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Stockholder Meeting Advance Notice Protections—Do They Mean What You Think? *Delaware Court Decisions Emphasize the Need for a Review*

Summary

In two cases decided during the most recent proxy season, the Delaware Court of Chancery sided with the activist stockholder interpretations of advance notice bylaw provisions. In those cases, activists were able to slate competing directors and bring related matters for a stockholder vote at annual meetings, notwithstanding that they had not complied with the corporation's bylaw provision requiring that notice be provided to the corporation at least 120 days prior to the annual meeting. Advance notice bylaw provisions are intended to require a stockholder to provide prior notice to a corporation of a stockholder's director nominees or business to be brought before a stockholder meeting. Such prior notice facilitates an orderly meeting and ensures that stockholders receive prior information about matters to be voted upon at the meeting. Advance notice provisions became a common public corporation meeting mechanic during the late 1980s but have largely escaped stockholder challenge until now. In the absence of an enforceable advance notice protection, activist stockholders are not prevented from proposing any otherwise proper matters for a vote at the annual meeting, including nominating a competing slate of directors, with no minimum advance notice to the corporation.

Separately, SEC Rule 14a-8 provides a framework in which a stockholder can request the corporation to include a proposal in the corporation's proxy statement, and considers stockholder eligibility requirements along with acceptable bases for the corporation to refuse to include the proposal. Bylaw advance notice protections are broader than Rule 14a-8 requirements because Rule 14a-8 only applies to stockholder proposals that are requested to be included in the corporation's proxy statement.

Given the uncertainty that these recent decisions create for corporations, corporations should, regardless of their state of incorporation, review and/or revise their advance notice provisions to avoid any ambiguity that an activist stockholder could unexpectedly exploit. The typical window for submitting proposals pursuant to an advance notice bylaw is about three months before the annual meeting. Thus, calendar year corporations should consider reviewing bylaws now so that amendments can be reviewed and adopted at upcoming fall board meetings. Doing so will provide stockholders with sufficient notice of any amendments that the corporation implements for the 2009 meeting.

Delaware Court Decisions

In *JANA Master Fund, Ltd. v. CNET Networks, Inc.*,¹ the JANA investment fund owned approximately 11% of CNET's common stock and sought to replace the two members of the CNET staggered board who were up for reelection, expand the board from eight to 13, and nominate five new members. Instead of requesting that CNET include its nominees and the board expansion proposal in the corporation's proxy statement, JANA prepared and distributed its own separate abbreviated proxy to the CNET stockholders.

¹ *JANA Master Fund, Ltd. v. CNET Networks, Inc.* available at [http://courts.delaware.gov/opinions/\(lasovfmakt2p11mgqm5pybel\)/download.aspx?ID=104050](http://courts.delaware.gov/opinions/(lasovfmakt2p11mgqm5pybel)/download.aspx?ID=104050).

CNET's advance notice bylaw provided:

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.

In response to JANA's proposal, the CNET board advised JANA that it would not allow a stockholder vote at the meeting on its proposal, because JANA had begun acquiring CNET stock in October 2007 and had not held its CNET stock for the required one-year period stated in the above bylaw provision.

The court concluded that CNET's Notice Bylaw applies only to proposals under Rule 14a-8 for which a stockholder sought inclusion in the corporation's proxy statement and that it does not apply to other stockholder proposals and nominations for which the dissident engages in independent solicitation. The court's interpretation was based on the explicit language of the bylaw, which the court stated contained three specific elements that did not make sense outside the context of proposals subject to Rule 14a-8:

- The phrase "any stockholder ... *may* seek to transact other corporate business at the annual meeting" (emphasis added) implies that permission is needed before making a proposal, which is only true under federal securities law if the stockholder seeks to include the proposal on the corporation proxy statement pursuant to Rule 14a-8;
- The deadline for submitting proposals is directly tied to the date on which CNET filed and mailed its own proxy materials, which implies that the purpose of the advance notice deadline is to give CNET adequate time to include stockholder proposals on its own proxy statement; and
- The last sentence of the bylaw above requiring compliance with "any applicable federal securities laws" is a clear reference to Rule 14a-8, and "[t]here is no reason for CNET to have grafted Rule 14a-8's burdensome requirements on its Notice Bylaw if that bylaw applied outside of the context of 14a-8 proposals."

In the second case, *Levitt Corp. v. Office Depot, Inc.*,² Levitt Corporation, which held approximately 1% of Office Depot's common stock, sought to replace two of the directors with its own nominees. Like JANA, Levitt prepared and filed its own separate proxy statement soliciting votes from other stockholders and did not demand that Office Depot include information about Levitt's nominees in the corporation's proxy statement.

Office Depot's advance notice bylaw provided:

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, 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.

² *Levitt Corp. v. Office Depot, Inc.* available at [http://courts.delaware.gov/Opinions/\(ouferxiqafjzkdzpeq2nc55\)/download.aspx?ID=105260](http://courts.delaware.gov/Opinions/(ouferxiqafjzkdzpeq2nc55)/download.aspx?ID=105260).

