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Western Investment Hedged Partners LP v. Sunset Financial Resources, Inc.: Exercising Control of Corporate Machinery through a Manipulative Democracy

In Western Investment Hedged Partners LP v. Sunset Financial Resources, Inc., the Maryland Business & Technology Court addressed a power struggle between the directors and shareholders of a corporation. The court held that corporate directors are protected against shareholder derivative suits so long as they perform their duties to the minimum degree required to maintain compliance with the company's bylaws and articles of incorporation. While the court attempted to illuminate the impact of shifting expectations and responsibilities of corporate directors, such an explanation came at the expense of minority shareholders and their already limited ability to influence and enact change. Rather than bolster and sustain the position of lesser stockholders in corporate elections, the court incorrectly reasoned that the actions of corporate directors are acceptable so long as they are facially legal. Moreover, the court failed to promote the interests of lesser shareholders and ignored the original purpose of this particular type of business entity, the real estate investment trust, which was designed to allow smaller investors a modicum of control in a larger corporate world. This ruling disturbs the already tenuous balance of power between directors and small scale shareholders, resulting in a dramatic and unwarranted shift in the balance of power in favor of corporate officers.

* J.D., University of Maryland School of Law, 2008; B.A., University of Pennsylvania, 2004.
2. Id., slip op. at 1–2.
3. Id., slip op. at 6–7.
4. Id., slip op. at 5–7.
6. W. Inv., No. 24-C-05-009540, slip op. at 7.
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I. THE CASE

The Lipson plaintiff group7 ("Lipson") operated its business from Salt Lake City, Utah, and shared a common business interest in acquiring, holding, and disposing of investments in various companies.8 Collectively, Lipson owned 1,021,300 shares of common stock in the defendant company, Sunset Financial Resources, Inc. ("Sunset Financial").9 Specifically, these shares were part of a Maryland Real Estate Investment Trust (REIT).10 Lipson's holdings amounted to 9.7% of Sunset Financial's total outstanding stock.11

On August 27, 2005, Lipson submitted a letter calling for a special meeting of the stockholders.12 The impetus behind Lipson's request was a growing dissatisfaction with Sunset Financial's management.13 The purpose of the proposed meeting was to remove a majority of the board members and replace them with directors who shared Lipson's views regarding the direction of the REIT.14 Subsequently, Sunset Financial's board of directors amended the company bylaws to increase the number of shareholders needed to call a special meeting from 25% to 50%.15

In response to the amendment of the bylaws, Lipson filed a Preliminary Consent Solicitation Statement with the Securities and Exchange Commission (SEC) specifically asking to conduct a special meeting of the company's stockholders to remove several of the current board members.16 Sunset Financial then enacted an additional series of amendments to the bylaws effectively creating more obstacles to meaningful minority participation in the corporate election process.17 Believing that the recent amendments sought to foil its efforts to reshape the board of directors, Lipson filed a complaint seeking a declaration setting aside the new amendments to the company's bylaws and enjoining their enforcement.18

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7. In addition to the individual, Arthur Lipson, the plaintiff group included two Delaware limited liability companies and a Delaware limited partnership. Id., slip op. at 1.
8. Id.
10. W. Inv., No. 24-C-05-009540, slip op. at 1; see infra Part II.A (discussing the origin of the modern REIT).
11. W. Inv., No. 24-C-05-009540, slip op. at 1; Sunset Financial reported these figures, 1,021,300 shares of common stock amounting to 9.7% of the total outstanding common stock, on August 10, 2005. Id.
12. Id.
13. Id.
14. Id., slip op. at 1--2.
15. Id., slip op. at 1.
16. Id.
17. Id. The new amendments altered many facets of the company's bylaws, including the procedure and time limitations for the board to field requests for special meetings, the procedure for nominating and electing directors at special meetings, the addition of an advanced payment requirement of certain costs associated with special meetings, and a provision permitting the secretary to cancel a special meeting up to ten days before the meeting date if a sufficient number of stockholders revoked their requests for the meeting. Id., slip op. at 3.
18. Id., slip op. at 2.
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Lipson and Sunset Financial attended a scheduling conference and proceeded with limited discovery.19 Sunset Financial then filed a motion for summary judgment.20 On March 3, 2006, the Maryland Business & Technology Court heard arguments on the motion to determine the reasonableness of the actions of Sunset Financial’s board of directors and the compatibility of those actions with the scope of their fiduciary duties as corporate directors.21 In reaching its decision for the defendant, the court relied heavily on Delaware case law due to the dearth of relevant Maryland jurisprudence.22

II. LEGAL BACKGROUND

In Blasius Industries, Inc. v. Atlas Corp.,23 the Delaware Court of Chancery explained that if it is “to have any validity, [the corporate election process] must be conducted with scrupulous fairness and without any advantage being conferred or denied” to any interested party. 24 This notion of fairness draws upon pivotal doctrine utilized within the corporate world—namely a corporate director’s fiduciary duty to the shareholders of the corporation.25 Fairness, however, is reciprocal and also serves to protect directors from the frivolous claims of shareholders by shielding them with the business judgment rule.26 These doctrines must be framed against the history and purpose of the REIT in order to determine the appropriate balance of power between directors and shareholders within the context of corporate REITs.

