

## CORPORATE ALERT



### DELAWARE COURT NARROWLY INTERPRETS ADVANCE NOTICE BYLAW PROVISIONS

Companies should carefully review their bylaws in light of two recent rulings from the Delaware Chancery Court that narrowly interpreted the language in advance notice bylaw provisions. In *JANA Master Fund, Ltd. v. CNET Networks, Inc.*, No. 3447 (March 13, 2008), the Delaware Chancery Court held that the advance notice provision in CNET's bylaws applied only to proposals that a stockholder wishes to have included on management's form of proxy pursuant to SEC Rule 14a-8, and therefore did not preclude an independently financed proxy solicitation. In *Levitt Corp. v. Office Depot, Inc.*, C.A. No. 3622-VCN (April 14, 2008), the Delaware Chancery Court held that a stockholder did not have to give advance notice of its intent to run a short slate for the election of directors at Office Depot because the company itself had properly provided notice that the election of directors would be considered at the meeting and there was no separate bylaw provision expressly addressing stockholder nominations. Each of these cases is discussed in more detail below.

#### JANA MASTER FUND, LTD. V. CNET NETWORKS, INC.

##### *Background*

This lawsuit arose in connection with a proxy contest in which JANA Master Fund, Ltd., an investment fund that owned approximately 11 percent of the common stock of CNET Networks, Inc., sought to gain control of the board of directors of CNET. In particular, JANA sought to (i) replace two current directors of CNET, (ii) expand the size of the board from eight to thirteen members and (iii) nominate five individuals to fill the newly created positions. JANA notified CNET of its intention to solicit proxies from stockholders in favor of its proposals and requested inspection of CNET's stocklist materials pursuant to Section 220 of the Delaware General Corporation Law. CNET refused to provide the requested stocklist materials to JANA on the basis that JANA failed to state a proper purpose for such inspection. According to CNET, because JANA had held its shares in CNET for less than one year, JANA's proposed proxy solicitation violated the advance notice provisions of CNET's bylaws, which provide in part that:

Any stockholder of the Corporation that has been the beneficial owner of at least \$1,000 of securities entitled to vote at an annual meeting for at least one year may seek to transact other corporate business at the annual meeting, provided that such business is set forth in a written notice and

mailed by certified mail to the Secretary of the Corporation and received no later than 120 calendar days in advance of the date of the Corporation's proxy statement released to security holders in connection with the previous year's annual meeting of security holders (or, if no annual meeting was held in the previous year or the date of the annual meeting has been changed by more than 30 calendar days from the date contemplated at the time of the previous year's proxy statement, a reasonable time before the solicitation is made). Notwithstanding the foregoing, such notice must also comply with any applicable federal securities laws establishing the circumstances under which the Corporation is required to include the proposal in its proxy statement or form of proxy.

JANA filed a complaint contending that either (i) the bylaw provision only applies to nominations and proposals made under Rule 14a-8 and is therefore inapplicable to JANA because JANA planned on independently financing its own proxy materials or (ii) the bylaw provision is invalid under Delaware law because it is an unreasonable restriction on stockholder franchise.

### ***The Court's Decision in JANA***

The court agreed with JANA that the bylaw provision did not apply to JANA's proposals. Based on its review of the language in CNET's advance notice provision, the court concluded that the bylaw provision applies solely to proposals and nominations that are intended to be included in the company's proxy materials pursuant to Rule 14a-8.

In his decision, Chancellor William B. Chandler III provided the following three reasons for concluding that the bylaw applied only to proposals under Rule 14a-8—

- The language in CNET's bylaw provision provides that any stockholder “may seek to transact other corporate business at the annual meeting.” The court focused on the language “may seek” and concluded that this language seemed to suggest that the stockholder must ask for permission or approval to make the proposal. Rule 14a-8 essentially requires a stockholder to request the inclusion of a proposal in a company's proxy materials. However, the federal securities laws do not require a stockholder to seek a company's permission for an independently financed proxy solicitation. Because JANA intended to finance its own proxy solicitation, the court concluded that the bylaw language did not apply to JANA's proposals.
- The deadline in CNET's bylaws for receipt of a notice by a stockholder of its intention to transact business at an annual stockholder meeting referred to the mailing date of CNET's proxy materials for the prior year. This language is strikingly similar to the deadline imposed by Rule 14a-8, which the court explains is designed to allow management enough time to include the stockholder proposal in its own proxy materials. The court indicated that it could not find “a single example of a permissible advance notice bylaw that has set the notice required by reference to the release of the company's proxy statement.”<sup>1</sup>

