

Advance Notice Bylaws: 'If It Ain't Broke, Don't Fix It!'

By Robert S. Reder, Alan J. Stone and Dean W. Sattler

In two recent decisions, the Delaware Court of Chancery found advance notice bylaws to be ineffective in preventing stockholders from nominating alternative director candidates without providing the requisite advance notice, indicating that any ambiguities in these bylaws will be construed against the corporation and in favor of activist stockholders

Two recent decisions have placed Delaware corporations on notice that they must carefully examine their advance notice bylaws, lest they find themselves subject to the default rule under Delaware law which allows stockholders, without warning, to nominate director candidates and raise other proposals at an annual meeting. In *Jana Master Fund, Ltd. v. CNET Networks, Inc.*, C.A. No. 3447-CC (Del. Ch. Mar. 13, 2008), *aff'd* No. 140, 2008 (Del. May 13, 2008), the Court of Chancery declared CNET's advance notice bylaw inapplicable to Jana's stockholder proposals submitted as part of its effort to take control of a majority of CNET's board of directors. In *Levitt Corp. v. Office Depot, Inc.*, C.A. No. 3622-VCN (Del. Ch. Apr. 14, 2008), the Court of Chancery upheld Levitt's right to nominate directors without advance notice, even though Office Depot's bylaws regulate the conduct of business at stockholders meetings by, among other things, requiring advance notice of stockholder proposals. Despite this victory, Levitt has dropped its proxy contest.

Robert S. Reder is a New York-based partner and the co-Practice Group leader of the Global Corporate Group of Milbank, Tweed, Hadley & McCloy LLP. **Alan J. Stone** is a New York-based partner in Milbank's Litigation Department. **Dean W. Sattler** is an associate in Milbank's Global Corporate Group, also located in the New York office.

There is little doubt that both CNET and Office Depot believed that their bylaws were effective to require advance notice of stockholder nominations, and they must have been more than a little surprised by these rulings. Despite appearances to the contrary, however, these rulings do not herald the demise of advance notice bylaws as an effective means of preventing surprises at stockholders meetings of Delaware corporations. The lesson to be learned is a fairly simple one: Corporations and their advisers should resist the temptation to tinker with traditional advance notice bylaw provisions in an effort to "improve" them.

JANA MASTER FUND, LTD. v. CNET NETWORKS, INC.

In December 2007, Jana, which owned approximately 11% of CNET's outstanding common stock, informed CNET that it intended to solicit proxies from stockholders in furtherance of its effort to take control of CNET's board at its 2008 annual meeting. CNET replied that because: 1) its bylaws provide that a stockholder must have owned at least \$1,000 of CNET common stock for at least a year as a prerequisite for bringing a proposal before a meeting of stockholders; and 2) Jana first purchased its CNET stock in October 2007, Jana would not be permitted to pursue its proposals. In response, Jana filed a complaint in the Court of Chancery, seeking a declaration either that CNET's bylaws were inapplicable to Jana, or that CNET's interpretation of the bylaws was invalid.

The relevant passage from CNET's bylaws provides 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 ... 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. (Emphasis added.)

Jana argued that this bylaw should apply only to proposals offered by stockholders for inclusion in Jana's proxy statement pursuant to Rule 14a-8 promulgated under the Securities Exchange Act of 1934. Because Jana intended to finance its own proxy solicitation and was not seeking to have its proposals included in CNET's proxy materials, it contended that the advance notice bylaw was inapplicable to its proposals.

The court agreed with Jana, focusing primarily on: 1) the fact that CNET's advance notice bylaw tied the deadline for submission of proposals to the same event as used in Rule 14a-8 — the mailing of the previous year's proxy materials — indicating to the court that the bylaw was only intended to address the inclusion of stockholder proposals in CNET's proxy materials; and 2) the requirement contained in CNET's advance notice bylaw that any proposal "must also comply with any applicable federal securities laws," which, according to Chancellor Chandler, "reminds shareholders seeking to make proposals under the bylaw that Rule 14a-8 sets requirements in addition to those laid out in the bylaw itself." Chancellor Chandler determined that "[t]here is no reason for CNET to have grafted Rule 14a-8's burdensome requirements into its Notice Bylaw if that bylaw applied outside the context of 14a-8 proposals."

In our experience, advance notice bylaws frequently make reference to Rule 14a-8, but only to make clear that the bylaw is not intended to contradict Rule 14a-8. We also are

aware of advance notice bylaws that (as is the case with Rule 14a-8) tie the notice date to the anniversary of the mailing of the previous year's proxy materials. Nevertheless, the court chose to construe the bylaw narrowly, permitting Jana to proceed with its proxy solicitation to take control of the board because it was not seeking to utilize Rule 14a-8 to present its proposals to CNET stockholders. It is noteworthy that in reaching his decision, Chancellor Chandler placed particular emphasis on the "rule of construction in favor of franchise rights" and to the fact that "Delaware courts have long recognized that the 'right of shareholders to participate in the voting process includes the right to nominate an opposing slate.'"

