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## Delaware Court Holds That an Advance Notice Bylaw Applies Only to Rule 14a-8 Proposals

On March 13, 2008, the Delaware Court of Chancery construed an advance notice bylaw provision to apply only to stockholder proposals submitted for inclusion in management's proxy statement under Rule 14a-8, rather than all stockholder proposals that were to be considered at the company's annual meeting. The decision, *JANA Master Fund, Ltd. v. CNET Networks, Inc.*, C.A. No. 3447-CC (Del. Ch. March 13, 2008), allows a hedge fund to proceed with its proposals to expand the company's staggered board of directors and nominate a new majority of directors to take control of the company. The bylaw at issue was unusually worded, so the court's ruling may not affect many corporations. Nevertheless, in light of this decision and a recent wave of stockholder proposals and hostile take-over activity, we recommend that our corporate clients review their governing documents carefully and make adjustments if necessary to avoid the court's narrow interpretation of the challenged bylaws.

Advance notice provisions regulate stockholder proposals and director nominations that are submitted for consideration at a company's stockholders meeting. These provisions generally require that such proposals or nominations be provided to the corporation by a specific date in advance of the meeting

and often require disclosure of certain information relating to the proponent of the proposal or nomination. Advance notice provisions serve an important purpose by ensuring a specific meeting agenda, providing for the orderly conduct of business, giving boards of directors the time necessary to review and deliver recommendations with respect to the proposals, and making certain that all stockholders are provided with all material information before casting their votes. Courts have enforced advance notice provisions except in rare circumstances where the provisions have unduly restricted stockholder voting rights or operated inequitably under the circumstances.

In *JANA*, the company argued that a hedge fund had failed to comply with the advance notice bylaw provisions in connection with a proxy contest. Those provisions provided 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 (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.

Applying contract interpretation rules, the *JANA* court construed the advance notice provisions narrowly and held that they applied only to stockholder proposals sought to be included in the company's proxy materials. The court reasoned, among other things, that basing the advance notice deadline on the date of the prior year's proxy statement and requiring the proposal to comply with Rule 14a-8 established that

the bylaw was not intended to apply to stockholder proposals being pursued independently of management's proxy statement. It also found that the phrase "may seek" to transact business was consistent with the notion that the stockholder was seeking access to management's proxy statement under the federal securities laws. The court concluded by noting that, to the extent the bylaw was ambiguous, it should be interpreted in favor of the stockholder.

It is important to recognize that the court did not rule on the legal validity of the bylaw or whether it was unreasonable or inequitable under the circumstances. Accordingly, the *JANA* decision does not call into question prior Delaware decisions upholding reasonable advance notice bylaws. Nevertheless, the consequences of this decision may be significant because it effectively permits any stockholder to conduct business at the company's annual meeting without providing any prior notice, so long as

the stockholder does not seek to include any information in the company's proxy statement.

The *JANA* decision is controversial and may be appealed. Its impact may also be limited because the unusual language in the challenged bylaws is probably not commonplace. We still recommend, however, that our corporate clients review their advance notice bylaws closely to make sure that they are drafted appropriately to apply to all stockholder proposals and director nominations to be considered at stockholders meetings. In particular, corporations may want to base the deadline for submitting a stockholder's notice on the prior year's meeting date, rather than the mailing of the proxy statement, and specify the requirements that must be set forth in the notice without referring to the federal proxy rules. It also bears noting that the proposals in *JANA* are part of a larger wave of similar maneuvers by stockholder activists and

a marked increase in hostile takeover activity, both by hedge funds and strategic buyers. For that reason, we also advise that our corporate clients assess their governing documents and takeover defenses generally. In particular, corporations may want to consider whether their bylaws should be amended to require disclosure of complex ownership arrangements that are being used with increasing frequency to circumvent traditional definitions of beneficial ownership. When used appropriately, advance notice provisions and takeover defenses are essential safeguards to protect corporations and their stockholders from aggressive and opportunistic tactics, unfair elections, and short-term investors whose interests may diverge significantly from other stockholders.

Please contact us if you have any questions about this case or its implications for you or your business.

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