

LICHT V. STORAGE TECHNOLOGY CORP.

2005 WL 1252355 (Del.Ch., May 13, 2005)*

The Plaintiff, Dr. Seymour Licht (the "Plaintiff"), challenges the widely-accepted notion that, under 8 Del. C. § 216, when the applicable standard for ascertaining the outcome of a shareholder vote is a majority of the shares present (or represented) and entitled to vote, "abstentions are in effect negative votes." The Plaintiff, a shareholder of both Defendant Storage Technology Corporation ("StorageTek") and Defendant World Airways, Inc. ("Airways"), is an advocate of cumulative voting for the election of directors. His efforts to secure the necessary support of his fellow shareholders to implement cumulative voting, according to him, have been thwarted by the practice of treating abstentions as the equivalent of negative votes. This practice, he says, is contrary to Delaware law and "stuffs the ballot box" in favor of management. The Defendants have moved to dismiss.

I. BACKGROUND

At the 2004 annual meeting of StorageTek's shareholders, as a result of a proposal submitted by the Plaintiff, the shareholders voted on the question of whether to adopt cumulative voting for the election of directors. StorageTek's proxy statement explained the requirements for establishing a quorum: "A quorum consists of a majority of shares of common stock issued and outstanding (which excludes treasury stock) on April 2, 2004, our record date. All shares that are voted FOR, AGAINST (including abstentions), or WITHHOLD FROM any matter will count for purposes of establishing a quorum." The proxy statement also set forth the methodology for counting the shareholders' votes: "Abstentions of proposals 2, 3, and 4 [the Plaintiff's proposal] will count as votes present at the meeting and will have the same effect as a vote against a matter." In order for those proposals to pass, "the affirmative vote of a majority of the shares represented at the meeting at which a quorum is present and entitled to vote on the subject matter shall be the act of the stockholders." The proxy card gave the stockholder the choice of "for," "against," and "abstain" with respect to "[a]pproval of a stockholder proposal regarding cumulative voting for the election of directors."⁷

A quorum was present at StorageTek's 2004 shareholder meeting. The Plaintiff's proposal for cumulative voting failed, and it would have failed even if the abstentions had not been counted as the equivalent of negatives votes.⁸

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⁷ The rules of the Securities and Exchange Commission require that shareholders voting on matters other than the election of directors be given the choice of "approval or disapproval of, or abstention with respect to each separate matter." 17 C.F.R. § 240.14a-4.

⁸ The shareholder response on the Plaintiff's 2004 cumulative voting proposal was: 39,711,152 in favor; 44,369,191 against; 7,362,562 abstentions; and 10,530,206 broker non-votes. A brief explanation of the term "broker non-votes" may be helpful. Under the rules of the New York Stock Exchange, which apply to each of the Defendants, brokers may vote the shares of their customers held in a "street name," even if no voting instructions are received, on, but only on, routine or "discretionary" matters. If the matter is "non-discretionary," the broker cannot vote (or give a proxy) unless it has received instructions from its customer, the beneficial owner. The Plaintiff's proposal for cumulative voting for directors is "non-discretionary." If a broker receives no instructions from the beneficial owner on a non-discretionary matter, the shares are not considered entitled to vote and are generally known as "broker non-votes." See *Berlin v. Emerald Partners*, 552 A.2d 482, 494 (Del.1989). "Broker non-votes," because the underlying shares may be voted on "discretionary matters," may be counted for purposes of establishing a quorum, as was done by the Defendants. The "broker non-votes" are not considered in determining the number of affirmative votes needed to pass a resolution involving a "non-discretionary" matter.

The Plaintiff again submitted his cumulative voting proposal for consideration at StorageTek's 2005 annual meeting of shareholders on April 27, 2005. The results were reported by StorageTek as follows:

Votes "For" Votes "Against" Abstentions Broker Non-Votes

42,509,977 36,001,925 9,175,421 8,494,773

But for the practice of treating abstentions as negative votes, his proposal would have been approved.