The court's construction of CNET's advance notice bylaw facilitated an interpretation that furthered this important principle of Delaware corporate law. The *CNET* ruling does not mean that an advance notice bylaw cannot employ a deadline tied to the mailing of the previous year's proxy materials or otherwise refer to Rule 14a-8, but it does mean that a bylaw which includes such references must clearly indicate that it is not otherwise intended to be limited to the circumstances to which Rule 14a-8 applies.

LEVITT CORP. V. OFFICE DEPOT, INC.

On March 14, 2008, Office Depot began dissemination of proxy materials for its April 12th annual meeting of stockholders. The accompanying notice of meeting listed as an item of business the election of directors. Dissatisfied with Office Depot's performance, Levitt Corp., which owns just over 1% of Office Depot stock, filed preliminary proxy materials announcing its intent to nominate two opposition director candidates for election to Office Depot's board. Office Depot objected, arguing that Levitt had failed to comply with the advance notice requirements set forth in Office Depot's bylaws, which provide that:

Section 14. Stockholder 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

... 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 ...

Notably, Office Depot's current advance notice bylaw does not specifically mention director elections or nominations. This is in contrast to previous versions of the bylaw, which (as is the case with traditional advance notice bylaws) discussed nomination procedures specifically and separately from other types of stockholder proposals.

Levitt sought a declaration from the Court of Chancery of its right to nominate its two candidates despite its failure to provide advance notice. Among the several grounds for inclusion of its nominees on the ballot, Levitt argued that no additional notice was required on the its part because Office Depot had already properly made director nominations an item of business before the annual meeting through the meeting notice's general reference to the election of directors. Office Depot disputed Levitt's construction, arguing that, to the extent the notice of meeting made the election of directors an item of "business," Levitt's attempt to nominate its own candidates for election to the board was a separate item of business, requiring Levitt also to provide advance notice.

Siding with Levitt, the court held that the "business" of electing directors had been properly brought before the annual meeting — in accordance with Office Depot's bylaws — by Office Depot itself. The court went on to explain that nomination of director candidates is a critical part of the election process. The court was unable to discern any reason why the business of electing directors should not include the "subsidiary business of nominating directors for election, *especially where no guidance on the nomination process is found in Office Depot's Bylaws* or in the Delaware General Corporation Law." (Emphasis added.) It therefore concluded that Levitt did indeed have the right to nominate two candidates for election to Office Depot's board at the 2008 annual meeting, despite not having provided Office Depot with advance notice within the time frame mandated by the bylaw.

Like the *CNET* decision, this result must have been surprising to Office Depot and its legal advisors, who surely expected that nominations of director candidates by stockholders would require the requisite advance notice under its bylaws, no matter which agenda items for the annual meeting were listed in the notice of meeting. As with *CNET*'s advance bylaw, however, Office Depot's bylaw is

unconventional; it does not address nomination procedures specifically and separately from other types of stockholder proposals. In order to ensure application to stockholder nominations, therefore, an advance notice bylaw should make a clear distinction between nominations of director candidates by the board, on the one hand, and by stockholders, on the other, and set forth specific procedures for nominations by stockholders.

CONCLUSION

Taken together, the *CNET Networks* and *Office Depot* holdings demonstrate that if a corporation's bylaws do not incorporate traditional formulations of advance notice requirements, or carefully phrased revisions thereof, Delaware courts will be reticent to disallow stockholder nominations of alternative director candidates, and perhaps other proposals as well, made without the requisite advance notice. While advance notice bylaws do not need to be placed on the endangered species list along with classified boards and stockholders rights plans, it is clear that any ambiguities will be construed in a manner which promotes the ability of stockholders to participate in the election process.

In fact, there really is no good reason for a properly constructed advance notice bylaw not to function as intended. But in light of these recent rulings, every corporation with an advance notice bylaw, and particularly those incorporated in Delaware, must ask counsel to make sure that its bylaw will not suffer the same unexpected fate as the provisions employed by *CNET Networks* and *Office Depot*. Indeed, there are many advance notice bylaws that have survived judicial scrutiny, and it is sensible to track the language of those bylaws rather than getting unnecessarily creative. The frequently used admonition "if it ain't broke, don't fix it" applies as much to the drafting of corporate bylaws as it does to other aspects of everyday life.

