Client Alert

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Activist Defense Update: Court Enforces Advance Notice Bylaw to Exclude an Activist Proxy Slate

In a recent bench ruling, the Delaware Court of Chancery enforced an advance notice bylaw and thereby precluded an activist investor from nominating a slate of directors and conducting a proxy contest at a company's annual meeting. The court enforced the plain terms of the advance notice bylaw, which required that notice of the nominations had to be given by a stockholder of record. The court found that the activist owned shares only in "street name" on the deadline for giving notice of its nominations, was aware of the bylaw's requirements, and failed to meet such requirements, and that the corporation was not at fault for the activist's mistake. The court also refused to give effect to a second notice submitted by the activist promptly after the deadline that had cured its share ownership deficiency.

Background

Bay Capital Finance, LLC v. Barnes and Noble Education Inc. involved an activist's attempt to conduct a proxy contest for board representation at a company's annual meeting.[1] The activist had previously made several proposals to acquire the company, which the board had rejected because it found the financial terms to be inadequate and the activist not credible as a buyer.

Under the company's bylaws, advance notice of director nominations had to be given not less than 90 days nor more than 120 days prior to the first anniversary of the preceding year's annual stockholders meeting. In addition, the notice had to be given by "a holder of record of shares of Common Stock ... at the time of giving of the notice of nomination." When the activist delivered its notice on the last day of the nomination window, the company determined that the notice did not comply with the bylaw because the activist was not a record holder of the company's stock.

The activist, which owned shares in street name, promptly transferred its shares into a record holder account on the day after the advance notice deadline. It then resubmitted its notice to the company. In doing so, the activist for the first time pointed to disclosure in the company's 2018 proxy statement regarding the deadline for director nominations at the 2019 annual meeting. That proxy statement suggested that notice must be given 90 days prior to the 2019 annual meeting, whereas the bylaw required notice at least 90 days prior to the first anniversary of the prior year's meeting. The activist then filed a lawsuit seeking a preliminary injunction to prevent the company from enforcing the advance notice bylaw to exclude its slate of nominees.

The Court of Chancery's Ruling

The court held that because the activist was not a record holder on the deadline for submitting director nominations as required by the bylaw, its notice was not timely and could therefore be disregarded by the company. In reaching its decision, the vice chancellor found that (i) the activist "was well advised and

[1] *Bay Capital Finance, LLC v. Barnes and Noble Education Inc.*, C.A. No. 2019-0539-KSJM, trans. ruling (Del. Ch. Aug. 14, 2019).

aware of the bylaw requirements," and (ii) "no evidence suggest[ed] that the company [was] in any way at fault for [the activist's] mistake." The court also was not persuaded by the activist's argument that it did not understand the distinction between record and street name ownership.

The court also rejected the activist's argument that its second notice was timely under the prior year's proxy statement. The court found "there's no factual basis for the [activist's] assertion of reliance" on the proxy statement disclosure. Rather, the evidence plainly showed that the activist had relied on the bylaw. The inconsistency in the proxy statement, therefore, did not justify the activist's failure to be a record holder on the deadline set forth in the bylaws. Moreover, nothing in the proxy statement suggested that beneficial ownership would suffice under the bylaws. In any event, the court also found that the alleged discrepancy in the proxy statement disclosure did not matter because, based on the scheduled date for the company's 2019 annual meeting, it resulted in the same deadline as set forth in the bylaws.

Implications

Bay Capital Finance is a noteworthy decision for companies responding to activist investors. Activists have previously criticized various procedural requirements commonly found in advance notice bylaws as well as bylaws dictating the process for stockholders to call special meetings — including requirements that the stockholders be record holders. This ruling indicates that at least in the absence of inequitable conduct by the corporation, Delaware courts will apply such bylaws as written. The result is similar to an approach taken by a Washington state court last year, which concluded that an activist failed to comply with numerous disclosure requirements set forth in the company's bylaws.[2]

In addition, the Court of Chancery was unwilling to use its equitable powers to permit a deficient notice to be cured, even though the activist appears to have cured the deficiency within one day after the advance notice deadline and the company does not appear to have questioned that the activist was a beneficial holder on the deadline. As the court explained:

> 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.

This result can be contrasted with the Court of Chancery's recent ruling in *Saba Capital v. Blackrock Credit Allocation Income Trust*.[3] There, the court held that a corporation had exceeded its authority under its bylaws by demanding within five days supplemental information from a dissident's nominees, which the court found was unrelated to the nominees' qualifications.

Bay Capital Finance is also an important reminder for corporations to be careful in drafting their annual proxy statement disclosures as they relate to the notice deadlines for nominations and proposals for the next year's annual meeting. Companies need to be careful in calculating deadlines for notice under their bylaws; distinguishing the deadlines for nominations and proposals under the bylaws with deadlines for proposals submitted under Rule 14a-8 of the Securities Exchange Act of 1934; and avoiding disclosure that could be inconsistent with the procedural and disclosure requirements under the advance notice bylaws.

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[2] *See Blue Lion Opportunity Master Fund, L.P. v. HomeStreet, Inc.*, Case No. 18-2-06791-O SEA (Apr. 2, 2018). For more background on this case, see our client alert "Advance Notice Bylaws: A Key Defense Against Shareholder Activists" (June 2018).

[3] *Saba Capital v. Blackrock Credit Allocation Income Trust*, C.A. No. 2019-0416-MTZ, mem. op. (Del. Ch. June 27, 2019).

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