A. Real Estate Investment Trusts

The modern REIT is vastly different than its precursor, the common law business trust.27 Historically, common law business trusts allowed groups of investors to pool their resources and invest in real estate as a collective unit.28 These trusts were especially appealing because they provided valuable incentives for investors, such as exemptions from state statutory restrictions on corporate investment in real estate and tax benefits.29 In 1935, however, the Supreme Court of the United States held in Morrissey v. Commissioner of Internal Revenue that such trusts were virtually indistinguishable from corporations and were not exempt from corporate tax re-

19. Id.
20. Id.
21. Id.
22. Id., slip op. at 4.
23. 564 A.2d 651 (Del. Ch. 1988).
24. Id. at 661.
26. Id. at 426.
27. Kelley, supra note 5, at 1–2.
28. Id.
29. Id. at 2. Specifically, common law business trusts “were not taxed on trust income currently distributed to the beneficial owners.” Id. The common law business trust also provided corporations with other beneficial tax breaks which heightened the attractiveness of this form of investment. Id.
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quirements. This decision directly lead to a shift in business law wherein REITs were no longer formed as common law business trusts, but rather took on the corporate form or the partnership form. This significant change resulted in adverse consequences for small time investors, such as REIT owners, who could not afford to operate within the fast-moving, expensive corporate world.

Following the Morrissey decision, and in the wake of World War II, Congress attempted to reclassify the status of REITs and allow their owners similar benefits to those previously available. This effort was thwarted by President Eisenhower in 1956 for numerous reasons, among them, “permitting REITs to avoid payment of the corporate tax might be availed of by existing real estate corporations, thereby depriving the Treasury of substantial revenue.” Despite this adverse presidential veto, Congress pushed forward with a new bill in 1960 that laid out clear terms for who would qualify for REIT tax treatment, with corporations specifically excluded. With President Eisenhower’s approval, and the Treasury Department’s withdrawal of its earlier objections, a new type of REIT came to life.

The new formation openly barred all corporations from identifying themselves as investment trusts, instead focusing tax benefits upon low level investors who could now “enjoy advantages that were available under prior law only to those with larger resources.” These advantages included “spreading the risk of loss by the greater diversification of investment that can be obtained through the pooling of investments,” as well as affording small time investors a chance to participate in investment projects that were beyond their capability on an individual level. Hence, REITs can be operated as corporations, but they are not like other corporations; they must leave their opportunities open to investors and distribute their gains in order to maintain their legal classification as REITs.

Since 1960, the REIT has continued to be shaped through a series of federal enactments, including the Tax Reform Act of 1969 and the Revenue Act of 1997. However, many of these modifications were technical in nature, and if anything, did very little to alter the scope of the REIT benefits for small scale investors. In spite of the Morrissey decision and the ensuing shifts in business law, the purpose of the REIT was, and still is, the result of a congressional effort to “give the small

31. KELLEY, supra note 5, at 2.
32. Id. at 3.
33. Id.
34. Id.
35. Id.
36. Id. at 3–4.
37. Id. at 3.
38. Id. at 3–4.
40. KELLEY, supra note 5, at 4–8.
41. See generally id.
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investor an opportunity to invest in real estate similar to the opportunity he had to invest in mutual funds.42 It is against this evolving backdrop of burdens and benefits that REITs and their shareholders operate.

B. The Deferential Business Judgment Rule and its Relationship to Corporate Governance

Judicial reluctance to second guess decisions by directors with respect to their business conduct can be traced back over 250 years.43 This hesitation to interfere with corporate decision-making occurs for a variety of reasons, including the “[r]ecognition of the possibility of error and the need to apply a relaxed standard before imposing liability so as to maintain the pool of potential directors.”44 In addition, courts demonstrate an unwillingness to overstep their judicial limits concerning directors by encouraging the “efficient acceptance of risk.”45 Finally, courts defer to corporate decision-making because “directors are, in most cases, more qualified to make business decisions than are judges.”46 Unfortunately for shareholders, these policy-based rationales encourage the judiciary to adhere to a rule designed to promote fairness, but instead sparks further imbalance through its strong veil of protection.