II. CONTENTIONS

The Plaintiff argues, first, that the proper standard for determining the success of a shareholder resolution is whether a majority of the votes cast were in favor of the resolution and, second, that abstentions should not be considered in calculating the number of shares required for approval of the resolution because the shareholders' decisions to abstain are equivalent to the shareholders' decisions to withhold authority from the proxy holder to vote on a particular matter and, thus, the proxy holder who has been directed to abstain had no voting power.

The Defendants have moved to dismiss on several grounds. They assert that no justiciable issue has been presented; that the Complaint fails to state a claim entitling the Plaintiff to relief because the voting procedures followed by each are expressly authorized by Delaware law; and that Plaintiff's claims are barred by a doctrine of laches. In addition, the Defendants have asked that the claims against them be severed.

III. ANALYSIS

[The court discusses the standard for dismissal in a motion to dismiss, and finds that the plaintiff's claims against StorageTek raise a justiciable issue.]

C. *The Statutory Standard*

Absent specific statutory requirements, Delaware corporations, through provisions in their certificates of incorporation or bylaws, are able to establish their standards for determining a quorum and the required vote for approval of any matter. The Delaware General Corporation Law, at § 216(2), provides a "default" standard for matters not involving the election of directors: "In all matters other than the election of directors, the affirmative vote of *the majority of shares present in person or represented by proxy at the meeting and entitled to vote on the subject matter* shall be the act of the stockholders."¹⁵ StorageTek's bylaws use the same standard: "Except as otherwise provided by statute or by the certificate of incorporation, ... the affirmative vote of a majority of the shares represented at a meeting at which a quorum is present and entitled to vote on the subject matter shall be the act of the stockholders."

¹⁵ 8 Del. C. § 216(2) (emphasis added). The "default" standard for the election of directors is "a plurality of the votes of the shares present in person or represented by proxy at the meeting and entitled to vote on the election of directors." 8 Del. C. § 216(3).

D. Is a Majority of Votes Cast the Necessary Measure?

The Plaintiff first argues that a majority of the votes cast (yea or nay) is all that is required for approval of a shareholder resolution. He relies upon *Bank of New York Co. v. Irving Bank Corp.*, which excluded abstentions in determining whether a shareholder-proposed amendment to a corporation's bylaws had been approved by the vote of its shareholders.¹⁸ The court concluded that "the abstain box is specifically provided in the proxy to enable the shareholder to not vote on an issue or issues." The controlling New York law provided that the corporate action had to "be authorized by a majority of the votes cast." Thus, the question in *Bank of New York* was whether an "abstention" was a "vote cast." The law of Delaware, however, does not prescribe a "votes cast" standard for determining whether a shareholder resolution has been approved. Instead, the law of Delaware, in the absence of a corporation's selection of a different standard, looks to a majority of shares (1) present or represented at the meeting and (2) entitled to vote.²¹ Thus, StorageTek's shareholder resolutions are not to be evaluated under a "majority of the votes cast" standard.

E. May Abstentions Be Treated, In Effect, As Negative Votes?

As noted, unless a statute mandates a certain methodology, Delaware corporations are free to establish their own voting requirements through bylaws or charter provisions.²² A "default" is provided if corporations do not determine their own means of voting and StorageTek chose that default standard as its methodology: a majority of those shares present (or represented) and entitled to vote on the matter.

The question of whether, under Delaware law, the shares of a stockholder-- whose shares are represented at a shareholders' meeting by a proxy holder and who has directed the proxy holder to abstain on a particular issue--are to be included within the count of "voting power present" for purposes of determining the number of affirmative votes needed to pass the resolution was implicitly answered in *Berlin v. Emerald Partners*. In *Berlin*, the Supreme Court considered whether shares held by a broker who had received no voting instructions could be considered as part of the total number of shares entitled to vote on a particular proposal. The issue was whether those shares could be counted as present for quorum purposes but not as part of the "voting power present" for a particular vote. The Supreme Court resolved this issue:

[A] stockholder who is present by proxy for quorum purposes may not be voting power present for all purposes. Voting power present is synonymous with the number of shares represented which are "entitled to vote on the subject matter." A stockholder who is present in person *or* represented at a meeting by a *general* proxy, is present for quorum purposes *and* is also voting power present on all matters. However, if the stockholder is represented by a *limited* proxy and does not empower its holder to vote on a particular proposal, then the shares represented by that proxy cannot be considered as part of the voting power present with respect to that proposal.

