



CNET and Office Depot: Precision Drafting Needed for Advance Notice Bylaws

BY DANIEL S. STERNBERG AND MATTHEW P. SALERNO

Two recent Delaware Chancery Court opinions, *Jana Master Fund, Ltd. v. CNET Networks, Inc.* and *Levitt Corp. v. Office Depot*, ruled in favor of stockholder activists seeking to nominate directors in order to wage proxy fights and as a result corporations should reconsider their bylaw provisions to ensure that management has sufficient notice and opportunity to respond to shareholder nominations and proposals.

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Mr. Sternberg is a partner and Mr. Salerno is an associate at Cleary Gottlieb Steen & Hamilton LLP.

Two recent Delaware Chancery Court opinions, favoring stockholder activists seeking to nominate directors in order to wage proxy fights, have corporations turning urgent attention to their bylaw provisions that set out the procedures and advance notice required for shareholder nominations and proposals. At issue in both cases were particular advance notice bylaw provisions with variations from more customary formulations that proved to be fatally flawed.

In *Jana Master Fund, Ltd. v. CNET Networks, Inc.*,¹ the court found that CNET's bylaws required advance notice of only those proposals that a stockholder seeks to include in management's proxy statement pursuant to Exchange Act Rule 14a-8 and did not require advance notice of proposals to be included in a stockholder's independently produced proxy materials.² In reaching this conclusion, the court relies on three key facts:

- First, the court focuses on language in the advance notice bylaw that references the bylaw's applicability to occasions when stockholders "may seek to transact" business at an annual meeting of stockholders. The court construes this language as limiting the advance notice bylaw to Rule 14a-8 proposals, because only in the context of Rule 14a-8 do shareholders "seek" to include nominations or proposals in management's proxy, in contrast to all other scenarios in which stockholders simply "make" a proposal.
- Second, the court focuses on the deadline for the giving of advance notice, which the CNET bylaw tied to the date of release of its annual proxy statement, rather than to the date of the company's previous or upcoming annual meeting, which is the more customary (although far from universal) formulation.³ The court explained that the most reasonable explanation for this requirement in CNET's bylaws was to allow management time to include the stockholder proposal in its own proxy materials.
- Finally, and in the court's view, most persuasively, the CNET bylaw required the stockholder's notice to comply "with any applicable federal securities laws establishing the circumstances

under which [CNET] would be required to include the proposal in its proxy statement or form of proxy." Ultimately the court found that this sentence was intended to limit the scope of the entire advance bylaw provision.

The CNET opinion was affirmed by the Delaware Supreme Court on May 13, 2008 on the basis of the lower court's opinion.

In the second opinion, *Levitt Corp. v. Office Depot*,⁴ a dissident shareholder filed a proxy statement seeking to elect two directors to the board of Office Depot without giving any advance notice of the nominations to the company, although the company's bylaws contained a provision requiring advance notice for a shareholder to bring "business" before the annual meeting. The Vice-Chancellor held that no advance notice was required. He noted that, although earlier versions of Office Depot's bylaws expressly required advance notice of director nominations, Office Depot's current bylaws required advance notice of only "business" to be conducted at an annual meeting. While the court accepted Office Depot's contention that the term "business" should be construed broadly and includes the *election* of directors at an annual meeting, the court held that Office Depot, in its notice of annual meeting, had in fact brought the "business" of electing directors before the meeting. In the absence of specific guidance on the nomination process in either Office Depot's bylaws or the Delaware general corporation law, the court stated that it could not find any compelling reason why the "business" of electing directors should not also include the subsidiary business of nominating directors. As a result, Office Depot, having already brought the business of electing directors (and the subsidiary business of nominating directors) before the meeting, could not prevent Levitt from presenting its nominees for election at the meeting.

Although both opinions involved somewhat unusual advance notice provisions, each indicates that the Chancery Court is wary of interpreting such bylaws so as to limit the right of shareholders to make nominations. In light of this guidance, corporations and their counsel should review the language of their advance notice bylaws to be sure that the language is clear and unambiguous, as any ambiguity risks being subject to a narrow (and possibly

unintended) construction that favors the right of shareholders to nominate directors.

Bylaws should separately and clearly describe the procedures that stockholders must follow in order:

- to nominate directors for office,
- to make shareholder proposals, and
- if desired, to seek inclusion of proposals in management's proxy materials under Rule 14a-8.

These bylaw provisions should be sufficiently separate to avoid any confusion as to which procedure must be followed in any particular circumstance. Advance notice bylaws should also clearly specify that no one may be elected as a director of the corporation and no business may be considered at a meeting of stockholders unless the director was nominated, or the proposal had been submitted, in accordance with the relevant provisions of the corporation's bylaws.

It is not uncommon for advance notice bylaws to require nominating shareholders, as a prerequisite of a valid nomination, to provide the company with specified information about themselves and their nominees, frequently incorporating by reference information called for by the disclosure requirements of the federal proxy rules. One clear lesson from the *CNET* decision is that, when incorporating the federal proxy rules by reference, drafters should be careful to avoid the unintended implication that such incorporation by reference is intended to limit the scope of the bylaw to Rule 14a-8 proposals. Moreover, in addition to fixing the possible flaws pointed out by the *CNET* and *Office Depot* cases, a number of corporations have recently amended their advance notice bylaws to supplement the disclosures required by the federal proxy rules by including a requirement that the proposing or nominating stockholder disclose any derivative, hedge or short positions held by them or their director nominees relating to the company's securities. We expect that this trend toward increasing the information required of nominating shareholders is likely to continue for the foreseeable future.

Advance notice bylaws serve an important role in corporate governance—they permit orderly meetings and election contests and provide a company's management fair warning so that the corporation can appropriately and adequately respond to stockholder proposals and nominations. *CNET* and *Office Depot* serve as a reminder to corporations and their counsel that shareholders considering nominations and the courts will closely

scrutinize advance notice bylaws and that, if advance notice bylaws are not crafted with appropriate care and precision to be clear and reasonable, a corporation and its other shareholders may be without the protection of the advance notice bylaw when they need it most.

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- 1 2008 WL 660556 (Del. Ch. March 13, 2008), aff'd 2008 WL 2031337 (Del. Supr. May 13, 2008).
- 2 The *CNET* Bylaw also included a provision limiting the ability to make proposals or nominations to shareholders who had owned at least \$1,000 of stock for at least a year (similar to restrictions found in Rule 14a-8). The nature of the court's analysis did not give it an opportunity to consider the validity of such restrictions in an advance notice bylaw.
- 3 The *CNET* court noted that it could not find a single example of a "permissible" advance notice bylaw that set the deadline for the required notice by reference to the release of the company's proxy statement. Although such bylaw provisions are not, in fact, uncommon, this bit of dictum may be an indication that they would be considered unreasonable if subjected to judicial scrutiny.
- 4 2008 WL 1724244 (Del. Ch. April 4, 2008).