One of the primary problems with analyzing a director’s actions within the scope of their corporate duties is that it is often difficult to determine when self-interest has affected the decisions of management.47 This murky territory has the potential to severely complicate the already difficult role of directors, subject directors to harsh scrutiny from shareholders, and expose directors to shareholder derivative suits for their actions.48 Courts and corporations have reacted by defaulting to and relying upon the protections of the business judgment rule—specifically, the “presumption that in making a business decision[,] the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company.”49 Unless there is a clear and palpable abuse of discretion, the actions of corporate directors enjoy a presumption of reasonableness.50

45. Id.
48. Id. at 425.
50. Id.
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Percy v. Millaudon,51 an 1829 case before the Louisiana Supreme Court, is widely considered to be one of the first decisions that specifically emphasized issues emblematic of the business judgment rule.52 In Percy, the court considered a claim stating that directors of a corporation were liable for numerous acts of self-interest, including “fraudulent and unfaithful conduct” resulting in $451,000 of debt to the corporation.53 The defendant directors, in response to these allegations, averred that “if in all the acts complained of, any be true, they were the acts of the whole board of directors, done and made in good faith, and free from bad and corrupt intention.”54

In reaching its conclusion, the court stated that it is of great importance to the public that the agents to whom their direction is entrusted “should be protected while they act faithfully.”55 Moreover, the court noted that “[t]here is not a scintilla of evidence that the defendants had any knowledge of . . . misconduct in this particular.”56 As a result of this conclusion, the directors were shielded from liability.57

The Percy decision was likely the first in a long series of opinions that have formulated the modern business judgment rule.58 In 1984, the rule was consolidated by the landmark decision of the Delaware Supreme Court in Aronson v. Lewis.59 In Aronson, a group of directors was accused of self-interest relating to an employment agreement that granted immense benefits to a seventy-five year old former director.60 Specifically, the plaintiff argued that the employment agreement lacked a valid business purpose, was a waste of corporate assets, and that the agreed upon compensation was grossly excessive in light of the scant services provided by the elderly director.61 After review, the court issued a declaration that has since become widely accepted as a presumption of directorial good faith and loyalty that shields corporate officers from legal action unless countered with particularized facts showing breach of fiduciary duty.62 The court expressly stated “[t]he business and affairs of a corporation . . . shall be managed by or under the direction of a board of directors . . .” and “[t]he business judgment rule is an acknowledgment of

51.  8 Mart. (n.s.) 68 (La. 1829).
53.  Percy, 8 Mart. (n.s.) at 68. These claims were based on the charge that the directors allowed the president and cashier of the company to discount notes from the fund without the required unanimous directorial consent. Id. Additionally, plaintiff charged that the directors “fraudulently reported the [state of the company] cash to be correct, whereas in truth it was not so; but there was a deficiency of $49,000.” Id. at 70.
54.  Id. at 72.
55.  Id. at 73.
56.  Id. at 80.
57.  Id.
60.  Id. at 808–09.
61.  Id. at 809.
62.  Id. at 811. This presumption is reiterated many times in Delaware case law following Aronson. Block et al., supra note 43, at 20.
the managerial prerogatives of Delaware directors." 63 With this strong assertion, the court defended the actions of corporate directors by offering them the umbrella protections of the business judgment rule.Shortly after the Aronson decision, the Delaware Supreme Court again addressed the business judgment rule in Unocal v. Mesa.64 In Unocal, a corporation's directors deterred a minority shareholder's hostile takeover by making a self-tender offer.65 The minority shareholder reacted to this defensive tactic by suing the corporation's directors, arguing they had breached their fiduciary duties to him as a shareholder, as evidenced by the fact that the corporation's directors stood to benefit from the self-tender offer.66 While there can be no question, the court stated, that directors must act loyally to the companies they represent, "[t]here is no obligation of self-sacrifice by a corporation and its shareholders," in the face of a perceived harm such as the attempted takeover coordinated by the minority shareholder.67 As such, the court held that the directors had acted in what they believed to be the best interests of the corporation. The court elaborated that it would not substitute its judgment for that of the board of directors unless it can be shown "by a preponderance of the evidence that the directors' decisions were primarily based on perpetuating themselves in office, or some other breach of fiduciary duty such as fraud, overreaching, lack of good faith, or being uninformed." 68 Accordingly, the Delaware Supreme Court applied the protections of the business judgment rule in defense of the Unocal directors.69

These cases illustrate the important balance within which directors must operate and the intense scrutiny to which they are subjected. As a result of this environment, directors are afforded the protection of the business judgment rule. However, if it is determined that a director has indeed breached his obligatory fiduciary duties, the director will not be shielded from liability and may face a variety of consequences, including, but not limited to, forced transfer of his corporate ownership interest back to the company, monetary restitution, and attorney's fees.70 Ultimately, past jurisprudence shows that so long as corporate directors adhere to their mandated fiduciary duties, the business judgment rule will protect them from shareholder challenges.

