RICHARD J. SHAKER, et al.	*	IN THE
Plaintiffs	*	CIRCUIT COURT
v.	*	FOR
FOXBY CORP., et al.	*	BALTIMORE CITY
Defendants	*	Part 20
	*	Case No.: 24-C-04-007613
	*	

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MEMORANDUM OPINION

This action was filed on October 12, 2004 by Richard J. Shaker, owner of 14,400 shares of stock in Foxby Corp., and three individuals ("the Shaker nominees") nominated by him to fill board positions at the corporation's September 7, 2004 annual meeting. The Complaint sets forth three counts against the defendant corporation ("Foxby"), Thomas B. Winmill, Foxby's President, CEO and General Counsel; James E. Hunt, Bruce B. Huber and John B. Russell ("the management nominees"); and Peter K. Weiner, another board member, alleging breaches of fiduciary duties and seeking declaratory and injunctive relief. Plaintiffs challenge the election of the three management nominees at the 2004 annual meeting, as well as by-law provisions adopted by the board since 2002, governing board election procedures. Defendants have filed a motion to dismiss the Complaint, or, in the alternative, for summary judgment. Plaintiffs have opposed the motion. Arguments were heard on March 7, 2005. By the Order accompanying this Memorandum Opinion the Court has denied defendants' motion.

Standard of Review

When considering a motion to dismiss filed pursuant to Maryland Rule 2-322(b), the Court must assume the truth of all relevant and material facts that are well-pleaded and all inferences that can be reasonably drawn from the pleadings. *Bennett Heating & Air Conditioning, Inc. v. Nations Bank*, 103 Md. App. 749, *rev'd in part on other grounds*, 342 Md. 169 (1996). If the Court considers matters outside the pleadings, however, it must treat the motion as one for summary judgment under Maryland Rule 2-501, after determining that there is no genuine dispute as to any material fact and that judgment can be entered as a matter of law. *Boyd v. Hickman*, 114 Md. App. 108 (1997). All parties must be given a reasonable opportunity to present material pertinent to such a motion. Md. Rule 2-322(c).

Discussion

Plaintiffs ask this Court to declare that Phillip Goldstein, Rojeev Dos and Andrew Dakos (the Shaker nominees) were duly elected to the board of directors at the 2004 annual meeting; that the management nominees were not elected (and enjoining them from taking office as directors); and that the by-law amendments adopted by the corporate directors since 2002, which affected the election of directors at the 2004 annual meeting, are null and void (and enjoining their enforcement).[1]

Because plaintiffs' entitlement to relief depends upon an analysis of the amended by-laws of the corporation, the Court will address first the notice provisions in the by-laws and then the other challenged provisions concerning director qualification, vote requirements and

[1] The Complaint asks the Court to declare the Net Asset Value Proposal adopted at the 2004 annual meeting. (Comp. ¶ 41.) But counsel appear to have abandoned this issue by not addressing it in plaintiffs' memorandum or argument.

judicial review of the election results.

I. The Notice Provisions in the By-Laws

The factual circumstances of the election are not disputed. At the 2004 annual election three directors were to be elected, labeled Class I, Class II, and Class V. There is no dispute that plaintiffs knew as of March 2004 that the Class II director would be elected at the 2004 annual meeting. (Compl. at 22.) There is also no dispute that the plaintiffs were on notice of the Class I and Class V positions as of July 23, 2004, when Foxby filed its proxy statement for the September 7, 2004 annual meeting. (Compl. at 23.) Plaintiffs' argument that filing a proxy statement with the Securities and Exchange Commission (SEC) was not a public announcement is without merit. As pointed out by the defendants, Article II, § 12(c)(3) of the by-laws states that an SEC filing constitutes a public announcement.

