

Western Investment Hedged Partners LP, et al. v. Sunset Financial Resources, Inc. (summary judgment, claims alleging improper actions by directors in connection with shareholder voting procedures and seeking declaratory and injunctive relief)

In *Western Investment Hedged Partners LP, et al. v. Sunset Financial Resources, Inc.* [¹], the Circuit Court for Baltimore City considered a motion for summary judgment by defendant Sunset Financial Resources, Inc., a Maryland real estate investment trust (“Sunset”), in response to a complaint filed by Plaintiffs, two Delaware companies and an individual, Arthur Lipson, seeking declaratory and injunctive relief concerning amendments to Sunset's bylaws.

Plaintiffs held approximately 9.7% of the stock of the defendant Maryland company. They became unhappy with Sunset's performance and sought a special shareholders meeting for the purpose of replacing Sunset's current directors with ones that shared their interests. In apparent response to Plaintiffs' actions, Sunset amended its bylaws to increase number of shareholders required to request a special meeting. After Plaintiffs filed a Preliminary Consent Solicitation Statement with the SEC seeking consent to cause the special meeting, Sunset amended its bylaws again to further provide structure for how special meetings were to be called and conducted. Following these actions, Plaintiffs filed their complaint seeking a declaration setting aside the bylaw amendments and enjoining their enforcement.

In responding to Sunset's motion for summary judgment, the Court first reviewed the substance of the bylaw amendments made in August and October of 2005. The August amendment changed the requirement for calling a special stockholders meeting from a 25% minority interest to a simple majority of outstanding Sunset shares, a change that both parties agree was brought about as a result of Plaintiffs' letter seeking such a meeting. While Plaintiffs contended that the change was made for the purpose of entrenching the current directors and defeating Plaintiffs' attempts to replace them, Sunset countered that the current bylaw provision allowed a minority to call a meeting even where 75% of the stockholders may be opposed to it and even where they may not have the necessary 2/3 majority vote to remove a director. In the October amendment, the Sunset directors further defined the procedures and parameters for requesting and voting at a special meeting and for nominating and electing directors at special meetings, and set forth other requirements. As with the August amendments, the parties disputed the motives behind the October amendments.

In its discussion, the Court referenced its prior opinion in *Shaker v. Foxby* [²], where it held that directors owed the plaintiff in that case, a dissident shareholder, a statutory and common law duty to enact bylaws containing fair voting procedures. The *Shaker* court cited with approval several Delaware cases, *Schnell v. Chris-Craft Indus., Inc.* [³] and *Blasius Indus.*,

¹ Maryland Business and Technology Case Management Program, Case No. 24-C- 05-009540 (3/7/06, Matricciani, J.), available at http://www.baltocts.state.md.us/about/publications/opinions/western_investment_memorandum_opinion.pdf.

² 2005 WL 914385 (Md. Cir. Ct.).

³ 285 A.2d 437 (Del. Supr. 1971).

Inc. v. Atlas Corp. [⁴], that set forth the principles of corporate governance that “the deferential business judgment rule is not applicable to board actions taken primarily for the purpose of interfering with the stockholder's vote, even if taken in good faith.” However, in its *Shaker* decision, this Court did not embrace the principle in *Blasius* that “director’s actions taken in good faith may constitute an ‘unintended violation’ of the duty of loyalty that the board owed to shareholders.”

In this case, the Plaintiffs conceded that the bylaws amendments made by Sunset’s directors were facially lawful and not unreasonable exercises of board authority. The basis of their complaint was that the Sunset directors' enactment of the amendments was unreasonable and taken for the primary purpose of entrenching themselves as directors. However, the Court held that there was little support for the Plaintiffs' claims. The Plaintiffs testified that they would have little trouble complying with the simple majority bylaw amendment. And although the Sunset directors admitted that the particular bylaw amendments were a defensive reaction to the Plaintiffs' attempts to oust the board, the Court did not view the board's action as setting up unfair obstacles to the exercise of shareholder rights. According to the Court, the directors had acted in good faith and would not be held accountable for unintended violations of their duties to stockholders.

Additionally, unlike in *Shaker* and *Blasius*, the bylaw amendments in this case were characterized not so much as defensive mechanisms but more as necessary provisions lacking in the original bylaws which were necessary to establish appropriate procedures for conducting special shareholder meetings. In fact, the Court noted, some of the provisions the Plaintiffs attacked in their complaint were not new at all. The Court's ultimate conclusion in granting the summary judgment to Sunset was that Sunset’s directors' actions in enacting the bylaw amendments had not exceeded the scope of permissible actions.

⁴ 564 A.2d 651 (Del. Ch. 1988).