63. Aronson, 473 A.2d at 811–12.
64. 493 A.2d 946 (Del. 1985).
65. Id. at 951–53.
66. Id. at 958.
67. Id.
68. Id.
69. Id.
C. The Fiduciary Duty of Loyalty Held by Corporate Directors

The success or failure of a corporation frequently hinges upon good faith dealings by directors with shareholders and the manner in which directors operate, both within the company and in outside transactions. The Delaware Court of Chancery echoed this sentiment by explaining that “[i]t is fundamental that directors stand in a fiduciary relation to the corporation and its shareholders, and that their primary duty is to deal fairly and justly.” Courts agree that the preeminent duty a director holds with respect to shareholders is a duty of loyalty.

In Cede & Co. v. Technicolor, Inc., the court stated that the duty of loyalty specifically “mandates that the best interest of the corporation and its shareholders takes precedence over any interest possessed by a director, officer or controlling shareholder and not shared by the stockholders generally.” Further, this duty requires an “undivided and unselfish loyalty to the corporation [that] demands that there be no conflict between duty and self-interest.” The Cede court went on to provide examples of a director allowing self-interests to supersede his commitment to a corporation by referencing instances where a director appears on both sides of a business transaction or a director receives a personal benefit from a transaction that the general stockholder does not receive. For the most part, courts have determined that a director does not violate the duty of loyalty when he or she acts or makes a decision that is based exclusively on the corporate merits of the decision rather than a personal or extraneous consideration.

The Delaware Court of Chancery propounded the idea of attacking the abuse of corporate power in Bowen v. Imperial Theatres, where certain corporate directors transferred shares of the company to themselves for no consideration. The Bowen court delved into the heart of the issue when it stated, “the material and controlling circumstance is that the directors in whose control the company’s stock was vested as its trustees, gave it to themselves for nothing in pursuance of a deliberate plan to retain control over its affairs,” and asserted that such conduct is nothing less than “reprehensible.” In response to this transaction, the court concluded that the deception was especially “gross” in light of how the directors flagrantly violated their

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72. Id.
73. Chiappinelli, supra note 25, at 380. In addition to the fiduciary duty of loyalty, directors also must adhere to the fiduciary duty of care. Id. at 406. This duty requires the director to perform his duties with the care that an ordinarily prudent person in a like position would use under similar circumstances. Id.
74. 634 A.2d 345 (Del. 1993).
75. Id. at 361 (citing Pogostin v. Rice, 480 A.2d 619, 624 (Del. 1984)).
76. Id.
77. Id. at 362.
78. Id.
79. 115 A. 918 (Del. Ch. 1922).
80. Id. at 921.
81. Id. at 922.
fiduciary duty of loyalty. The court also concluded that corporate directors cannot, "in violation of their trust, take action which profits themselves, and then by a formula of their own making close the lips of the corporation against future objection."

Despite its extremely powerful protection, shareholders are not powerless against the shield of the business judgment rule because "[t]he machinery of corporate democracy and the derivative suit are potent tools to redress the conduct of a torpid or unfaithful management."94 Schnell v. Chris-Craft Industries, Inc.95 provides a keen illustration of this principle. In Schnell, the court held that corporate management breached its fiduciary duty of loyalty by manipulating the corporate machinery for its own self-interests.96 Specifically, the court ruled that "management had] attempted to utilize the corporate machinery . . . for the purpose of perpetuating itself in office; and . . . for the purpose of obstructing the legitimate efforts of dissident stockholders in the exercise of their rights."97 The court reached this conclusion as a result of the defendant managers' electoral entrenchment tactics, including "the hiring of two established proxy solicitors as well as a refusal to produce a list of its stockholders" in addition to severely limiting the window in which to wage a successful proxy fight.98

