solicitation efforts during the adjournment period. SWIB also asserts that the defendants improperly failed to disclose during the adjournment period that: (i) Galvadon closed the polls on Proposals 1 and 3 but adjourned the Annual Meeting without closing the polls on Proposal 2; (ii) Proposal 2 would have failed to pass had Galvadon not adjourned the Annual Meeting; (iii) Peerless shareholders could still vote or change their votes during the adjournment period; or, (iv) Peerless would continue to solicit "yes" votes on Proposal 2 during the adjournment period (the "Adjoumment Period Disclosures").

Under Delaware law, a board of directors is under a fiduciary duty to disclose fully and fairly all material information within the board's control when seeking shareholder action.[82] This disclosure obligation clearly attaches to proxy statements.[83] There is, however, no per se doctrine imposing liability with regard to the fiduciary duty to disclose? Further, an action of this type does not include the elements of reliance, causation, or actual quantifiable monetary damages.*' Instead, "[t]he essential inquiry in such an action is whether the alleged omission or misrepresentation is

[82] *Stroud II,* 60A.2dat 75, 84.
[83] *Arnold v. Society For Savings Bancorp.,* Del. Supr., 650 A.2d 1270, 1277 (1994).
[84] *Loudon v. Archer-DanieLs-Midland Co.,* Del. Supr., 700 A.2d 135, 137-38 (1997).
[85] *Malone v. Brincat,* Del. Supr., 722 A.2d 5, 12 (1998).

material. Materiality is determined with respect to the shareholder action being sought."[86]

The Delaware Supreme Court has adopted the materiality standard expressed by the United States Supreme Court in *TSC Industries, Inc. v. Northway, Inc.*:

> [a]n omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote.. .. [This standard] does not require proof of a substantial likelihood that disclosure of the omitted fact would have caused the reasonable investor to change his vote. What the standard does contemplate is a showing of a substantial likelihood that disclosure of the omitted fact would have caused the reasonable investor to change his vote. What the standard does not contemplate is a showing of a substantial likelihood that, under all the circumstances, the omitted fact would have assumed actual significance in the deliberations of the reasonable shareholder. Put another way, there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available.[87]

At this point, I note that regardless of how these disclosures or omissions may have affected SWIB's vote, the materiality standard refers to the deliberations of a "reasonable investor," not "the plaintiff."

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[86] *Id.* (citations omitted).

[87] *Rosenblatt v. Getty Oil Co.*, Del. Supr., 493 A.2d 929,944 (1985) (quoting *TSC Indus., Inc. v. Northway, Inc., 426* U.S. *438,449* (1976)).

First, I will analyze the claims pertaining to disclosures that SWIB believes should have occurred prior to the Annual Meeting. Again, briefly, these are that the defendants failed to fully and fairly give notice that they planned to adjourn the Annual Meeting and seek additional votes in favor of Proposal 2 if the two aforementioned conditions were met. In response, Peerless correctly points out that it expressly followed the procedure set forth in its by-laws as well as § '222(c) of the Delaware General Corporation Law (the "DGCL") regarding the required notice for a reconvened shareholders meeting. The statute states in relevant part:

> When a meeting is adjourned to another time or place, unless the bylaws otherwise require, notice need not be given of the [reconvened] meeting if the time and place thereof are announced at the meeting at which the adjournment is taken.[88]

SWIB does not dispute that the defendants' conduct abided by the express language of the statute.

Also, the defendants' disclosure obligations do not require them "to characterize their conduct in such a way as to admit wrongdoing."[89] As stated in *Stroud II,* "a board is not required to engage in 'self-flagellation' and draw legal conclusions implicating itself in a breach of fiduciary duty from surrounding facts and circumstances prior to a formal adjudication of

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[88] 8 *Del.* c. § 222(c).
[89] *Loudon v. Archer-Daniels-Midland,* Co., 700 A.2d at 143.

the matter."[90] In arguing that Peerless had a duty to disclose its intention to adjourn the Annual Meeting and solicit additional votes, SWIB argues just that. These disclosures were simply not required of the defendants.

Next, I consider the need to make the Adjournment Period Disclosures. At first glance, I am skeptical that these disclosures on purely procedural matters would have significantly altered the 'total mix' of information made available to investors in deciding how to vote on the substance of Proposal 2.[91] More importantly though, SWIB, itself, made the disclosures it complains. of, albeit in rough form, during the Adjournment Period. The July 1 Letter sent by SWIB to all Peerless shareholders states:

> **PEERLESS SYSTEMS ADJOURNS MEETING!** Peerless now wants to start the clock over on its meeting. Shareholders refused to approve the option plan at the June 17, 1999 annual meeting. Now Peerless wants to use the very questionable practice of keeping the polls open on the option plan hoping they can get shareholders to switch their votes. Don't let them get away with this unfair tactic. **VOTE <u>AGAINST</u> PEERLESS SYSTEMS' PROPOSAL #2!**[92]

Compared with the proposed Adjournment Period Disclosures, the July 1 Letter is clear that the defendants adjourned the Annual Meeting without

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[90] Stroud *II*, 606, A.2d at 84 n. 1.