<sup>1</sup> The court provided the following support for this statement: See *Openwave Sys. Inc. v. Harbinger Capital Partners Master Fund I, Ltd.*, 924 A.2d 228 (Del. Ch. 2007) (upholding bylaws that require advance notice be given “not less than 20 days nor more than 90 days prior to the first anniversary of the preceding year's annual meeting”); *Accipiter Life Sciences Fund, L.P. v. Helfer*, 905 A.2d 115 (Del. Ch. 2006) (upholding bylaws that require notice be given within ten days from the public announcement of the annual meeting date); *Harbinger Capital Partners Master Fund I, Ltd. v. Nw. Corp.*, C.A. No. 1937-N, 2006 WL 572823 (Del. Ch. Feb. 23, 2006) (denying motion to expedite in case challenging advance notice bylaw that required plaintiff “to identify its slate of proposed board candidates three months in advance of the meeting”); *Mentor Graphics Corp. v. Quickturn Design Sys., Inc.*, 728 A.2d 25, 42 (Del. Ch. 1998) (discussing, but not ruling on the validity of, an advance notice bylaw requiring notice be given 90-100 days before a meeting), *aff'd sub nomine Quickturn Design Sys., Inc. v. Shapiro*, 721 A.2d 1281 (Del. 1998); see also *In re Unitrin, Inc. S'holders Litig.*, C.A. No. 13656, 1994 WL 698483

- The court found the last sentence in CNET’s advance notice bylaw provision to be the most persuasive. This sentence provides that any “notice must also comply with any applicable federal securities laws establishing the circumstances under which the corporation is required to include the proposal in its proxy statement or form of proxy.” The court explains that this language incorporates all of the requirements of Rule 14a-8 and that there is no reason for CNET to include such burdensome requirements in its advance notice bylaw provision if the bylaw provision applies outside the context of Rule 14a-8 proposals.

Based on the reasoning set forth above, and Delaware’s general policy against disenfranchisement, the court believed that the only reasonable conclusion is that the bylaw applies solely to proposals and nominations that are intended to be included in the company’s proxy materials pursuant to Rule 14a-8. CNET has appealed the court’s decision to the Delaware Supreme Court.

## **LEVITT CORP. V. OFFICE DEPOT, INC.**

### ***Background***

The *Levitt* case also rose in connection with a proxy contest. In this lawsuit, Levitt, a one percent stockholder of Office Depot, filed a preliminary proxy statement with the SEC in support of two dissident director nominations for election to the board of directors at Office Depot’s annual meeting. Office Depot rejected the submission of Levitt’s nominations because Levitt did not comply with Office Depot’s advance notice bylaw provision, which provides, in part, that:

At an annual meeting of the stockholders, only such business shall be conducted as shall have been properly brought before the meeting. To be properly brought before an annual meeting, business must be (i) specified in the notice of the meeting (or any supplement thereto) given by or at the direction of the Board of Directors, (ii) otherwise properly brought before the meeting by or at the direction of the Board of Directors or (iii) otherwise properly brought before the meeting by a stockholder of the corporation who was a stockholder of record at the time of giving of notice provided for in this Section, who is entitled to vote at the meeting and who complied with the notice procedures set forth in this Section. For business to be properly brought before an annual meeting by a stockholder, the stockholder must have given timely notice thereof in writing to the Secretary...

To be timely, a stockholder’s notice shall be received at the company’s principal office..., not less than 120 calendar days before the date of Company’s proxy statement released to shareholders in connection with the previous year’s annual meeting....

Levitt made several arguments for its contention that the advance notice bylaw provision did not govern its director nominations. Levitt’s arguments included that (i) the bylaws do not include an express advance notice restriction on director nominations by stockholders, (ii) the term “business” does not “clearly and unambiguously” include the nominations of directors and therefore the restriction should not be interpreted to limit shareholder democracy, (iii) if the term “business” does encompass director nominations, no additional notice is required because Office Depot has already properly made director nominations an item of business before the annual meeting through Office Depot’s general reference to the election of directors in its notice to stockholders of the annual meeting, and (iv) if applicable, the advance notice period is unreasonably long.