More tellingly, the Maryland Business and Technology Court also considered a director's fiduciary duty of loyalty in Shaker v. Foxby Corp.99 where it applied key Delaware decisions like Schnell. In Shaker, the court denied a corporate board of directors' motion to dismiss the complaint, reasoning that the board likely violated company bylaws in a manner that detrimentally impacted the stockholders' ability to participate in the corporate election process.100 Specifically, the court was persuaded by the plaintiffs' assertion that "the facially inoffensive [electoral] notice provisions were enforced in this case in a discriminatory fashion," which primarily served the interests of the corporate board at the expense of the shareholders.101 Elaborating on this sentiment, the court explained that the board was seemingly in violation of the corporation's fiduciary duty of loyalty to the shareholders because

82. Id. at 921-22.
83. Id. at 922. This statement was made in response to the director's attempts to cover up their actions by fraudulently marking the shares in question as fully paid for so as to deflect inquiries into the sale and their conduct. Id.
85. 285 A.2d 437 (Del. 1971).
86. Id. at 439.
87. Id.
88. Id.
90. See id. In Shaker, the plaintiff was timely notified that one director position would be open for election during the proxy season. Id., slip op. at 3. However, the corporate directors then decided to add two additional director positions to the ballot, and left plaintiff with only ten days to present an alternative candidate slate. Id. This late change to the election agenda gave the plaintiff little time to prepare for a proxy contest, and resulted in the subsequent lawsuit for breach of the duty of loyalty. Id.
91. Id., slip op. at 4–5.
the primary purpose of its actions was to prevent the effectiveness of a shareholder vote. Ultimately, the court remanded the case for further discovery, but not without allowing for the possibility that the directors had committed a breach of their fiduciary duty of loyalty as a direct result of their active attempts to stymie the minority shareholder’s voting efforts.

These cases illustrate the importance of the duty of loyalty and the dire consequences that ensue if directors act in a manner outside the scope of their assigned duties. Courts have very clearly indicated that “[c]orporate directors cannot manipulate the property, of which they have control in a trust character,” for any personal interest. If directors find themselves on the wrong side of this rigid standard, then they will not have the benefit of the business judgment rule’s protections because their actions will not reflect, “a fair exercise in good faith of the power with which they are clothed.”

III. SUMMARY OF THE COURT’S REASONING

In Western Investment, the Maryland Business & Technology Court issued a ruling in favor of Sunset Financial, indicating that corporate directors are free from liability if they act and make decisions that are facially valid and within the scope of the corporations’ bylaws. In the opinion, the court explained this conclusion by applying the business judgment rule and examining the legality of the amended bylaws.

The court began its analysis by examining Sunset Financial’s two primary adjustments to its bylaws. The first change increased the percentage of stockholders required to call a special meeting from a 25% minority interest to a simple majority interest of 50%. The second bylaw amendment was far more sweeping, changing the time limitations for the board to set dates for special meetings. These amendments affected the procedures for nominating and electing directors in addition to adding a procedure by which the secretary of the corporation had the power to cancel special meetings up to ten days before the meeting date. The court sought to determine whether the changes were, as Lipson contended, an unlawful defense mechanism to stymie its efforts to influence corporate elections, or as Sunset Financial asserted, an extension and clarification of the existing bylaws.

92. Id., slip op. at 5.
93. Id., slip op. at 11.
95. Id.
97. Id., slip op. at 2–7.
98. Id., slip op. at 2–4.
99. Id., slip op. at 3.
100. Id.
101. Id.
102. Id., slip op. at 4.
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To analyze these changes, the court examined the guiding principles of Schnell v. Chris-Craft Industries, Inc.\(^{103}\) and Blasius Industries, Inc. v. Atlas Corp.\(^{104}\) The court explained that these cases stand for the general proposition that "the deferential business judgment rule is not applicable to board actions taken for the primary purpose of interfering with the stockholder's vote, even if taken advisedly and in good faith."\(^{105}\) Additionally, the court recited the familiar axiom that the directors of a Maryland corporation owe their stockholders a fiduciary duty of loyalty.\(^{106}\) The court concluded, however, that a shareholder's right to take part in the corporate election process does not supersede good faith actions of corporate directors even when they unilaterally diminish shareholder influence in elections.\(^{107}\)

In addition to these competing interests, the court explained that perhaps the most compelling statement made by either party was the simple fact that "[p]laintiffs here concede that the August 31, 2005 by-law amendment [altering the number of stockholders needed to call a special meeting] is facially lawful."\(^{108}\) Moreover, the court noted that Lipson was "hard-pressed to contend that any of the October 5, 2005 by-law amendments [further altering the procedure and time limitations for requesting a special meeting], viewed independently, would be found to be unreasonable exercises of the board's authority."\(^{109}\) In light of these conclusions, the court found it difficult to accept Lipson's argument that the bylaw amendments were enacted for the purpose of confounding efforts to influence the election process.\(^{110}\) Further, the court discovered little evidence indicating that Sunset Financial actively sought to create barriers to impede Lipson's proposals.\(^{111}\) As a result of these inadequacies in Lipson's argument, the court determined that the directors' actions did not create unfair obstacles to the exercise of Lipson's rights as a shareholder.\(^{112}\) Instead, the court concluded that "[t]he directors acted in good faith and [would] not be held accountable for any unintended violations of their duties to the stockholders."\(^{113}\)

