

## Using Advance Notice Corporate Bylaws to Control Shareholder Activism: New Legal Developments

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# Using Advance Notice Corporate Bylaws to Control Shareholder Activism: New Legal Developments

Strafford CLE

**Steven Haas, Hunton Andrews Kurth LLP**  
**Lawrence Elbaum, Vinson & Elkins LLP**  
October 17, 2019

# Agenda

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1. Overview
2. Components of an Advance Notice Requirement
3. Recent Legal Developments
4. Enforcement Considerations
5. Lessons Learned

# Overview

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## What is an advance notice requirement?

- Provision in certificate of incorporation or bylaws
- Requires advance notice of a stockholder's intent to nominate a director or propose other business
- Delaware law and the Model Business Corporation Act do not regulate the manner in which stockholders can bring business before shareholder meetings

# Prevalence and Purpose

## Prevalence

- 95% of S&P 1500 companies require notice of proposals and nominations\*

## Purpose

- Provide sufficient time for company to prepare proxy materials
- Provide predictability and orderly meetings
- Ensure adequate disclosure to board and other stockholders
- Avoid ambushes that will harm the company and its other stockholders

“Advance notice requirements are ‘commonplace’ and ‘are often construed and frequently upheld by Delaware courts.’ They are useful in permitting orderly shareholder meetings....”

*Goggin v. Vermillion, Inc.*, 2011 WL 2347704, at \*4 (Del. Ch. June 3, 2011) (quoting *Openwave Sys. Inc. v. Harbinger Capital P’rs Master Fund I, Ltd.*, 924 A.2d 228, 238-39 (Del. Ch. 2007))

\*Source: Deal Point Data, LLC



# Prevalence and Purpose (cont'd)

- Advance notice provisions have routinely been upheld by courts and are a key defense to shareholder activism and hostile takeovers

“[A]n advance notice bylaw will be validated where it operates as a reasonable limitation upon the shareholders’ right to nominate candidates for director. More specifically, such a bylaw must, on its face and in the particular circumstances, afford the shareholders a fair opportunity to nominate candidates.”

*Hubbard v. Hollywood Park Realty Enterprises, Inc.*, 1991 WL 3151 (Del. Ch. Jan. 14, 1991)

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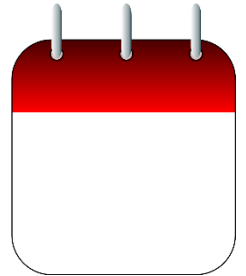
# Components of an Advance Notice Requirement

# Components

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## Timing for Giving Notice

- Window and deadline for nominations and proposals
  - Typically based on the anniversary of the date of (1) the prior year's annual meeting or (2) the mailing of the prior year's proxy statement
- Requirements to update notice
  - Record date
  - Prior to meeting date



# Components – Timing

## Reopening of window for certain events

- **Change of Meeting Date**

- Typical bylaw provides that if meeting date is more than 30 days earlier or 60 days later than prior year's meeting date, the window adjusts and provides stockholders with a minimum of 10 days to provide notice after company's announcement of meeting date
- Compare Rule 14a-8: If meeting date changes by more than 30 days from the date of the previous year's meeting, then the deadline is a "reasonable time" before the company begins to print and send its proxy materials

Example: "In the event that the date of the annual meeting is more than 30 days before or more than 60 days after such anniversary date, notice by the stockholder must be so delivered not earlier than the close of business on the 120th day prior to the date of such annual meeting and not later than the close of business on the later of the 90<sup>th</sup> day prior to the date of such annual meeting or, if the first public announcement of the date of such annual meeting is less than 100 days prior to the date of such annual meeting, the 10th day following the day on which public announcement of the date of such meeting is first made by the Corporation."

# Components – Timing (cont'd)

## Reopening for Creation of New Directorships

- Reopens window if size of board is increased in order to give stockholders at least 10 days to nominate persons for new directorships
  - Reopening is limited to the new directorships, not existing directorships or other business
  - *Cf. Liquid Audio, Inc. v. MM Companies, Inc.*, 813 A.2d 1118 (Del. 2003): Invalidated board's creation of two additional directorships in the face of a proxy contest as an impermissible defensive action

Example: “In the event that the number of directors to be elected to the Board of Directors is increased by the Board of Directors, and there is no public announcement by the Corporation naming all of the nominees for director or specifying the size of the increased Board of Directors at least 100 days prior to the first anniversary of the preceding year’s annual meeting, a stockholder’s notice required by this Section X shall also be considered timely, but only with respect to nominees for any new positions created by such increase, if it shall be delivered to the Secretary at the principal executive offices of the Corporation not later than the close of business on the 10th day following the day on which such public announcement is first made by the Corporation.”