¹⁸ An abstention is not a "no" vote. StorageTek takes the position that the "voting power present" is the sum of the "for" votes, the "against" votes, and the abstentions. By including abstentions within the number of shares considered part of the voting power present, the number of shares required to achieve a majority is increased and, in a sense, the power of the "for" votes is diluted. Here, the Plaintiff objects to having to "cover" the abstentions with what he considers unnecessary additional "for" votes.

²¹ Other jurisdictions have a "votes cast" standard. See, e.g., N.J. STAT. ANN. § 14A:1-2.1(r) ("Votes cast" means all votes cast in favor of and against a particular proposition, but shall not include abstentions."); N.J. STAT. ANN. § 14A:5-11(1) ("Whenever any action, other than the election of directors, is to be taken by vote of the shareholders, it shall be authorized by a majority of the votes cast at a meeting of shareholders by the holders of shares entitled to vote thereon, unless a greater plurality is required by the certificate of incorporation or another section of this act.").

²² See generally 8 Del. C. § 216.

In reaching the conclusion that a majority of shares with voting power present had voted in favor of a merger proposal, the Supreme Court went through the arithmetic as to what votes should be counted for what purposes:

The Certificate of Judges of Voting reflects that the *power to vote* on Proposal One was *withheld* on 1,329,958 shares. The inspectors of election at the stockholders meeting counted 10,513,703 (11,843,661 [the number of shares entitled to vote] minus 1,329,958) shares as voting power on Proposal One, with 9,934,172 of these shares voted in favor of the proposed merger, 432,796 opposed, and 146,735 abstained. On Proposal Two, all 11,834,661 shares represented voted, with 11,151,902 shares voted in the affirmative, 485,912 voted against, and 161,747 abstained.

Given that the Supreme Court included abstentions among the shares entitled to vote, it is implicit in the Supreme Court's opinion that an abstention and a vote withheld because of the absence of any instruction are materially different for purposes of Delaware law, and that an abstention, whether accomplished in person or through a proxy holder following his principal's instructions, is part of the "voting power present."

Berlin holds that shares are not "voting power present" if the proxy holder has been granted a "limited" proxy that "does not empower" the proxy holder to vote on a particular matter. The Plaintiff argues that the StorageTek's proxies are "limited" because they do not grant discretion to the proxy holder and because they specifically deny the proxy holder the power to vote "for" or "against" a particular proposal. However, as noted in *North Fork Bancorporation*:

[T]he mere usage of the term "limited proxy" in *Berlin* does not mean that all limitations on the power of a proxy holder to vote with respect to a proposal can be equated to the absence of *any* instructions about voting or that the presence of any limitation will necessarily mean that the shares represented by such a "limited" proxy are not "voting power present" for purposes of that proposal. This will lead to absurd result that even a "limited" proxy instructing a vote "for" or "against" a proposal would not count as part of the "voting power present" on the proposal. Instead, I read *Berlin*'s reference to a "limited proxy" to refer to those situations where the proxy holder is not given any authority *at all* to vote *on the issue*.²⁸

The "limited" proxies in *Berlin* were granted by brokers holding shares, but for which no express directions had been given by the beneficial owner. The shares were "represented" at the shareholders' meeting for the limited purpose of establishing a quorum and could be voted on discretionary matters, all in accordance with the applicable rules of the New York Stock Exchange.²⁹ *Berlin* addressed those circumstances where the broker had received no

²⁸ [...] There may be some debate as to whether [...] an abstention is a vote. Compare *Hammersmith v. Elmhurst-Chicago Stone Co.*, 1989 WL 99129, at *3 (Del Ch. Aug. 17, 1989) (reflecting the view that an abstention is a "voluntary decision not to vote"), and Mark A. Morton & William J. Haubert, *Abstentions and Broker Non-Votes in Delaware*, INSIGHTS, at 37 n. 29 (Del.1993) ("The authors do not ... read the *Berlin* decision as implicitly holding that abstentions should be counted as 'votes cast.'"), with *North Fork Bancorporation*, 825 A.2d at 862 ("[T]he proxy] cards empowered [the proxy holders] to ... vote 'abstain'...."). It is clear, for purposes of understanding the reference in *North Fork Bancorporation* to "not given any authority at all to vote on the issue," that the Court considered instructions to abstain as a functional grant of voting authority to the proxy holder.