Finally, the court addressed Lipson's specific claim that the bylaw amendments amounted to strategic defense mechanisms enacted to bar the plaintiffs from call-

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103. 285 A.2d 437 (Del. 1971).
104. 564 A.2d 651 (Del. Ch. 1988).
105. W. Inv., No. 24-C-05-009540, slip op. at 4.
106. Id., slip op. at 4-5.
107. Id., slip op. at 5.
108. Id.
109. Id.
110. Id., slip op. at 5-6.
111. Id. Additionally, the court explained that in this case, both parties had the opportunity to partake in discovery, and despite this process, Lipson still offered little support in the record to substantiate its claims of misconduct on the part of Sunset Financial. Id. To the contrary, Lipson "testified that [it] would not anticipate any difficulty in complying with the simple majority by-law amendment enacted on August 31, 2005." Id., slip op. at 6.
112. Id.
113. Id.
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ing a special meeting to elect new corporate directors.\textsuperscript{114} The court, rejecting this argument, concluded that the amendments were "necessary provisions wholly lacking in the original corporate by-laws and necessary to establish appropriate procedures for conducting special meetings of stockholders," rather than a corporate defense mechanism.\textsuperscript{115} The court stressed that one of the bylaw amendments, the secretary's power to cancel meetings, was not, in fact, a new addition to the corporate bylaws, but rather always had existed and simply was being clarified.\textsuperscript{116} Based on this reasoning, the court granted summary judgment to Sunset Financial on the grounds that, as a matter of law, the director's actions were not implicit attempts to usurp control from the stockholders and that the bylaw amendments were not invalid.\textsuperscript{117}

IV. ANALYSIS

In \textit{Western Investment}, the court ruled that the actions of corporate directors essentially were impervious to legal claims, so long as those actions were facially valid.\textsuperscript{118} In reaching its decision, the court ignored settled principles that indicate a need for balance of corporate power between directors and shareholders, particularly with respect to corporate elections.\textsuperscript{119} As a result, the court unacceptably reduced the already limited ability of minority shareholders to adequately protect their own investment in the corporation.

A. \textit{Strict Legality of the Director's Actions vs. the Rights of the Stockholder}

In \textit{Schnell}, the court stated that "inequitable action does not become permissible simply because it is legally possible."\textsuperscript{120} When the court in \textit{Western Investment} ruled that the directors had acted appropriately in amending Sunset Financial's bylaws because such amendments were facially legal,\textsuperscript{121} it ignored the important admonitions of \textit{Schnell} that explicitly established that facially valid actions do not necessarily amount to actions congruent with a director's fiduciary obligations.\textsuperscript{122} While the conduct of Sunset Financial's corporate board may have been facially legal, it is equally undeniable that these same actions constituted concrete obstacles to Lipson's purposes—namely influencing the corporate electoral process.

Additionally, the facts of \textit{Schnell} are strikingly similar to the fact pattern in \textit{Western Investment}, as \textit{Schnell} dealt with a corporate election that was affected drasti-

\textsuperscript{114} \textit{Id.}
\textsuperscript{115} \textit{Id.}
\textsuperscript{116} \textit{Id.}
\textsuperscript{117} \textit{Id.}, slip op. at 6–7.
\textsuperscript{118} \textit{Id.}, slip op. at 7.
\textsuperscript{119} \textit{Schnell v. Chris-Craft Indus., Inc.}, 285 A.2d 437, 439 (Del. 1971).
\textsuperscript{120} \textit{Id.}
\textsuperscript{121} \textit{W. Inv.,} No. 24-C-05-009540, slip op. at 7.
\textsuperscript{122} \textit{Schnell}, 285 A.2d at 439.
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cally by amendments to long-standing corporate bylaws. Specifically, the directors in Schnell did not provide a list of all stockholders to the minority group seeking to campaign for positions on the directorial board. These directors also changed the date of the annual meeting in a manner that hindered the minority group's campaign efforts. As a result, the court held that management had attempted to utilize corporate machinery for the purpose of entrenching themselves in office in violation of established principles of corporate governance.