# Components – Contents of Notice

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## Form of Notice

- Written notice required to be delivered to secretary at principal executive office
- Scope of required disclosures related to nominations or other business
  - Record holder
  - Beneficial owner, if any
  - Affiliates, associates, and others acting in concert
  - Nominees, if any

# Components – Contents of Notice

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## Disclosures About the Shareholder

- Name and address
- Share ownership
- Other equity interests
  - Options, warrants, puts, convertible securities, etc.
  - Derivative instruments and other synthetic ownership interests
  - Short interests
  - Rights to dividends
- Voting agreements/arrangements
- Other material interests
- Other information required to be filed in a proxy statement under the Exchange Act

# Components – Contents of Notice (cont'd)

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## Disclosures About the Business

- Brief description
- Reasons for conducting the business
- Text of resolution(s) (including any bylaw amendments)
- Description of material interests and any agreements, arrangements or understandings

## Disclosures About Nominees

- Information about nominees required to be disclosed in a proxy statement under the Exchange Act
- Description of compensation and other material agreements, arrangements and understandings
- Consent to serve
- Certification of no undisclosed voting agreements
- D&O questionnaire



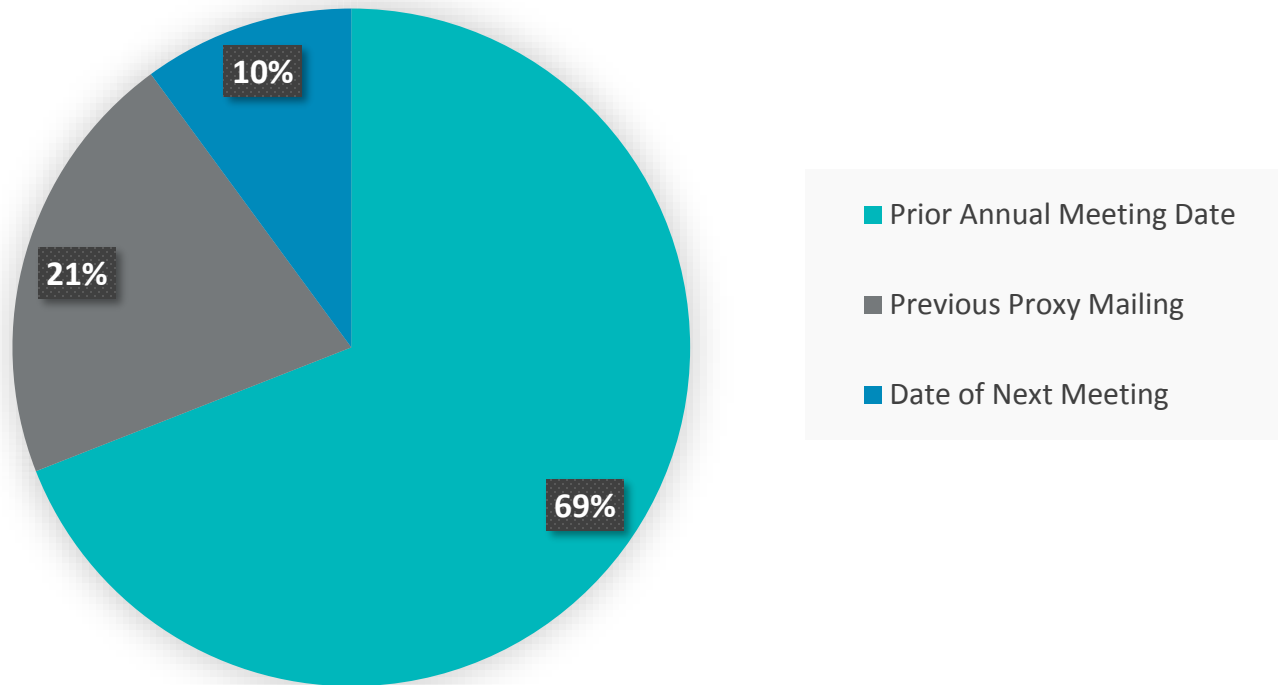
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# Components of an Advance Notice Requirement

