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Corporate Governance Group

Client Alert

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Delaware Court of Chancery Again Strictly Construes Advance Notice Bylaw to Permit “Untimely” Stockholder Proposal

In its second ruling on an advance notice bylaw in as many months, the Delaware Court of Chancery in *Levitt Corp. v. Office Depot, Inc.*¹ has upheld a stockholder’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. In a similarly stockholder-friendly ruling last month, the Court of Chancery declared CNET Networks’ advance notice bylaw inapplicable to a stockholder’s proposals submitted as part of its effort to take control of CNET Networks’ board of directors.² There can be no doubt that both corporations believed that their bylaws required advance notice of stockholder nominations and were more than a little surprised by these rulings.

Despite appearances to the contrary, these rulings do not herald the demise of advance notice bylaws as an effective means of preventing surprises at stockholders meetings of Delaware corporations. However, they do indicate that any ambiguities in advance notice bylaws will be construed against a corporation seeking to restrict stockholder nominations of alternative director candidates and other proposals. The lesson to be learned from these cases is clear: corporations should resist the temptation to tinker with traditional advance notice bylaw provisions in an effort to “improve” them.

On March 14, 2008, Office Depot began dissemination of proxy materials for its April 12th annual meeting of stockholders. The Notice included with these proxy materials listed as an item of business for the annual meeting: “To elect twelve (12) members of the Board of Directors for the term described in this Proxy Statement.” Unsatisfied with Office Depot’s performance, Levitt Corp., which owns just over 1% of Office Depot stock, filed preliminary proxy materials with the Securities and Exchange Commission announcing its intent to nominate two opposition director candidates to Office Depot’s board at the upcoming annual meeting. Office Depot objected, arguing that Levitt had failed to comply with the advance notice requirements set forth in Article II, Section 14 of Office Depot’s bylaws, which provide in part as follows:

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In addition, if you would like copies of our other Client Alerts or either of the recent Delaware cases construing advance notice bylaws discussed herein, please contact any of the attorneys listed. You can also obtain this and our other Client Alerts by visiting our website at <http://www.milbank.com> and choosing the “Client Alerts & Newsletters” link under “Newsroom/Events”.

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¹ *Levitt Corp. v. Office Depot, Inc.*, C.A. No. 3622-VCN (Del. Ch. Apr. 14, 2008).

² *JANA Master Fund, Ltd. v. CNET Networks, Inc.*, C.A. No. 3447-CC (Del. Ch. Mar. 13, 2008). For a discussion of this decision, see our previous Client Alert entitled “RECENT CHANCERY COURT RULING WILL REQUIRE DELAWARE CORPORATIONS TO RE-EXAMINE THEIR ADVANCE NOTICE BYLAWS (“If it ain’t broke, don’t fix it!”)”, March 24, 2008.

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 ...

It should be emphasized that 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. The Court's opinion neither discussed the reason for this change in the bylaw nor treated the change as dispositive to the outcome of the case.

Levitt sought a declaration from the Court of Chancery of its right to nominate its two director candidates despite its failure to provide advance notice. Among its several arguments for inclusion of its nominees on the ballot, Levitt urged that the term "business", as used in Office Depot's advance notice bylaw, encompasses director nominations. According to this line of reasoning, no additional notice was required on the part of Levitt because Office Depot had already properly made director nominations an item of business before the annual meeting through the Notice's general reference to the election of directors.³ Office Depot disputed Levitt's construction of the bylaw, arguing that, to the extent its Notice made the election of directors an item of "business" for the meeting, Levitt's attempt to nominate candidates for election to the board was a separate item of business, requiring Levitt to issue its own advance notice.

Siding with Levitt, the Court held that the term "business" does include the nomination of directors, and 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, which is "typically understood as spanning from nomination to voting to vote tabulation to announcement and certification of the results." 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 does 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 contemplated by the bylaw.⁴ This result is somewhat surprising, as most practitioners would consider the nomination of director candidates by stockholders to be different "business" than the nomination of director candidates by a board of directors. In order to address this result, an effective advance notice bylaw will need to make clear the distinction between nominations of director candidates by the board, on the one hand, and stockholders, on the other.

