

# THE GUARDIAN

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## Delaware Court Interprets Advance Notice Bylaw as Applying Only to Nominations and Proposals Made Pursuant to SEC Rule 14a-8

Last week, the Delaware Court of Chancery issued a surprising decision in *JANA Master Fund, Ltd. v. CNET Networks, Inc.* (“CNET”), interpreting the advance notice provision of a public company’s bylaws to apply only to nominations and proposals that are intended to be included in a company’s proxy materials pursuant to SEC Rule 14a-8. SEC Rule 14a-8 provides the conditions under which a shareholder can include a proposal in a company’s proxy materials, and the procedures with which the shareholder must comply.

Earlier this year, the SEC adopted a controversial amendment to Rule 14a-8(i)(8) which effectively limited shareholders’ access to a public company’s proxy materials with respect to proposals related to the nomination or election of directors. The amendment to Rule 14a-8(i)(8) codified the SEC Staff’s interpretation of the proxy rules by allowing companies to exclude shareholder proposals relating to the nomination or election of directors, or procedures related to the foregoing from the company’s proxy materials. While the SEC’s rulemaking clarifying Rule 14a-8 was long anticipated and widely covered by the media, the CNET decision leaves one to wonder whether the court was aware of the recent amendments

to Rule 14a-8 and fully appreciated the current limitations of Rule 14a-8—in particular, that it cannot be used by shareholders to make nominations of directors.

The background of the case is as follows. JANA Master Fund is an investment fund that owns, along with its affiliates, approximately 11% of the outstanding stock in CNET Networks, Inc. (“CNET”). CNET currently has a staggered, eight-person board with two directors whose terms would be expiring at the 2008 Annual Meeting. In December 2007, JANA informed CNET of its intention to solicit proxies from shareholders to replace the two directors up for re-election, expand CNET’s board to thirteen seats, and nominate five individuals to fill the newly created board seats. If successful, this plan would result in JANA obtaining control of a majority of CNET’s Board of Directors. CNET took the position that JANA had failed to comply with provisions of CNET’s advance-notice bylaw which requires that a stockholder seeking to bring business before the annual meeting (which, in CNET’s view, would include the nominations of directors) beneficially own \$1,000 of CNET common stock for at least one year. At the time of CNET’s 2008 Annual Meeting, JANA would have held such stock for only eight months.

## The Guardian

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The advance-notice bylaw provision at the center of this dispute provides as follows:

*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 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 contended that the advance-notice provision does not apply to its proposal, because it only applies to nominations made under Rule 14a-8 of the federal securities laws, i.e., this bylaw only applies to nominations and proposals a shareholder wishes to have included on management's form of proxy. Because JANA intended to prepare and mail its own proxy materials, it argued that this bylaw is not applicable. JANA also contended that, if this bylaw was read to apply, it is invalid under Delaware law because it is an unreasonable restriction on the shareholder franchise.

While the Delaware Chancery Court declined to consider the validity of the bylaw itself, the Court held in favor of JANA and interpreted the advance-notice bylaw to not apply outside the context of Rule 14a-8. In other words, because JANA was not requesting that CNET include its proposals or nominations in CNET's proxy materials, JANA was not required to comply with the advance-notice

bylaw's requirements. In discussing how it reached such an interpretation, the Court delved into some of the historical and philosophical underpinnings of the adoption of Rule 14a-8. This decision, however, fails to mention that Rule 14a-8, as amended, cannot be used to nominate directors, and undoubtedly this is probably one of the areas that will be argued by CNET on appeal. In its decision, the court provides three reasons for concluding that the advance-notice bylaw can be read only to apply to proposals made pursuant to Rule 14a-8:

- (a) *The language in the first sentence of the advance-notice bylaw provision which states that stockholders "may seek to transact other corporate business" could not make sense outside of the Rule 14a-8 context.* The court parsed the words "may seek" to imply that a stockholder needed to ask permission as they would in the Rule 14a-8 context when seeking the inclusion of a proposal in the company's proxy statement. The court contrasted that with an independently financed proxy solicitation where the federal securities laws do not require the shareholder to seek management's permission.
- (b) *The deadline provided in the advance-notice bylaw for the receipt of a notice by a shareholder that it intends to transact business at the annual meeting referenced the mailing date of CNET's proxy statement for the previous year.* The court reasoned that "[t]he most reasonable explanation for so requiring is that the bylaw is designed to allow management time to include the shareholder proposal in its proxy materials." The court went on to declare that "[t]his Court cannot 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. Although not dispositive, this suggests that the CNET Notice Bylaw is designed to govern shareholder proposals under Rule 14a-8 rather than to operate as an advance notice bylaw."

## The Guardian

### Shareholder Activism Update

(c) *The language in the last sentence of the advance notice bylaw that reads “[n]otwithstanding 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” indicates that the bylaws are intended to apply only to situations where stockholders wish to place proposals in the management’s proxy materials under Rule 14(a)-8. The court reasoned that this sentence was intended to graft into the advance-notice bylaw all of the requirements of Rule 14a-8 and that there would have been no reason to have done so if this bylaw applied outside the context of Rule 14a-8 proposals.*

Earlier this week, CNET announced that it would pursue an appeal of this decision to the Delaware Supreme Court. Like many other practitioners in this area, we believe it is likely that this case will be overturned on appeal. Irrespective of the outcome of this litigation, the decision should have little future consequence as precedent, because CNET’s advance-notice and advance-nomination bylaws were far from what many would consider “typical” provisions.

As a result of this decision, companies should, in consultation with counsel, take steps to ensure that their bylaws contain advance-notice and advance-nominations provisions that are unambiguous, clear as to the circumstances and situations to which they apply, and not susceptible to being interpreted in a similar fashion to the way in which the Delaware Chancery Court interpreted CNET’s advance-notice bylaws. In addition, while the court declined to opine on the validity of any aspect of CNET’s advance-notice bylaws, the court referenced its previous warning that “when advance notice bylaws unduly restrict the stockholder franchise or are applied inequitably they will be struck down.” Accordingly, companies should also have their advance-notice and advance-nominations bylaw provisions, particularly those that include threshold requirements (e.g., minimum beneficial ownership, period of beneficial ownership, etc.) of

who can submit a nomination or proposal (outside of Rule 14a-8), reviewed to ensure that they do not contain unreasonable restrictions on the shareholder franchise.

For additional guidance on advance-notice and advance-nomination bylaws and the issues raised by the CNET decision, please do not hesitate to contact your regular Blank Rome contact or any of the members of Blank Rome’s Shareholder Activism Group. ■

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