LAW OFFICES

**SILVER, FREEDMAN & TAFF, L.L.P.**

A LIMITED LIABILITY PARTNERSHIP INCLUDING PROFESSIONAL CORPORATIONS

3299 K STREET, N.W., SUITE 100
WASHINGTON, D.C. 20007
PHONE: (202) 295-4500
FAX: (202) 337-5502 or (202) 337-5503
WWW.SFTLAW.COM

# ADVANCE NOTICE AND OTHER BYLAW PROVISIONS – REVIEW YOURS NOW!

## What is an advance notice bylaw provision?

An advance notice bylaw provision is one that requires a shareholder seeking to propose business at a shareholder meeting, or seeking to submit his or her own director nominees for election at a shareholder meeting in opposition to the board's nominees, to submit notice of the proposal or nominations a specified period of time before the meeting date. The notice typically must contain information regarding the shareholder submitting the notice and, in the case of opposition nominees, information regarding these nominees. The purpose of this requirement is to ensure an orderly process for the conduct of shareholder meetings and to allow the company adequate time to prepare for such a proposal and/or a contested election, both in terms of strategy and the drafting of its proxy materials.

## What's the urgency to review my company's advance notice bylaw provision?

In two very recent, unrelated cases, the Delaware Chancery Court narrowly interpreted advance notice bylaw provisions and held that they did not apply to proxy contests initiated by dissident shareholders. In both cases, the court basically indicated that if there are any ambiguities at all in interpreting these provisions, they will be resolved in favor of the dissident shareholder.

In *Jana Master Fund Ltd. v. CNet Networks*, the court held that an advance notice bylaw applied only to shareholder proposals submitted for inclusion in the *company's* proxy materials pursuant to Securities and Exchange Commission Rule 14a-8, and not to other shareholder proposals or to director nominations submitted by a shareholder that are the subject of a shareholder's *own* proxy solicitation. Jana Master Fund informed CNet of its intention to solicit proxies from CNet shareholders in favor of its own director nominees and its proposal to increase the size of the CNet board (and submit its own nominees to fill the new directorships). CNet claimed that Jana Master Fund did not comply with CNet's advance notice bylaw, which provides that a shareholder must beneficially own $1,000 or more of CNet stock for at least one year (Jana Master Fund had only been a CNet shareholder for several months). The court disagreed, ruling that the CNet advance notice provision applied only to shareholder proposals and nominations that are intended to be included in the company's proxy materials, and not to a separate, *shareholder-financed* proxy solicitation, such as the one which Jana Master Fund planned to conduct. Key to the court's decision was its observation that the CNet bylaw provision closely paralleled SEC Rule 14a-8, and did not make a distinction between proposals submitted under that rule and other proposals.

In *Levitt Corp. v. Office Depot, Inc.*, the court held that a bylaw provision limiting business to be transacted at an annual

shareholder meeting to (1) business proposed by the board, or (2) business proposed by a shareholder with advance notice, did not require a shareholder who sought to nominate candidates for election to the board to give advance notice of its intent to nominate, where the company's notice of the meeting specified that one item of business at the meeting would be the election of directors. In so holding, the court found that in providing notice of the election of directors as an item of business, Office Depot had brought the "business" of considering director candidates – both board nominees and Levitt Corp.'s dissident nominees – before the meeting. The court said that Office Depot's notice applied not only to director elections, but also to "the subsidiary business of nominating directors for election," stating in a footnote that had the notice "separated precisely the business of election from the business of nomination," it might have reached a different conclusion.

The key lessons from the *CNet* and *Office Depot* cases are that an advance notice bylaw should (1) make clear that the requirement to provide advance notice of a shareholder proposal applies not only to a proposal submitted for inclusion in the company's proxy materials under SEC Rule 14a-8, but also to proposals submitted outside that rule (which is why the dissident stockholder prevailed in the *CNet* case), and (2) clearly distinguish between providing advance notice of a shareholder proposal and providing advance notice of director nominations (which is why the dissident stockholder prevailed in the *Office Depot* case). But perhaps the biggest takeaway from these two cases is that the Delaware Chancery Court construes these types of provisions narrowly and has a clear predisposition of resolving any ambiguities in favor of dissident shareholders.