At the hearing and in their complaint and opposition, the plaintiffs do not dispute that the notice requirements are valid on their face, only that their validity might be compromised if they were passed to interfere with shareholder voting rights. As authorized by Maryland statute, by-laws may specify an advance notice requirement for director nominations. Md. Code Ann. Corps. & Ass'ns § 2-504(f) (1999)[2]. Article II, § 12(a)(2) of the Foxby by-laws requires shareholders to give notice of annual meeting business, e.g., notice of the Shaker nominees, to the secretary, within 90 days of mailing of the annual meeting notice. In turn, Article II, § 12(a)(3) of the by-laws requires notice of nominees for a newly created director position announced less than one hundred days before the annual meeting to be given to the

[2] Unless otherwise stated, all statutory citations are to the Corporations and Associations Article.

directors within ten days of the public announcement.

As to the Class II position, the ninety day requirement of Article II, § 12(a)(2) applies as the default rule to any business to be addressed at an annual meeting. Not only did the August 15, 2003 proxy statement clearly state that May 17, 2004 was the ninety day notice deadline for the 2004 September annual meeting, the plaintiffs knew as of March 2004 that the Class II director would be elected in September, two months before the notice deadline expired. The plaintiffs, however, failed to comply with the notice deadline by giving Foxby notice of the Shaker nominees on August 4, 2004.

As to the other two director positions, Class I and Class V, the ten day deadline applied. The Class I position became open when the director resigned. Even though the by-laws do not specifically address positions opened because of resignations, a corporation must notify shareholders of the annual meeting at least ten days beforehand. *See* § 2-504(a). The Court agrees with the defendants that logically the ten day notice provision would apply to this director position. Similarly, the Class V position was a newly created position, hence, the ten day notice requirement of Article II, § 12(a)(3) applied. Plaintiffs received notice of the Class I and V position on July 23, 2004. The ten day deadline expired on August 2, but plaintiff Shaker did not give notice of his nominees until August 4.

On the basis of these facts, defendants ask this Court to determine that the Shaker nominees were not properly before the meeting for voting purposes. Therefore, the declared results of the elections in favor of the management nominees should stand.

Plaintiffs assert, however, that the facially inoffensive notice provisions were enforced in this case in a discriminatory fashion for the purpose of benefitting the Investment

Manager, at the expense of the shareholders. To support this contention, they point to the fact that the proxies submitted by plaintiff Shaker were received and counted for purposes of establishing a quorum for the meeting (which would not have existed without them), but they were not counted for any voting purposes at the meeting. Additionally, plaintiffs note that the management-controlled board expended considerable sums of corporate money to engage in a proxy fight with Plaintiff Shaker after receiving the notices which defendants now insist were ineffective. This, they argue, constitutes a waiver of objection and evidence that the directors treated the 2004 election as contested.

Plaintiffs' most compelling argument is that the by-law notice provisions had a discriminatory impact on the stockholders as they were applied to this "control of the board" situation. Although plaintiff Shaker had reason to know that a Class II director position was open two months prior to the notice deadline, he was unlikely to engage in a costly proxy fight with management over a single board position. It was only when the corporation announced in its July 23, 2004 SEC filing that two other director positions would be subject to vote at the annual meeting, that such an effort to seize board control became worthwhile. At that point, the stockholders had only ten days to give the board notice of any alternative candidate slate.

In an analogous situation, where management attempted to advance the date of an annual meeting to ward off a proxy contest with dissident stockholders, the Supreme Court of Delaware ordered that the new meeting date be nullified, stating:

> In our view, those conclusions amount to a finding that management has attempted to utilize the corporate machinery and the Delaware Law for the purpose of perpetuating itself in office; and, to that end, for the purpose of obstructing the legitimate efforts of dissident stockholders in

> the exercise of their rights to undertake a proxy contest against management.

Schnell v. Chris-Craft Indus., Inc., 285 A.2d 437, 439 (Del. 1971).

A more recent unpublished opinion[3] by the Delaware Chancery Court imposed a preliminary injunction against the enforcement of an advance notice by-law requirement which would have deprived shareholders of the opportunity to nominate a dissident slate of corporate directors. Relying in part on *Schnell v. Chris-Craft Indus., Inc.*, *supra*, and *Blasius Indus., Inc. v. Atlas Corp.*, 564 A.2d 651 (Del. Ch. 1988), the court addressed a fact pattern where the board had taken no affirmative action to thwart the shareholder challenge, but merely declined to waive the by-law requirement of notice in advance of the annual shareholders' meeting. The Delaware court said:

> ... the case-by-case development of the laws governing fiduciary obligations - a process that is integral to our common law tradition - cannot be constrained by so facile a distinction. From a semantic and even legal viewpoint, "inaction" and "action" may be substantive equivalents, different only in form. Morever, occasions do arise where board inaction, even where not inequitable in purpose or design, may nonetheless operate inequitably. If that occurs, it cannot tenably be maintained that equity is without power to grant relief to an aggrieved party in an appropriate case.

