Legal Update

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Electronic Communications With Shareholders – Not as Easy as You Think

In this Internet age, with the volume of snail-mail slowing to a trickle and email dominating business discourse, it is understandable that many companies are opting to send virtually all their communications electronically. When it comes to official shareholder communications, however, California and many other states have adopted laws that impose surprisingly rigorous conditions on the right to transmit electronically.

California Law Requirements

Tucked away in the preliminary definitions of the California Corporations Code, Section 20 provides in effect that a corporation may use electronic transmissions for communications under or pursuant to the Corporations Code only if:

(i) the recipient has provided “an unrevoked consent to the use of those means of transmission” for such communications, and

(ii) “the transmission creates a record that is capable of retention, retrieval, and review, and that may thereafter be rendered into clearly legible tangible form.”

In addition, if the transmission is to a shareholder who is a natural person, the consent to the transmission must be preceded by or include “a clear written statement to the recipient as to (a) any right of the recipient to have the record provided or made available on paper or in nonelectronic form, (b) whether the consent applies only to that transmission, to specified categories of communications, or to all communications from the corporation, and (c) the procedures the recipient must use to withdraw consent.”

In several sections, the Corporations Code explicitly allows specified communications (including notices of shareholder meetings, notices disclosing actions taken by written consent of shareholders, and the delivery of annual financial reports) to be made by electronic transmission, but only if they are compliant with Section 20.

Possible Pitfalls

It is likely that many smaller private companies, which usually lack an expert corporate secretary or in-house corporate counsel, violate the rule inadvertently and routinely, creating uncertainty about the validity of the notice or even the underlying transactions. The temptation to send emails to the shareholders rather than to spend the afternoon addressing envelopes and licking stamps, is undoubtedly driving them to electronic shareholder communication in general, without realizing that some such communications are impermissible and inadequate.

A non-compliant transmission can give disgruntled shareholders a basis for a valid objection, which could be expected at a minimum to be disruptive and add cost to the process. And even without a shareholder protest, improper notice can be problematic for management or company counsel later performing diligence or asked to give comfort in the form of a representation or opinion that depends on the validity of the electronic transmission.

Given the exacting requirements of Section 20, and the hassles that may arise from failing to meet them, sending paper notices to shareholders through the mail may still be the most reliable and efficient way to comply with the law. If the email tide proves too powerful to resist, however, vigilance is in order to insure full and continued compliance with the law's surprisingly strict requirements.

This Legal Update does not constitute legal advice and does not create an attorney-client relationship. For more information about electronic communication with shareholders, contact Greg Beattie (greg@veritascl.com; 510 550-8605) at Veritas Corporate Law, P.C.