[91] The Court's concerns relating to the Adjournment Period Disclosures all properly speak to the procedural integrity of the vote on Proposal 2 as opposed to the substantive merits of that proposal. As such, the Court also considers the equitable effects of these disclosure issues on claim I.

[92] Pl.'s Ex. 20.

closing the polls on Proposal 2. The July 1 Letter also indicates by negative inference that Proposal 2 would have failed to pass had Galvadon not adjourned the Annual Meeting when it states that the "[s]hareholders refused to approve the option plan at the June 17, 1999 annual meeting."[93] Further, the letter not only makes obvious that shareholders were implored to vote on Proposal 2, but also that shareholders had the option to switch their vote during the adjournment period. Finally, the July 1 Letter also is explicit that Peerless was working to solicit "yes" votes on Proposal 2 during the adjournment period. Given these disclosures by SWIB to all the Peerless shareholders, even if the defendants had made the Adjournment Period Disclosures, these disclosures would not have significantly altered the total mix of information available to the Peerless shareholders. Additionally, given the relatively miniscule impact that the July 1 Letter appears to have had on the Peerless shareholders judging from the small increase in the "no" vote count at the Reconvened Meeting, the disclosures by themselves would not meet the test for materiality. I, therefore, grant summary judgment on claim III in favor of the defendants.

[93] *Id.*

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[93] *Id.*

G. Does the Doctrine of Unclean Hands Bar SWIB From Seeking Equitable Relief?

The Defendants argue that SWIB knowingly misrepresented the facts in soliciting against Proposal 2 in its June 1 and July 1 Letters and failing to correct its errors prior to the Reconvened Meeting. The standard for the application of an unclean hands defense "is that the inequitable conduct must have an 'immediate and necessary' relation to the claims under which relief is sought."[94] Before applying the doctrine though, we must remember that, as stated above, on a motion for summary judgment, the Court must view all of the evidence in the light most favorable to the non-moving party.[95] Here, the defendants assert that their interpretation of certain terms in the two letters, namely the points dealing with potential dilution, option grants, and option repricing is correct and therefore that SWIB intentionally misrepresented the facts. SWIB disputes these contentions and argues for a different interpretation of the text of these letters that is consistent with its view of the facts. There are clear issues of fact relating to the events called

[94] *Nakahara v. NS 1991 Am. Trust*, Del. Ch., 718 A.2d 5 18, 523 (1998); see ***Eastern States Petroleum v. Universal Oil Prod. Co.,*** Del Supr., 8 A.2d 80, 82 (1939).
[95] Brown ***v. Ocean Drilling & Exploration Co.,*** Del. Supr., 403 A.2d 1114, 1115 (1979).

into question by this defense. As a result, neither party is entitled to summary judgment on this issue.

II. CONCLUSION

In *Blasius*, ***this Court*** observed that:

> [i]t has, for a long time, been conventional to dismiss the stockholder vote as a vestige or ritual of little practical importance. It may be that we are now witnessing the emergence of new institutional voices and arrangements that will make the stockholder vote a less predictable affair than it has been.[96]

Since the *Blasius* opinion was issued over a decade ago, several large institutional stockholders, including SWIB, have become increasingly proactive in challenging management proposals by asserting their rights as stockholders. This is a wholesome development for purposes of corporate governance under Delaware's corporation law.

This trend over the last decade towards the increased vigilance of shareholders is evidenced not only by the efforts of large institutional shareholders such as SWIB, but also by the increasingly powerful role played by smaller investors in challenging the traditional power of officers and directors in deciding matters of corporate governance. The recent

[96] *Blasius*, *564* A.2d at 659 (citations omitted).

Securities and Exchange Commission release concerning the disclosure of information to analysts and individual investors attests to this new order.[97]

The strengthening of shareholder interest in monitoring the activities of officers and directors only further emphasizes the importance of the shareholder franchise as the bedrock foundation upon which the legitimacy of directorial power rests. Any efforts by those controlling the vote to alter the results of that vote, even where there is no clear conflict of interest between the directors and the shareholders, must be undertaken with extreme caution so as not to undermine the legitimacy of the corporate structure itself. In this case, it is not clear at this point whether the defendants exercised this high degree of caution embodied in the "compelling justification" standard. It is clear, however, that adjournments that are specifically aimed at interfering with the results of a valid shareholder vote will bestir deep judicial suspicion.

In sum, although the defendants would appear to have a difficult road ahead of them if they are to demonstrate a compelling justification for their actions, I am nevertheless not prepared to declare, as a matter of law, that Peerless cannot satisfy the compelling justification burden. Therefore, I

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[97] Selective Disclosure and Insider Trading, Exchange Act Release No. 34-43154, 73 S.E.C. Docket 3, Release No. IC 24599 (Aug. 15, 2000).

deny both the plaintiffs and the defendants' motions for summary judgment on Claim I. I also deny both motions for summary judgment on Claim II 'as genuine issues of material fact clearly exist regarding it. On Claim III, I grant the defendants' motion for summary judgment.

IT IS SO ORDERED.