Most Common Provisions

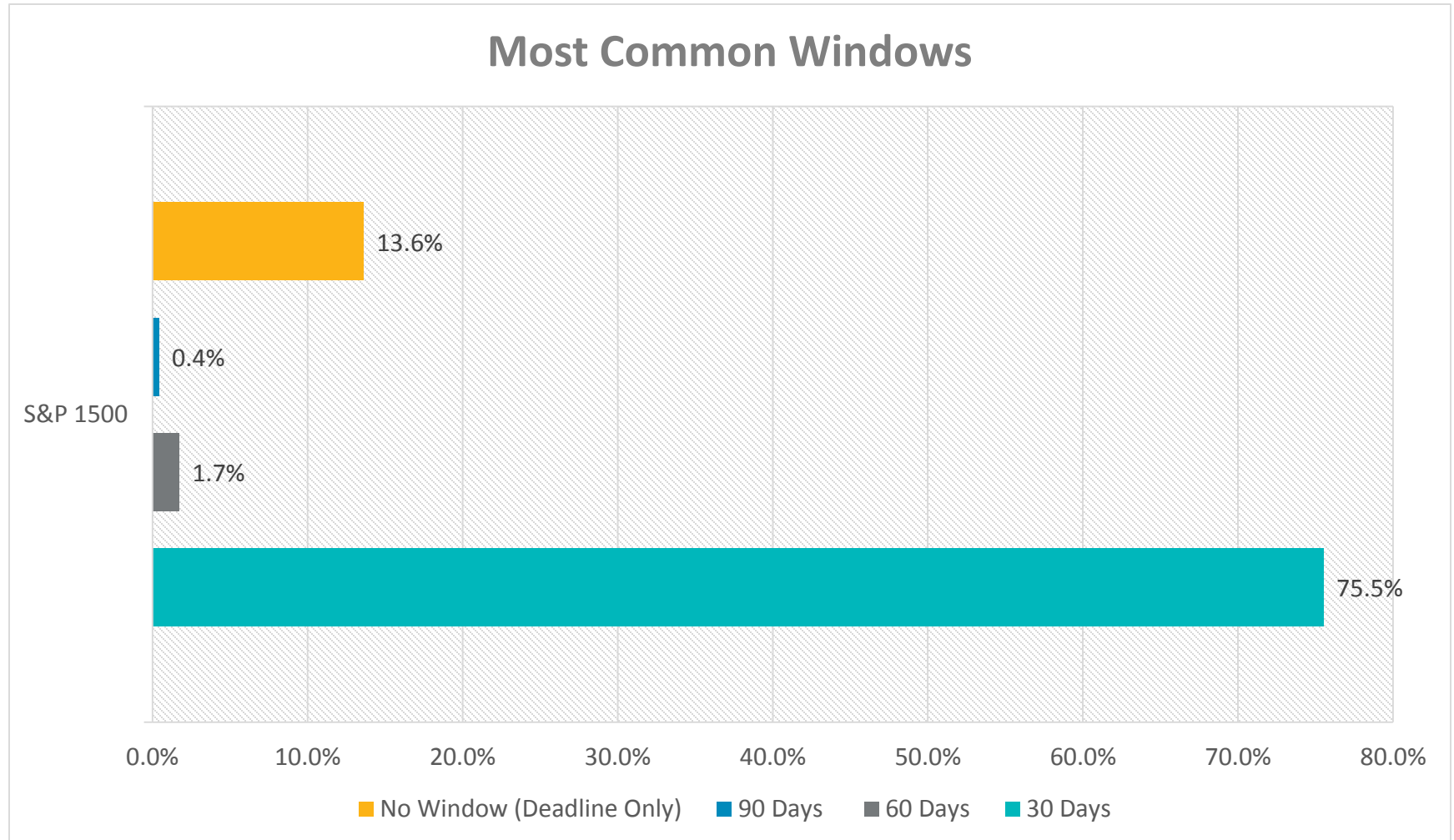
# Most Common Provisions

## Event on Which Nomination Deadline is Based



*\*Source: Deal Point Data, LLC*

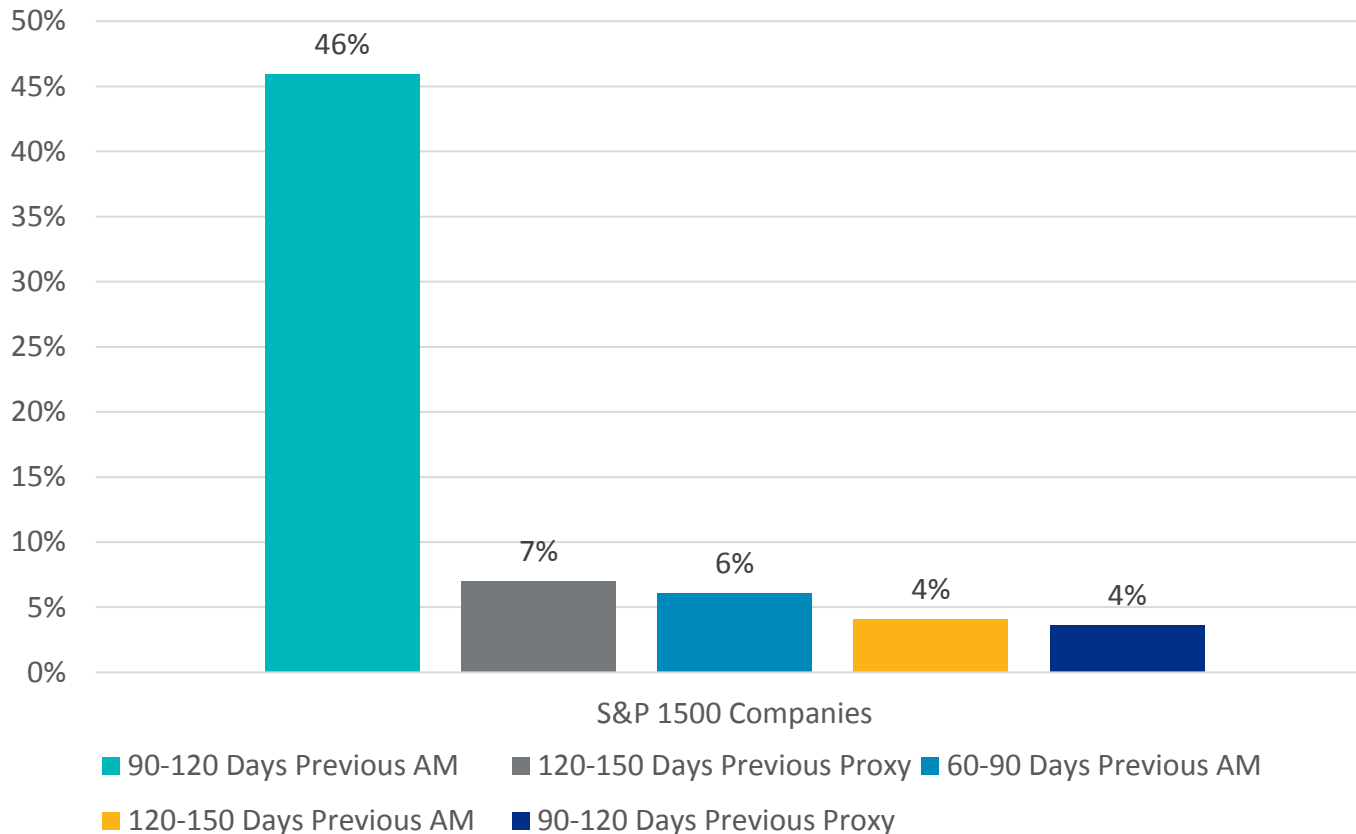
# Most Common Provisions – Window



*\*Source: Deal Point Data, LLC*

# Most Common Provisions – Deadline

Advance Notice Deadlines



*Compare Rule 14a-8: 120 days prior to date of prior year's proxy statement*

Notes: "AM" = Annual Meeting; percentages as a percentage of index

*\*Source: Deal Point Data, LLC*

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# Potential Pitfalls and Investor Considerations

# Potential Pitfalls

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- Case law identifies potential pitfalls, such as:
  - *Levitt Corp. v. Office Depot, Inc.*, C.A. No. 3622-VCN (Del. Ch. Apr. 14, 2008)
  - *JANA Master Fund, Ltd. v. CNET Networks, Inc.*, C.A. No. 3447-CC (Del. Ch. Mar. 13, 2008)
  - *Hill Int'l v. Opportunity Partners, L.P.*, No. 305, 2015 (Del. July 2, 2015)