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....

Such stockholder's notice shall set forth as to each matter the stockholder proposes to bring before the annual meeting (i) a brief description of the business desired to be brought before the meeting and the reasons for conducting such business at the meeting and any material interest in such business of such stockholder and the beneficial owner, if any, on whose behalf the proposal is made; and (ii) as to the stockholder giving the notice and the beneficial owner, if any, on whose behalf the proposal is made (A) the name and address of such stockholder ..., (B) the class and number of shares of the corporation which are owned of record and beneficially ..., and (iii) in the event that such business includes a proposal to amend either the Articles of Incorporation or the Bylaws of the corporation, the language of the proposed amendment....

Nothing in these Bylaws shall be deemed to affect any rights of the stockholders to request inclusion of proposals in the corporation's proxy statement pursuant to Rule 14a-8 under the Exchange Act.

Office Depot argued that Levitt's "business" was the nomination of its two candidates to the board, and it interpreted its bylaw to require that Levitt present its nominations before the annual meeting in one of the ways provided in the bylaw.

Levitt first argued that the bylaw should not apply to its proposal to nominate directors because nomination of directors was not discussed in the bylaw. Also, a previous version of the Office Depot bylaws contained a provision explicitly governing such a procedure, which was deleted in the current version. Levitt then argued that nomination of directors was not "business" and that even if the nomination of directors were considered "business," Office Depot had already provided stockholders sufficient notice in its proxy statement under clause (i) of the bylaw by including in its proxy statement material discussing the nomination and election process.

The Court of Chancery rejected the first argument, stating that "the nomination of directors is unambiguously within the purview of the term 'business.'" However, the court agreed with Levitt's second argument, holding that the information provided by Office Depot in its proxy materials not only provided notice of the plan to nominate and elect its preferred slate of directors, but also allowed for the possibility of nominations from other stockholders. Because Office Depot had already provided notice to its stockholders, none was required for Levitt's proposal, and the court issued a declaration that Levitt was entitled to make its nominations at the next annual meeting.

Recommendations

We recommend that corporations review and/or amend their advance notice bylaws to avoid the issues raised by these recent decisions and to protect themselves from unanticipated stockholder proposals and director nominations. Doing so is particularly necessary if the bylaw provisions excerpted above are similar to your corporation's existing bylaws. We believe that properly drafted provisions will be enforced and effective. If a corporation's bylaws do not currently include these protections, they should be amended prior to the upcoming proxy season. Following these two decisions, our research of public filings of bylaw amendments indicates that over 150 publicly held corporations have revised their advance notice bylaws applicable to the upcoming proxy season to avoid the ambiguities identified in the Court of Chancery decisions.

Well-drafted advance notice bylaws should include the following:

- Clearly drafted and unambiguous requirements that timely prior notice be provided to the corporation, in writing, for ANY proposal that a stockholder wishes to bring before the annual meeting, along with a requirement that the proposal be a proper matter for stockholder action.
- Bylaw provisions clearly differentiating between the notice procedures for director nominations at both annual and special meetings and those for other business.
- Comprehensive disclosure requirements in the bylaws for stockholders that wish to make a proposal, as well as disclosure about any directors nominated by a stockholder. A description of the proposal, along with any material interest of the stockholder advocating it, should be provided. All ownership interests should be disclosed so that other stockholders can get a complete disclosure of the economic interests of the proponent in the corporation. You may consider whether to require disclosure of derivatives or hedge positions. Nominees for director should disclose any

relationships (economic or otherwise) that they have with the stockholder proposing their nomination, along with all information necessary to determine whether the nominee is truly qualified. This information should be equivalent to what the corporation needs to include in a proxy statement for the board's nominees.

- A clear distinction between the requirements of the bylaws and the independent requirements of Rule 14a-8 for inclusion in the corporation's proxy statement. To emphasize this distinction, advance notice requirements should be drafted in reference to a period prior to the date of the previous year's annual meeting, rather than the date the corporation mailed its proxy materials. Consider a period of at least 90 but not more than 120 days prior to the anniversary of last year's annual meeting.

Corporations also should confirm that they have clearly drafted descriptions in their proxy statements which are consistent with their bylaw advance notice procedures and the independent requirements of Rule 14a-8 for proposals. Also note that if the notice procedures are amended, the proxy statement discussion should be revised to properly describe the new notice procedures reflected in the amended bylaws.

The corporation is required to file a Form 8-K describing bylaw amendments and file the amendments as an exhibit within four business days of the date of their adoption. All bylaw amendments which materially change the procedures for stockholders to recommend director nominees must be disclosed in Form 10-Q (Part II, Item 5) and Form 10-K (Part III, Item 10).

If you have any questions about the issues raised in this advisory, please contact any of the following Katten Muchin Rosenman LLP attorneys:

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