These cases are significant for all public companies, even those not incorporated in Delaware, as the courts of other states frequently look to the decisions of the Delaware courts for guidance on corporate law matters.

You should eliminate any ambiguities in your advance notice bylaw provisions long before the deadlines for submitting shareholder proposals and director nominations for your next annual shareholder meeting. Of course, if your company does not have advance notice requirements, your bylaws should be amended to add them. The bylaws of most companies can be amended by the board of directors without shareholder approval. Note that any bylaw amendment must be reported on a Form 8-K (Item 5.03) within four business days after the amendment.

**What if my Company's advance notice provisions are similar to those in the *CNet* and *Office Depot* cases, but the deadline for submitting shareholder proposals and/or director nominations for my company's next annual meeting has already passed?**

At the very least then, based on the distinctions drawn by the court in the *Office Depot* case, you should specify in the company's notice of the meeting that the agenda item on director elections applies only to the election of director candidates described in the proxy statement and not to nominations.

**What if my company's advance notice bylaw provision is contained in the articles of incorporation, rather than the bylaws?**

Although unusual, the advance notice provisions of some companies are contained in the articles or certificate of incorporation,

instead of the bylaws. In this case, shareholder approval would almost certainly be required for any changes to the advance notice provision. Depending on the nature of the ambiguity and how vulnerable it leaves the company, as well as the vote requirement to amend, seeking shareholder approval may or may not be worthwhile.

**Other than eliminating ambiguities of the type at issue in the *CNet* and *Office Depot* cases, is there anything else my company should consider changing in its advance notice provisions or any other bylaw provisions?**

Several companies have recently amended their advance notice bylaw provisions to require that shareholders submitting notice of a proposal or nominations disclose any hedging activities or derivative transactions in which they have engaged. This is intended to help expose "short timers" and others that use synthetic or temporary stock ownership techniques, which the company can point to in arguing that a dissident shareholder does not have the long-term best interests of shareholders at heart.

In addition to the advance notice provisions, other areas that should be considered include:

- ***SEC E-Proxy Rules***. A public company can mail a brief notice to its shareholders alerting them to the availability of proxy materials on the company's website, and need only provide hard copies to shareholders who request them. If you wish to use this new system, you might need to amend your bylaws (e.g., to permit the electronic submission of proxies).

- ***State Law Changes.*** The corporate laws of many states have been amended over the last few years to catch-up on technological innovations, such as providing shareholder notices electronically, and for other reasons. It's a good idea to review your bylaws from time to time to ensure they conform to current state law and to potentially take advantage of improvements in the law, such as more favorable indemnification provisions that might be available.

- ***Lower Shareholder Quorum Requirement***. If a quorum requires the presence (in person or by proxy) of a majority of your shareholders, you should consider lowering the quorum requirement to one-third (or the lowest level allowed under state law), especially if the requirement is not set forth in your articles or certificate of incorporation and would not require shareholder approval to change. There has been a proposal to eliminate the discretion of brokers to vote in uncontested elections of directors without voting instructions from their customers. Because such a large percentage of street name shares are now voted this way, if this proposed change becomes effective, a majority quorum requirement could be difficult to meet.

- ***Director Retirement Provisions***. If you have a mandatory director retirement provision in your bylaws, consider whether it remains appropriate as currently written or whether it should be changed or eliminated. For example, if your audit committee financial expert is nearing retirement age and you anticipate difficulty in finding a replacement for him or her, or don't want to replace this individual, it may be time to amend or repeal your mandatory retirement bylaw provision.

If you don't have a mandatory director retirement provision, consider whether you should have one.

* * *

For further information, please contact Craig M. Scheer at (202) 295-4525 or cscheer@sftlaw.com.

For over 30 years, Silver, Freedman & Taff, L.L.P. has represented financial institutions and other companies nationwide in connection with initial public offerings and other capital raising transactions, mergers and acquisitions, regulatory and enforcement issues, tax and compensation matters, and corporate governance matters. With attorneys who previously served with the federal banking and thrift regulators as well as the Securities and Exchange Commission, Silver, Freedman & Taff, L.L.P. provides a full array of legal services to financial institutions and other companies.

*This document provides general information and should not be used or taken as legal advice. Such advice requires a detailed analysis of applicable requirements and an evaluation of precise factual information.*

© 2008 Silver, Freedman & Taff, L.L.P.