# Investor Views

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- Investor views on advance notice bylaws
- Proxy advisory firms

# Proxy Advisory Firms

Proxy Advisor	Published Policies on Advance Notice Bylaws
ISS	<p>Vote case-by-case on advance notice proposals, giving support to those proposals which allow shareholders to submit proposals/nominations as close to the meeting date as reasonably possible and within the broadest window possible, recognizing the need to allow sufficient notice for company, regulatory, and shareholder review.</p> <p>To be reasonable, the company's deadline for shareholder notice of a proposal/nominations must not be more than 60 days prior to the meeting, with a submittal window of at least 30 days prior to the deadline. The submittal window is the period under which a shareholder must file his proposal/nominations prior to the deadline.</p> <p>In general, support additional efforts by companies to ensure full disclosure in regard to a proponent's economic and voting position in the company so long as the informational requirements are reasonable and aimed at providing shareholders with the necessary information to review such proposals.</p>
Glass Lewis & Co.	<p>We typically recommend that shareholders vote against proposals that would require advance notice of shareholder proposals or of director nominees. These proposals typically attempt to require a certain amount of notice before shareholders are allowed to place proposals on the ballot. Notice requirements typically range between three to six months prior to the annual meeting. Advance notice requirements typically make it impossible for a shareholder who misses the deadline to present a shareholder proposal or a director nominee that might be in the best interests of the company and its shareholders.</p> <p>We believe shareholders should be able to review and vote on all proposals and director nominees. Shareholders can always vote against proposals that appear with little prior notice. Shareholders, as owners of a business, are capable of identifying issues on which they have sufficient information and ignoring issues on which they have insufficient information. Setting arbitrary notice restrictions limits the opportunity for shareholders to raise issues that may come up after the window closes.</p>



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# Recent Developments

# Placeholder Slates

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- In 2016, Corvex Management LP ran a proxy contest at The Williams Companies Inc. Corvex nominated ten directors but wanted more time to identify longer term directors. As a result, Corvex indicated that if its nominees (the “placeholders”) were elected, they would then resign and appoint the new directors.
- In response, some companies have updated their bylaws to address this “placeholder scenario”
  - Require a written representation from each nominee that he or she intends to serve the entire term
  - Bylaw requirement functions as a director qualification

# ***Blue Lion v. HomeStreet***

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In *Blue Lion Opportunity Master Fund, L.P. v. HomeStreet, Inc.*, Case No. 18-2-06791-O SEA (Apr. 2, 2018), a Washington state court enforced an advance notice bylaw, finding that it was deficient.

- Among other things, the court found that the activist failed to provide the information that, as required by the bylaw, would have to be disclosed in a proxy statement in a contested election under Section 14 of the Securities Exchange Act of 1934, such as:
  - the methods the hedge fund would employ to solicit the Company’s security holders, including the manner and nature in which any of its employees would solicit security holders;
  - in the event specially engaged employees, representatives, or other persons were or would be employed to solicit security holders, (i) the material features of any contract or arrangement for such solicitation and the identity of the parties, (ii) the cost or anticipated cost thereof, and (iii) the approximate number of such employees or employees of any other person (naming such other person) who would solicit security holders;
  - the hedge fund’s estimated costs and total expenditures to date in connection with the proxy solicitation;
  - whether the hedge fund would seek reimbursement of its costs from the Company;
  - the amount of indebtedness if any part of the Company’s securities purchased by the hedge fund or its affiliates was represented by funds borrowed;
  - the amount of securities held by each “associate” of the “participants” in the proxy solicitation, including their names and addresses; and
  - the name and principal business of the organization in which each director nominee had worked during the past five years.