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(Del. Ch. Oct. 13, 1994) (implicitly upholding an advance notice bylaw requiring notice be given 60 days in advance of meeting), *rev’d on other grounds sub nomine Unitrin, Inc. v. Am. Gen’l Corp.*, 651 A.2d 1361 (Del. 1995).

### ***The Court's Decision in Levitt Corp.***

In granting Levitt's motion for judgment on the pleadings, the court first concluded that the nomination of directors is unambiguously within the purview of the term "business" and thus stockholder director nominations implicate the advance notice provision. In reaching this conclusion, the court looked to the plain meaning of the term "business," which includes an "affair" or "matter," and determined that because the nomination of directors is an affair or matter, the bylaw requires the nomination of directors to be properly brought before the meeting. The court also stated that references in Delaware law and Office Depot's bylaws to "the election of directors and the conduct of such other business as may come before the meeting..." imply that the election of directors is a form of business and, therefore, the act of nomination would also be considered business.

Having found that the term "business" includes the nomination and election of directors, the court went on to determine whether Levitt was required to give advance notice of its intention to nominate two directors. Because Office Depot had sent out a notice of meeting that speaks generally of electing directors as an item of business for the annual meeting, the court could discern no persuasive reason why the business of nominating directors for election would not be included in such business. The court concluded that the business of electing and nominating directors was properly brought before the annual meeting by the notice of meeting and that Levitt's effort to nominate two directors was within the scope of that business.

### **REVIEW ADVANCE NOTICE BYLAW PROVISIONS**

As we wait to see whether these decisions are upheld, reversed or clarified, companies should be carefully reviewing their advance notice bylaw provisions to determine whether an amendment to their bylaws may be appropriate. For most companies, the advance notice deadline has likely already passed for their 2008 annual stockholders' meeting, so they may be able to hold off on any bylaw amendments until these cases have run their course. On the other hand, if a company's advance notice deadline has not yet passed, the company should examine its advance notice bylaws provision and consider any necessary changes in light of these cases. Companies will want to ensure that their advance notice bylaw provisions accurately reflect the company's intent. In particular, to avoid the issues raised by these cases, an advance notice bylaw provision should:

- clearly apply to all proposals made or sought to be made at any stockholder meeting, whether or not the stockholder wishes to have the proposal included in the company's proxy statement pursuant to Rule 14a-8
- set a deadline for notice of stockholder proposals that is in reference to the annual meeting date, rather than the mailing date of the proxy materials and is a reasonable period of time prior to the annual meeting
- specify the information required in the notice rather than incorporating the requirements of the federal securities laws
- explicitly address stockholder nominations for directors, as well as other business proposed by stockholders.

In addition to the above, companies should consider whether to increase the disclosure requirements in their advance notice provisions to capture additional information relating to the ownership position of stockholder proponents. Some companies have amended their bylaws recently to require information regarding whether stockholder proponents have

hedged their position in the company's stock or otherwise entered into a transaction with the effect of increasing or decreasing the stockholder's economic or voting power in the stock.<sup>2</sup> This information should help flesh out whether such proponents may have interests that differ from other stockholders and may also deter activist investors from manipulating a company's stock price for their own gain.

## CONTACT INFORMATION

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<sup>2</sup> Companies that have recently amended their bylaws to require additional information on stockholder proponents include Five Star Quality Care, Inc., Redwood Trust, Inc., HRPT Properties Trust, Sara Lee Corporation and Coach, Inc. For example, Coach's advance notice bylaw provision now requires:

"...A stockholder's notice to be proper must set forth...as to the stockholder giving the notice and any Stockholder Associated Person...whether and the extent to which any hedging or other transaction or series of transactions has been entered into by or on behalf of, or any other agreement, arrangement or understanding (including any short position or any borrowing or lending of shares of stock) has been made, the effect or intent of which is to mitigate loss to or manage risk of stock price changes for, or to increase the voting power of, such stockholder or any such Stockholder Associated Person with respect to any share of stock of the Corporation...."