²⁹ The "limited" proxy considered in *Berlin* arose out of the practice under which shareholders leave their shares with their brokers, or their designee, in "street name." The brokers hold legal title, as the owners of record, and, as far as the corporation is concerned as a matter of Delaware law, see 8 Del. C. § 212, they have the legal authority to vote the shares in person or by proxy. The stock exchanges, however, have rules that govern the relationship, for these purposes, between the brokers, as record owners, and their customers (the shareholders), as beneficial owners. These rules are the source of the distinction between a proxy holder's authority to vote on "discretionary"

instructions. Here, the proxy holders were given specific instructions and, thus, the proxies were not "limited" proxies within the scope of *Berlin's* analysis. In sum, *Berlin's* holding may not fairly be applied, particularly in light of the way in which the Supreme Court reviewed the counting of the votes, to offer any support for the Plaintiff's proposition that abstentions recorded through the acts of proxy holders may not be counted as part of the "voting power present."

If a shareholder is at a shareholders' meeting and abstains, the shares owned by that shareholder are fairly characterized as both present and entitled to vote. That the shareholder may voluntarily decide not to vote those shares either affirmatively or negatively, *i.e.*, to abstain, does not alter the fact that the shares are present at the meeting and are entitled to vote, thereby constituting "voting power present." The holder of a proxy, as agent of the shareholder and thus "standing in the shoes" of the shareholder, has voting power through the proxy and implements, on behalf of his principal, the shareholder's voluntary decision not to vote "for" or "against," *i.e.*, to abstain. Thus, the voting power of the shares is the same as if the shareholder were present in person. It is for this reason that the Plaintiff's resort to the dictionary is unavailing. "Abstention" is defined as the "withholding of a vote." The proxy holder, with instructions to abstain, was directed to withhold both affirmative and negative votes from a particular matter.³² The proxy holder, however, was present, with express direction as to how to act for his principal; presumably, that was how the shareholder would have acted if the shareholder had attended the meeting. Those shares, thus, were "represented" at the meeting and "entitled to vote."

In *Hammersmith v. Elmhurst-Chicago Stone Co.*, this Court followed *Berlin* and distinguished between a limited proxy holder (with *no* authority to vote on an issue) and a proxy holder directed to abstain (someone acting for a shareholder who *chooses* not to vote).³³ Simply put, under Delaware law, there is a distinction between an abstention and the lack of authority to vote; the shares represented at the meeting by a proxy holder who has been directed to abstain are present at that meeting and entitled to vote; that they are not voted affirmatively or negatively does not change their status as constituting voting power present.

Accordingly, StorageTek's approach to calculating the number of shares constituting a majority of the shareholder vote on the Plaintiff's proposals for cumulative voting (and on other matters submitted for shareholder approval) is consistent with the requirements of Delaware law. StorageTek is thus entitled to dismissal of the Complaint.

matters as contrasted with "non-discretionary" matters. The "limited" proxy in *Berlin*, under these rules, was one granted by the broker, as record owner; it was "limited" because the beneficial owner had not given instructions and because the stock exchange rules limited the authority of the broker. See *Berlin*, 552 A.2d at 493-94.

³² In *North Fork Bancorporation*, the Court concluded that instructions directing the proxy holder to "withhold" support for certain candidates in the election of directors did not preclude consideration of the shares as "voting power present."

³³ 1989 WL 99129, at *3 (Del. Ch. Aug. 17, 1989) ("George, Sr. makes a valid point when he distinguishes between a limited proxy holder who has no authority to vote on certain issues and the co-trustees here, who had full authority to vote on all issues if they are able to agree. However, when the co-trustees are unable to agree, their situation is *far more similar to that of a limited proxy holder than it is to that of an individual stockholder who chooses not to vote*. The word 'abstain' is defined as 'to withhold oneself from participation, to forebear or refrain voluntarily ...' Here, there has been no voluntary decision not to vote.") (citation omitted) (emphasis added).