The directors of Sunset Financial, in a similar fashion, while not changing the date of the proposed meeting, changed the manner of arranging special meetings by amending the bylaws to require the approval of 50%, rather than 25%, of the stockholders. In failing to recognize Sunset Financial's plainly obstructive actions, the court improperly weakened the influence that a minority shareholder may have on a corporation. The degree to which Sunset Financial tried to limit Lipson's influence extended beyond the realm of reasonableness and created a situation that was "contrary to established principles of corporate democracy."

While the traditional standards of corporate democracy grant deference to the decisions and actions of corporate directors, a balance of power is still an essential component for a successful relationship between directors and investors. Directors are equipped with wide latitude to serve the corporation as they see fit, and this discretion is protected by the business judgment rule. In particular, this shield exists to ensure that minority shareholders do not unduly influence the corporate machinery though frivolous claims against management by instilling a "powerful presumption in favor of actions taken by the [corporate] directors."

Despite this broad protection, minority shareholders wield some real power, as recognized by state courts and encouraged by federal regulatory agencies. For example, the SEC has adopted certain amendments to the federal proxy rules in an effort to "foster shareholder communication and remove unnecessary limitations on shareholders' use of their voting rights. Ultimately, while directors need broad corporate control in order to take the risks necessary to operate a profitable business, there is a palpable distinction between broad control and absolute control.

123. Id.
124. Id.
125. Id.
126. Id.
130. Id. at 391–92.
Exercising Control of Corporate Machinery

*Shaker* elaborated upon this notion by reiterating the principle that mere lawful acts do not always constitute what is best for a corporation and its shareholders.\(^{133}\) *Shaker* unequivocally stands for the proposition that there must be balance between directors and shareholders, particularly "with respect to [matters] of internal corporate governance." The court further stated "those in charge of the election machinery of a corporation must be held to the highest standards of providing for and conducting corporate elections," and therefore, the business judgment rule will be dilated to an extent as a means of ensuring an equitable voting procedure.\(^{135}\) Based on this conclusion, the court ruled that despite the facially legal actions of the directors, their decisions apparently had leveraged control away from the shareholders and unreasonably altered the balance between director and shareholder.\(^{136}\)

These cases emphasize the importance of the corporate election process and the absolute need for scrupulous fairness. By overlooking the holdings outlined in *Schnell* and *Shaker*, which assert a need for balance, the *Western Investment* court undermined the influence of Lipson and the minority group based on its conclusion that facially valid actions equate to acceptable conduct. Merely because directors act legally does not mean that their actions are synonymous with the best interests of the corporation. In *Shaker*, the directors may have behaved within the technical guidelines of their leadership roles, but, as the plaintiff contended, their underlying intentions were to stymie shareholder voting power.\(^{137}\) Likewise, in *Schnell*, the court held that while the directors adhered to a valid portion of Delaware Corporation Law, such reliance was "contrary to established principles of corporate democracy" and therefore "may not be permitted to stand."\(^{138}\) Both *Shaker* and *Schnell* appear strikingly similar to *Western Investment* in that corporate management affected a series of changes to voting procedure in a manner that ultimately would hinder the efforts of minority shareholders. Based upon a series of facts that are nearly identical, one might wonder how the *Western Investment* court reached a decision that was so radically dissimilar.

B. Without Loyalty the Corporate Structure Crumbles

If corporate directors possessed the authority to make decisions and to act in a manner that primarily served their personal interests, the "system of business corporations by which so large a part of the world's work is now conducted may become a system of frauds."\(^{139}\) Directors of corporations act in a fiduciary capacity,

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134. *Id.*, slip op. at 11.
135. *Id.*, slip op. at 9 (quoting Aprahamian v. HBO & Co., 531 A.2d 1204, 1206–07 (Del. Ch. 1987)).
136. *Id.*, slip op. at 9–11. As a result of this decision, the court remanded the case for further discovery. *Id.*, slip op. at 11. In particular, the court wanted to learn more about the director's actions in relation to "[t]he reasonableness and/or the discriminatory effect of the by-law amendments." *Id*.
137. *Id.*, slip op. at 3.
and their "office is one of trust and they are held to the high standard of duty required of trustees." Directors have the inherent power to make decisions and to control the future of a corporation. Such power, however, is not a blank check that allows them to make decisions to suit their own fancy while ignoring minority interests.