# Bay Capital

- In *Bay Capital Finance, LLC v. Barnes and Noble Education Inc.*, C.A. No. 2019-0539-KSJM, trans. ruling (Del. Ch. Aug. 14, 2019), the activist was not a “record holder” as required by the bylaws
  - Deficiency was cured immediately after the deadline
  - Activist also claimed that proxy statement disclosure was inconsistent with the deadline in the bylaws
- Court enforced advance notice bylaw
  - Activist was aware of the record ownership requirement
  - Corporation was not responsible for activist’s failure to comply
  - No evidence that activist relied on allegedly inconsistent proxy statement disclosure that would have created a later deadline



*“Not even Delaware’s strong public policy favoring the stockholder franchise will save Bay Capital from its dilatory conduct. Bay Capital blew the deadline. It then made up excuses for doing so. No record evidence suggests that the company is in any way at fault for that mistake. If this Court required the company to accept the nomination in these circumstances, advance notice requirements would have little meaning under Delaware law. “*

# *Saba Capital*

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- In *Saba Capital v. BlackRock Credit Allocation Income Trust*, C.A. No. 2019-0416-MTZ, mem. op. (Del. Ch. June 27, 2019), the company demanded, within five business days, supplemental information from an activist related to the nominees' qualifications
  - Bylaws gave Board authority to request "any subsequent information reasonably requested by the Board of Directors to determine that the Proposed Nominee has met the director qualifications as set out in [the bylaws]"
- Court held that, although the company's "goals were understandable," the information request "went too far" and was not related to director qualifications under the bylaws
  - Court also dismissed claim that board had breached its fiduciary duties in trying to enforce the bylaw
- Compare *Saba Capital Masters Fund, Ltd. v. BlackRock Muni New York Intermediate Duration Fund, Inc.*, Case No. 24-C-19-003186 (Md. Cir. Ct. July 12, 2019) (finding that directors acted reasonably under the bylaws and statute in requesting additional information about the dissident's nominees)

# *Xerox*

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In *In re Xerox Corp. Consol. S'holder Litig.*, Index No. 650766/18 (N.Y. Sup. Ct. Apr. 27, 2018), the court enjoined enforcement of an advancement notice bylaw

- Court ruled that a fundamental merger transaction announced after the deadline and opposed by the dissidents justified a waiver of the advance notice deadline

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# Enforcement Considerations

# Enforcement Considerations

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- Receipt of notice
  - What to do?
- Non-compliance generally falls into three categories:
  - Untimely notice
  - Timely but deficient notice
  - Timely but shareholder fails to comply with post-deadline obligations
- Request for waivers



# Enforcement Considerations (cont'd)

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Litigation considerations – non-exclusive factors to consider:

1. When the advance notice requirement was adopted
  - For example, was it adopted on a “clear” day versus a “cloudy” or “rainy” day?
2. Type of deficiency
  - For example, did the stockholder fail to comply with an explicit requirement?
3. Arguments that enforcement is equitable/inequitable
4. Material change in unforeseeable circumstances since the deadline

# Enforcement Considerations (cont'd)

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- Venue
- Investor/public relations
- Overall defense strategy
- Other

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# Lessons Learned

# Lessons Learned: #1

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## Adopt advance notice provisions on a “clear day” whenever possible

- Court are more likely to uphold advance notice provisions in place on a clear day.
  - *See AB Value Partners, LP v. Kreisler Manuf. Corp.*, C.A. NO. 10434-VCP (Del. Ch. Dec. 16, 2014)
- However, even a clear day adoption does not ensure an ANB will always be enforced
  - *See Hubbard v. Hollywood Park Realty Enterprises, Inc.*, 1991 WL 3151 (Del. Ch. Jan. 14, 1991)

# Lessons Learned: #2

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## Periodically review advance notice provisions

- Bylaw may be flawed
- Bylaws may need to be revised in response to judicial rulings
  - *Example: Levitt Corp. v. Office Depot, Inc.*, C.A. No. 3622-VCN (Del. Ch. Apr. 14, 2008); and *JANA Master Fund, Ltd. v. CNET Networks, Inc.*, C.A. No. 3447-CC (Del. Ch. Mar. 13, 2008)
- “State of the art” terms evolve
  - *Example: Derivative shares*
- Bylaw may need to be tailored to the company

# Lessons Learned: #3

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## Be careful in preparing annual proxy statement disclosure of deadlines

- Public companies are required to disclose deadlines in their proxy statements
  - See Item 1(c) of Schedule 14A and Rule 14a-5(e) promulgated under the Securities Exchange Act of 1934
- Errors or inconsistencies may undermine or excuse compliance with advance notice requirements
  - In *Bay Capital*, court found no evidence that dissident relied on proxy statement (and, alternatively, that proxy statement disclosure did not create a different deadline)

# Lessons Learned: #4

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## Be prepared to receive a stockholder's notice

- D&O questionnaire
  - Should be ready
  - Use same questionnaire provided to incumbent board

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## Questions?

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