

**DELAWARE COURT OF CHANCERY SUGGESTS THAT FEDERAL SECURITIES  
REGULATIONS DO NOT TRUMP STATE ANNUAL MEETING LAW**

In *Newcastle Partners, L.P. v. Vesta Insurance Group, Inc.*, 2005 Del. Ch. LEXIS 174 (Del. Ch. Nov. 15, 2005), Vice Chancellor Stephen P. Lamb of the Delaware Court of Chancery suggests that rules (the “Rules”) promulgated under the Securities and Exchange Act of 1934 (the “’34 Act”) prohibiting companies that have not distributed an annual report and either a proxy or information statement from holding a meeting of stockholders for the election of directors (an “Annual Meeting”) do not preempt Delaware state law Annual Meeting requirements.

Under Section 211(c) of the Delaware General Corporation Law (the “DGCL”), Delaware corporations must hold, or designate a date for, Annual Meetings (or take action by written consent in lieu of an Annual Meeting) within thirteen months of their last Annual Meeting (or last action by written consent to elect directors in lieu of such a meeting). Under Rules 14c-2 and 14c-3 under the ’34 Act, however, an annual report and an information statement (or, if proxies are solicited, an annual report and proxy statement under Rule 14a-3) must be provided to stockholders before an Annual Meeting is held. A corporation delinquent in preparing these reports may face a situation in which, facially at least, Delaware law requires an Annual Meeting that federal regulations arguably prohibit.

This is exactly the situation that confronted the Court of Chancery in *Newcastle Partners*. Because Vesta Insurance Group, Inc. (“Vesta”) had not held an Annual Meeting in over thirteen months, Newcastle Partners, L.P. filed an action under Section 211 of the DGCL in the Court of Chancery seeking to compel Vesta to hold its annual meeting. The Court held a trial on August 19, 2005, to determine whether Vesta should be ordered to hold its annual meeting and, if so, when. Vesta defended the action by claiming that its inability to publicly file its audited financial statements as required by the federal securities laws and regulations excused it from holding its annual meeting under Delaware law. Vesta claimed that Rules 14c-2 and 14c-3 precluded it from holding its annual meeting because the company did not have audited financials on file with the Securities and Exchange Commission (the “SEC”). Vesta argued that, at a minimum, the meeting should not be scheduled until late 2005 because it believed it could file its audited financials by September or October, thereby allowing the company time to solicit proxies in advance of its annual meeting. At the conclusion of trial, the Court ruled from the bench and ordered Vesta to hold its annual meeting within ninety days from the date of the Court’s oral ruling, or no later than November 17, 2005. In so ruling, Vice Chancellor Lamb rejected Vesta’s arguments premised upon the federal securities laws stating:

I know of no authority from the SEC or from any federal court or other federal body or, indeed, from this Court that suggests that when a company finds itself in a position Vesta is in, that this Court lacks authority or is somehow preempted by federal law from granting relief under Section 211(c). That sort of preemption is never lightly found, and is never presumed. And *there is no basis, to my knowledge, in the law as it exists today to even entertain seriously the proposition that my authority under 211(c) is impaired or preempted by the fact that the company has not been able to file its financial statements . . .* As we all know, there is a host of authority in this Court in situations that are analogous to this in which the relief under 211 has been granted. So that’s all I need to say on that subject.

*Newcastle Partners, L.P. v. Vesta Ins. Co.*, C.A. No. 1485-NC, Tr. at 257-58 (Del. Ch. Aug. 19, 2005) (Transcript Ruling) (emphasis added).

When Vesta subsequently determined that it could not finalize and publicly file its financial statements before the end of the ninety-day period, it moved for reconsideration of the Court’s order under Court of Chancery Rules 60(b) and 62(b). Vesta’s motion, like its original defense of the case, was based on the apparent conflict between the Court’s order and the federal securities laws and regulations. Although Vesta had received communications from the SEC touching on the conflict, the Court found these communications to “merely ask[] for further explanation” and “fall[] far short of a definitive interpretation of the SEC rules,” *Newcastle Partners, L.P.*, 2005 Del. Ch. LEXIS 174, at \*10, and thus itself considered whether the “SEC would ever undertake to stop an annual meeting of stockholders ordered by [a state] court.” *Id.* at \*10-\*11. Consistent with its prior oral ruling in the case, the Court found “[n]othing in either [the ’34 Act] or regulation[s to] suggest[] any purpose to interfere with the power of state courts to require that stockholder meetings be held in accordance with the requirements of state corporation law in situations where the registrant corporation is delinquent in its SEC filing obligations and, thus, is unable to comply with the literal terms of the SEC proxy rules.” *Id.* at \*14.

With this in mind, the Court turned to the internal affairs doctrine, which generally provides that “only the law of the state of incorporation governs and determines issues relating to a corporation’s internal affairs.” *Id.* at \*16 (quoting *Vantagepoint Venture Partners 1996 v. Examen, Inc.*, 871 A.2d 1108, 1113 (Del. 2005)). Noting that exceptions to the internal affairs doctrine “occur only when the law of the state of incorporation is ‘inconsistent with a national policy on foreign or interstate commerce,’” *id.* (quoting *Vantagepoint Venture Partners 1996*, 871 A.2d at 1113), the Court held that “[a]ny suggestion that there is an irreconcilable conflict between the mandate of this court’s Order and Final Judgment and SEC statutes and regulations would both misconstrue the scheme of federal proxy regulation and weaken a basic premise of American corporate law that is a defining characteristic of our federal system.” *Id.* at \*17.

Immediately after the Court of Chancery’s ruling denying Vesta’s motion for reconsideration, Vesta appealed to the Delaware Supreme Court. By a summary order, the Delaware Supreme Court affirmed the Court of Chancery’s opinion “on the basis of and for the reasons assigned by the Court of Chancery in its well-reasoned decision.” *Vesta Insurance Group, Inc. v. Newcastle Partners, L.P.*, 2005 Del. LEXIS 463 (Del. Nov. 16, 2005) (Order).

The *Newcastle Partners* opinion clarifies that Delaware law does not consider the Rules to obviate the Section 211 Annual Meeting requirement. As the opinion itself notes, however, the SEC has not taken a formal position on this issue, and corporations and practitioners, while obtaining more certainty from the perspective of state law, ought be aware of the continuing federalism issues.

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