

THE GUARDIAN

The Latest News and Information to Assist
Companies in the New Age of Shareholder Activism

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May 2008 No. 4

Delaware Chancery Court Interprets Advance-Notice Bylaw as Not Requiring a Shareholder to Provide Advance Notice for Director Nominations

Earlier this year, the Delaware Court of Chancery issued a surprising decision in *JANA Master Fund, Ltd. v. CNET Networks, Inc.*,¹ 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 public company's proxy materials, and the procedures with which the shareholder must comply. 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 submitting its nominations of candidates for election as directors. If the *JANA* decision was not enough to persuade companies to reexamine, with the assistance of counsel, their advance-notice and advance-nominations provisions, the Delaware Chancery Court's latest ruling on advance-notice bylaws in the *Levitt Corp. v. Office Depot, Inc.*,² described below, should provide ample and compelling justification for companies to take immediate steps to conduct such a review and ensure that their advance-notice and advance-nomination bylaws are unambiguous, clear as to the

circumstances and situations to which they apply, and are not susceptible to being misinterpreted in light of the court's recent rulings on such provisions.

In *Levitt Corp. v. Office Depot, Inc.*, the Delaware Chancery Court interpreted Office Depot Inc.'s advance-notice bylaw as being applicable to the nomination of directors, but ruled that no advance notice of intent to nominate candidates for election as directors was required to be provided by the insurgent shareholder, Levitt Corp. The Chancery Court reasoned that no such notice was required because Office Depot had already properly made director nominations an item of business before its annual meeting through the general reference to the election of directors that was contained in the "Notice of Annual Meeting of Shareholders" that Office Depot included in its Annual Meeting Proxy Statement. Accordingly, the Chancery Court ruled that Office Depot could not prevent Levitt from nominating two directors for election at Office Depot's 2008 Annual Meeting.

While many companies have separate bylaw provisions for advance notice of director nominations and other shareholder proposals (e.g., bylaw amendments, board resolutions, etc.), Office Depot's bylaws did not contain a separate advance-notice bylaw provision for director nominations. Interestingly, earlier versions of Office Depot's bylaws contained a separate advance-notice bylaw for director nominations and required the nominating shareholder to provide certain information about the nominee, such as his name, age, and address. However, the most recent

1. See *JANA Master Fund, Ltd. v. CNET Networks, Inc.*, 2008 WL 660556 (Del. Ch. Mar. 13, 2008), expedited appeal granted, No. 141,2008 (Del. Mar. 19, 2008).

2. See *Levitt Corp. v. Office Depot, Inc.*, C.A. No. 3622-VCN, slip op. (Del. Ch. Apr. 14, 2008).

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version of Office Depot's bylaws contained no such separate advance-notice provision for director nominations and, in fact, made no reference to shareholder nominations of directors. Despite the fact that most practitioners would typically include language in an advance-notice bylaw provision related to the nomination of directors requiring various information about the nominees—including the information required by Regulation 14A—that requirement was omitted from the current version of Office Depot's bylaws.

Levitt contended, among other things, that since Office Depot's advance-notice provision made no explicit reference to director nominations, it could not be interpreted to exclude Levitt's intended nominations. Levitt argued that, comparing the current bylaws with the previous bylaws, the only conclusion that a reasonable shareholder could draw was that Office Depot intended to eliminate the advance-notice requirement for director nominations. Levitt also contended that if Office Depot's advance-notice bylaw was intended to restrict shareholder nominations, "given the special prominence of the shareholder franchise under Delaware law," such restriction would have to be "clear and unambiguous" and such was not the case and, accordingly, "restrictions that are not clear and unambiguous should not be interpreted to limit shareholder democracy."

The Delaware Chancery Court, focusing on the following language contained in Office Depot's advance-notice bylaw provision, disagreed with Levitt's contention and viewed the advance-notice bylaw as clearly and unambiguously applying to the nomination of directors, since the advance-notice bylaw purports to apply to any affair or matter to be conducted or considered at an annual meeting:

Section 14. Stockholders Proposals. *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.*

Finding support elsewhere in Office Depot's bylaws as well as in the Delaware General Corporation Law, the chancery court first concluded that "business," as used in Office Depot's bylaws, encompasses the election of directors and the related act of nominating directors. Accordingly, the chancery court concluded that

Office Depot's advance-notice bylaw applied to the nomination of directors. The Chancery Court next addressed whether Levitt was required to give advance notice of its intention to nominate two directors. Levitt argued that it was not required to give notice because Office Depot had already specified in its "Notice of Annual Meeting" that the business would include electing directors and, accordingly, the business of electing directors was already properly brought before the annual meeting. Office Depot had attempted to argue that its "Notice of Annual Meeting" brought before the annual meeting only the narrow business of voting for or against its slate of directors. The chancery court disagreed with Office Depot, and concluded that the "Notice of Annual Meeting" established that the business of electing directors, unrestricted by any limiting qualification, had been properly brought before the annual meeting.