The Delaware Court of Chancery, in Bowen v. Imperial Theatres, limited directorial control when it ruled against a group of directors that had violated their duty of loyalty through self-interest. This ruling is directly relevant to the matter at hand because the court allowed Sunset Financial to pass amendments that implicitly benefited the existing board of directors by hindering Lipson's efforts to call a special meeting to enact an electoral change. Further, Western Investment effectively makes it more difficult for minority shareholders like Lipson to enact change because it allows the company directors to alter the way special meetings are arranged during the initiation process. In doing this, the court committed the very transgression that the Bowen court warned against, namely permitting directors to act for their own benefit, while at the same time erecting virtually insurmountable hurdles to prevent challenges to their supremacy. While there is certainly a distinction between the obvious tangible benefits the directors received in Bowen through their self-interested transfer of stock and the entrenchment of power that the directors sought in Western Investment, the end result was nearly identical—both the directors in Bowen and Western Investment acted primarily for the purpose of preserving their own interests as opposed to furthering the interests of the company.

In addition, it is difficult to comprehend the application of a protective veil for the Sunset Financial directors when compared to past cases in which the business judgment rule has been applied. In Unocal v. Mesa, the Delaware Supreme Court determined that corporations and their representative directors are not obligated to sacrifice the company and their own personal well-being in the face of threatening takeover attempts. However, the Unocal court qualified this blanket statement by instructing that it would have to carefully consider the application of the business judgment rule if the shareholders demonstrated that the directors acted primarily to perpetuate their terms in office. Western Investment presents a series of facts

140. Id.
142. Elliott, 80 N.E. at 452.
143. 115 A. 918 (Del. Ch. 1922).
144. Id. at 921.
146. Id., slip op. at 2–3.
147. Bowen, 115 A. at 922.
149. Id.
and actions ripe for close review, especially considering that the outcome of the case allowed a group of directors to remain in near absolute control of the corporate machinery and the election process. The lessons of Unocal and Bowen hinge upon shared balance, the type that does not appear to exist in the Sunset Financial Corporation.

C. The Purpose of the REIT in Relation to Small Scale Investors

In addition to issues concerning the legality of Sunset Financial’s directors’ actions and fiduciary duties, the Western Investment court overlooked the primary purpose of the REIT and perhaps the strongest argument in support of Lipson’s claims: REITs give “small investors the opportunity to invest in real estate.”\textsuperscript{150} Specifically, REITs were created to encourage “small investors to participate in the type of real estate investments that were traditionally available only to institutions or wealthy individuals.”\textsuperscript{151} Congress attempted to achieve this general policy initiative of broadening the base of investors in the wider business world by providing tax based benefits that promote participation by individuals without vast wealth.\textsuperscript{152}

Despite this foundational policy of increasing the involvement and influence of non-traditional investors, the Western Investment court still ruled in favor of increased directorial power. Rather than preserve the original objectives of the REIT, the court weakened this form of investment for all small scale investors. Unfortunately for Lipson, the court failed to recognize the importance of protecting the investments of individuals and turned a blind eye to the long history that has shaped the REIT, including the congressional push to establish a strong form of investment for financially limited individuals.\textsuperscript{153} Moreover, the court neglected to consider the value of financially diverse investors in a world that is continually catering to corporations and ignoring individual shareholders.\textsuperscript{154} While the REIT was not designed to wrest control away from directors, its original purpose was to grant average citizens an opportunity to invest their money and have a voice in a realm traditionally dominated by powerful and immoveable corporations. The court’s holding in Western Investment is directly contrary to this purpose.

\textsuperscript{150} Cornell, supra note 39, at 1571.
\textsuperscript{151} Id. at 1569.
\textsuperscript{152} Id.
\textsuperscript{153} Organizations that operate as REITs do not have to pay federal tax on income or gains and can opt to pass their income through to shareholders. REIT investors also enjoy the advantages of limited liability and transferability of shares (i.e., liquidity) that a corporate structure offers, without incurring the costs of double taxation. Thus, a REIT is essentially a combination of a corporation and a partnership in that it combines the benefits of a corporation with the pass-through nature of a partnership.
\textsuperscript{154} Goforth, supra note 129, at 404–05.
V. CONCLUSION

The court's ruling in Western Investment likely will have negative implications for the future of Maryland corporations and REITs in particular. Essentially, the court provided too much discretion for corporate directors to dictate the terms of corporate elections, widening the power gap between management and shareholders. The court has ruled in this fashion based on a superficial viewpoint of the law, rather than considering its substance and the corporate director's fiduciary obligations to his or her stockholders. Moreover, this decision ignores the initial purpose of a REIT, which is to allow smaller investors a semblance of control within the larger corporate world.155 Unfortunately, the seemingly invincible power of a corporate director has been used to manipulate the election process and has tilted the balance between corporate directors and shareholders beyond a reasonable level.