R.D. Hubbard v. Hollywood Park Realty Enterprises, Inc., 1991 WL 3151 (Del. Ch.), 17 Del. J. Corp. L. 238, 257.

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[3] Md. Rule 1-104 generally prohibits citation to unreported Maryland decisions but Delaware courts do not prohibit their citation. *See Hudson v. Prime Retail, Inc.*, 2004 WL 1982383 (Md. Cir. Ct.) at p. 13, n.17.

For at least a half century, the Maryland courts have exercised their equity jurisdiction to consider whether corporate by-laws were invalid under our law, as unreasonable when applied to challenges to the control of corporate boards of directors. *Roland Pk. Shop. Center v. Hendler*, 206 Md. 10, 24 (1954). Other Maryland cases have addressed directors' actions taken to ensure their continued control, *Mtge. Board Ass'n v. Baker*, 157 Md. 309, 321 (1929) and scrutinized directors' actions for fairness applying the fiduciary duty rule, *Cummings v. United Artists*, 237 Md. 1, 24-25 (1964) (although not deciding whether to apply fiduciary duty rule or less stringent business judgment rule).

This Court believes that Maryland law provides the same protection to shareholder voting rights that obtains in Delaware, in similar factual contexts, such as the present one involving a proxy fight over control of the board. *Cf. Brown v. McLanahan*, 148 F.2d 703, 708 (4th Cir. 1945). Assuming the truth of plaintiffs' allegations for purposes of the present motion, plaintiff Shaker took appropriate actions to notify the directors and the SEC of his intent to challenge the management nominees with his own slate. The board reacted by engaging in a contest for shareholder proxies, which would have been unsuccessful, except for the invocation of the notice provisions in the amended by-laws. Thus, under the circumstances of this case, the Court finds that the application of the notice provisions brings this action within the equitable powers of the Court to determine whether defendants breached their fiduciary duties to the shareholders by enforcing unreasonable or discriminatory by-law provisions against plaintiffs.

II. The Other Challenged By-Law Provisions

Plaintiffs allege that the by-law amendments adopted by the board of directors since 2002 have as their sole purpose the destruction of shareholder voting rights and the

prevention of meaningful challenges to board control by the Investment Manager[4] and its affiliates. Plaintiffs further allege that the Investment Manager is motivated to control the board in order to protect its lucrative fees as a return on its $425,000 purchase of the investment advisory agreement.

The remaining by-law amendments which plaintiffs seek to have declared null and void can be characterized as "qualification" and/or "supermajority" by-laws, as well as a by-law purporting to limit judicial review of board election results. Plaintiffs contend that these by-law amendments constitute unlawful interference with the shareholder franchise and a violation of the board's fiduciary duties as prescribed by Maryland law.

On these issues the Court is not helped particularly by the parties' opposing interpretations of Maryland's statutory scheme for electing and qualifying directors. Both positions beg the question. Plaintiffs cite § 2-404(b)(1)(i) to assert that the determination of director qualification arises only after their election. Defendants cite § 2-403 to support their contention that director qualifications are properly established by charter or, as in this case, by corporate by-law. But the Complaint alleges that, these matters notwithstanding, the "qualification" by-law, the "supermajority" by-law and the "judicial review" by-law, as amended, are unreasonable and impermissibly impact shareholder voting rights. (Compl. ¶¶ 34-37 and 52-54.)