The final issue for the Delaware Chancery Court to resolve was whether the business of electing directors includes the subsidiary business of nominating directors for election. The chancery court concluded that it did. In a footnote to its opinion, the chancery court noted that a different result may have been obtained in this case had the "Notice of Annual Meeting" been drafted to specifically describe the business before the annual meeting as the election of Office Depot's twelve nominees for election as directors rather than just generally the election of twelve directors.

As was also the case in *JANA Master Fund, Ltd. v. CNET Networks, Inc.*, the Chancery Court avoided having to consider the validity of any aspect of the advance-notice bylaw itself, including the length of the advance-notice period. However, unlike in the JANA case, the Chancery Court declined to pass on Levitt's arguments that since the advance-notice period was measured by reference to the date of the release of proxy statements, it should be limited to proposals made pursuant to Rule 14a-8 for inclusion in Office Depot's proxy materials.

While the JANA and Levitt cases suggest that the Delaware Chancery Court is going to continue to narrowly interpret advance-notice provisions, in both cases, more careful drafting of the advance-notice provisions would have likely significantly improved the odds of a different result in both cases. Among the drafting lessons to be gleaned from the Levitt case are the following:

- Companies should include in their bylaws completely separate advance-notice provisions with respect to shareholder nominations of candidates for election as directors and other proposals of business to be brought before the meeting (e.g., bylaw amendments, precatory resolutions, etc.). The advance-notice provision applicable to nominations should be placed in the article of the bylaws that

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contains most of the provisions applicable to the functioning of the board of directors. The other advance-notice provision applicable to all other stockholder proposals should be placed in the article of the bylaws that includes most of the provisions relating to shareholder meetings. Companies should also avoid attempting to economize on language by combining any aspects of these provisions even if some, if not much, of the language will be the same in both provisions.

- Companies should explicitly include in their advance-notice provisions applicable to the proposals of business, other than nominations of candidates for election as directors, a statement to the effect that notwithstanding anything to the contrary contained in such provision, a shareholder intending to nominate candidates for election as directors must separately comply with the advance-notice bylaw provisions specifically applicable to the nomination of candidates for election as directors for such nomination to be properly brought before the meeting.
- To the extent that a unitary advance-notice provision is used, companies need to make it abundantly clear that the advance-notice provision applies to all shareholder proposals, including proposals to nominate candidates for election to the Board of Directors.
- Companies should also make it abundantly clear that their advance-notice provisions apply to all shareholder proposals regardless of whether the shareholder is seeking to have the proposal included in the company's proxy statement pursuant to Rule 14a-8 or whether the shareholder intends to prepare and mail his own proxy statement.
- Due to the possibility that even a carefully drafted advance-notice provision may be misinterpreted by the Chancery Court, companies should ensure that they are complying with Rule 14a-4(c), so that management retains discretionary authority to vote its proxies against a shareholder proposal.

Companies should also consider, in consultation with their counsel, whether the typical "notice of annual meeting" contained in their annual meeting proxy statement should, in their enumeration of the items of business to be considered, specifically refer to the election of directors as the election of X nominees recommended by the company's board rather than just the election of X directors. We believe the better course of action for ensuring that a shareholder seeking to nominate candidates for election as directors does not escape having to provide advance notice of such nomination is to make the appropriate revisions in the text of the bylaws. However, as noted above, the court did suggest

that a different result may have been obtained in the Levitt case had the "notice of annual meeting" been more carefully drafted.

While the *JANA* case by itself was perhaps not reason enough to initiate an immediate review of a company's advance-notice bylaws, the rulings in these two cases clearly suggest that companies should, in consultation with their counsel, initiate such an immediate review of these bylaw provisions in order to avoid repeating the experience of Office Depot of discovering that its advance-notice bylaw does not require the advance notice of shareholder nominations that it had been led to assume was required. ■

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