Taken together, the *CNET Networks* and *Office Depot* holdings demonstrate that if a company's bylaws do not incorporate traditional formulations of advance notice requirements, or carefully phrased revisions thereof, Delaware courts will be reticent to disallow stockholder proposals if the bylaws can in any manner be construed to allow the proposal to be submitted to stockholders. There really is no reason for a properly-constructed advance notice bylaw not to function as intended. But every publicly-held corporation with an advance notice bylaw, and particularly those incorporated in Delaware, should ask counsel to make sure that its current bylaw will not suffer the same unexpected fate as *CNET Networks'* and *Office Depot's* provisions.

³ Levitt also attempted to make the argument, similar to one that prevailed in the *CNET Networks* case, that because the timing of the advance notice is linked to the release date of Office Depot's proxy statement for the prior year, advance notice would be necessary only for a stockholder who seeks inclusion of a proposal in Office Depot's proxy materials under SEC Rule 14a-8 and not where, as here, the proposal or nomination is shareholder-funded. Unlike the *CNET Networks* Court, the *Office Depot* Court did not seem persuaded by this distinction, noting "in passing" that the Office Depot bylaw makes "no effort to distinguish between (i) a shareholder-funded and shareholder-proposed item and (ii) a company-funded but shareholder-proposed item."

⁴ Despite its success in the litigation against Office Depot, Levitt has decided to abandon its effort to elect directors to the Office Depot board.

Please feel free to discuss any aspect of this Client Alert with your regular Milbank contacts or with any of the members of our Corporate Governance Group, whose names and contact information are provided below.

Beijing

Units 05-06, 15th Floor, Tower 2
 China Central Place, 79 Jianguo Road, Chaoyang District
 Beijing 100025, China
 +86-10-5969-2700
 Edward Sun +86-10-5123-5120 esun@milbank.com

Frankfurt

Taunusanlage 15
 60325 Frankfurt am Main, Germany
 +49-69-71914-3400
 Norbert Rieger +49-69-71914-3453 nrieger@milbank.com

Hong Kong

3007 Alexandra House
 18 Chater Road
 Central, Hong Kong
 +852-2971-4888
 Anthony Root +852-2971-4842 aroot@milbank.com

London

10 Gresham Street
 London EC2V 7JD, England
 +44-20-7615-3000
 Stuart Harray +44-20-7615-3083 sharray@milbank.com

Los Angeles

601 South Figueroa Street
 Los Angeles, CA 90017
 +1-213-892-4000
 Ken Baronsky +1-213-892-4333 kbaronsky@milbank.com
 Neil Wertlieb +1-213-892-4410 nwertlieb@milbank.com

Munich

Maximilianstrasse 15 (Maximilianhoeefe)
 80539 Munich, Germany
 +49-89-25559-3600
 Peter Nussbaum +49-89-25559-3636 pnussbaum@milbank.com

New York

One Chase Manhattan Plaza
 New York, NY 10005
 +1-212-530-5000
 Scott Edelman +1-212-530-5149 sedelman@milbank.com
 Roland Hlawaty +1-212-530-5735 rhlawaty@milbank.com
 Thomas Janson +1-212-530-5921 tjanson@milbank.com
 Robert Reder +1-212-530-5680 rreder@milbank.com
 Alan Stone +1-212-530-5285 astone@milbank.com
 Douglas Tanner +1-212-530-5505 dtanner@milbank.com

Singapore

30 Raffles Place, #14-00 Chevron House
 Singapore 048622
 +65-6428-2400
 David Zemans +65-6428-2555 dzemans@milbank.com

Tokyo

21F Midtown Tower, 9-7-1 Akasaka, Minato-ku
 Tokyo 107-6221 Japan
 +813-5410-2801
 Darrel Holstein +813-5410-2841 dholstein@milbank.com

Washington, DC

International Square Building, 1850 K Street
 Washington, DC 20006
 +1-202-835-7500
 Glenn Gerstell +202-835-7585 gerstell@milbank.com