Neither party disputes the right of stockholders to elect directors at annual

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[4] Since July 12, 2002 the company's investment manager has been CEF Advisors, Inc. Defendant Winmill serves as President of CEF Advisors, Inc., which is a wholly-owned subsidiary of Winmill & Co., Inc., a publicly-owned company, whose voting stock is controlled by Winmill's family. (Compl. ¶¶ 8, 14 & 15.)

meetings under Maryland law. § 2-404(b). The next logical questions then are what duty the corporation has to ensure fair voting procedures and by whom and how those procedures may be challenged. A leading case from the Delaware Chancery Court holds that even unintended violations of shareholder voting rights are actionable. *Blasius Indus., Inc. v. Atlas Corp., supra*, 564 A.2d 651 (Del. Ch. 1988).

The *Blasius* decision cites an earlier Delaware case in which board action was enjoined for interference with shareholder voting rights and quotes it as follows:

> The corporate election process, if it is to have any validity, must be conducted with scrupulous fairness and without any advantage being conferred or denied to any candidate or slate of candidates. In the interests of corporate democracy, those in charge of the election machinery of a corporation must be held to the highest standards of providing for and conducting corporate elections. The business judgment rule therefore does not confer any presumption of propriety on the acts of directors ....

Aprahamian v. HBO & Company, 531 A.2d 1204 (Del. Ch. 1987). While neither plaintiffs[5] nor defendants have found significant Maryland authority on this point, the Court is persuaded that the Maryland courts would recognize shareholder voting rights as having the same or similar status as recognized by the Delaware cases.

Indeed, defendants do not appear to cavil with the notion that a stockholder may sue to enforce his or her voting rights. But they take strong issue with the entitlement of plaintiff Shaker to bring this action directly rather than derivatively in the name of the corporation. For this proposition defendants rely on the "special injury" requirement which was until recently a

[5] Plaintiff Shaker is the only plaintiff stockholder and so he is the only plaintiff able to assert such a claim.

part of the analysis of direct versus derivative claims contained in the Delaware decisional law. *But see Tooley v. Donaldson, Lufkin & Jenrette, Inc.*, 845 A.2d 1031, 1035-36 (Del. 2004). That analysis, even if it has any continuing support in Maryland decisions, is not persuasive here because the parties are unable to articulate any corporate harm occasioned by the adoption of the challenged by-law amendments. To the contrary, defendants insist that these amendments were necessary to protect this closed-end investment company from the kind of seizure of control and conversion to an open-end fund which plaintiffs attempted in this case. Plaintiffs do not contend that the corporation suffered any injury. The only injury in this situation, if any, was to plaintiff Shaker's right to participate in a corporate election pursuant to by-laws consistent with law. § 2-110. This clearly suggests that plaintiff Shaker is entitled to pursue this cause of action directly.

Defendants contend that directors of a Maryland corporation do not owe fiduciary duties to stockholders and that the duties they owe are solely to the corporation, as prescribed in § 2-405.1, which by its terms limits enforcement to derivative actions on behalf of the corporation. In the present context of shareholder voting rights, however, this cannot be the case. Despite the lack of Maryland decisional law on this point, plaintiffs' claim raises a fundamental issue of corporate governance. As the Delaware Chancery Court said in *Blasius*:

> The shareholder franchise is the ideological underpinning upon which the legitimacy of directorial power rests ... Thus, when viewed from a broad, institutional perspective, it can be seen that matters involving the integrity of the shareholder voting process involve considerations not present in any other context in which directors exercise delegated power ... 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.

Blasius Indus., Inc., 564 A.2d at 659-60.

This Court believes that the directors owed plaintiff a statutory and common law duty to enact by-laws containing fair voting procedures. Whether they did that in this case presents factual questions that cannot be resolved on the record now before the Court. The reasonableness and/or the discriminatory effect of the by-law amendments in question raise mixed questions of law and fact, better resolved following discovery. Md. Rule 2-322(c). *Cf.*, *Mountain Manor Realty v. Buccheri*, 55 Md. App. 185, 199 (1983).

Accordingly, defendants' motion to dismiss or to grant summary judgment will be denied.

ALBERT J. MATRICCIANI, JR.
Judge

cc: John B. Isbister, Esquire
Jaime W. Luse, Esquire

Gregory E. Keller, Esquire

G. Stewart Webb, Jr., Esquire