

Delaware Courts Continue To Enforce Unambiguous Advance Notice Bylaws, But Incumbent Director Conduct Remains Subject to Equitable Review

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In early 2020, in *BlackRock Credit Allocation Income Tr., et al. v. Saba Capital Master Fund, Ltd.*,¹ the Delaware Supreme Court reiterated that Delaware courts will enforce clear and unambiguous advance notice bylaws according to their terms using ordinary contractual principles. Its ruling reversed a decision by the Court of Chancery and held that a dissident stockholder was barred from presenting its slates of nominees for two closed-end investment funds and a trust because the nominees failed to provide supplemental information within the time period set by clear and unambiguous bylaws.

The Delaware Supreme Court highlighted that there was no evidence of manipulative or inequitable conduct on the part of the entities in enforcing the bylaws, and noted that the dissident stockholder had ignored a clear deadline to provide the supplemental nominee information without raising any objections, and then appeared to proffer after-the-fact justifications for its noncompliance.²

More recently, two Court of Chancery decisions again reiterate that, as a default rule, clear and unambiguous advance notice bylaws will be enforced. Nevertheless, both courts held that application of such bylaws remains subject to equitable review to determine if the incumbent board acted manipulatively or otherwise inequitably in rejecting stockholder board nominees. Notably, the two courts applied slightly different standards of review.

The decisions further indicate that clear and unambiguous bylaws adopted on a “clear day” in order to achieve the legitimate goal of an orderly corporate electoral process are unlikely to fail equitable review in the absence of specific evidence of inequitable conduct.

Furthermore, these recent decisions make clear that the Delaware courts will not use equitable review to bail out a stockholder whose own conduct played a role in causing its notice to be deemed ineffective by the corporation and its incumbent board, or who failed to allow sufficient time to correct deficiencies in the notice prior to the relevant deadline.

CytoDyn

In *Rosenbaum v. CytoDyn Inc.*,³ the Court of Chancery denied a request for permanent, mandatory injunctive relief on behalf of dissident stockholders and their proposed slate of board nominees and entered judgment on behalf of the defendants, CytoDyn and the incumbent board. The dissidents asked the court to find that the incumbent board and CytoDyn had wrongfully rejected the plaintiffs’ nomination notice and compel CytoDyn to allow plaintiffs’ nominees to stand for election at the annual meeting.

The court began by considering the appropriate standard of review to apply to the rejection of the dissidents’ nomination notice. Plaintiffs argued that enhanced scrutiny under *Blasius Indus., Inc. v. Atlas Corp.*⁴ applied, requiring a “compelling justification” for the incumbent board’s actions, because, by rejecting the nomination notice, the board sought to prevent CytoDyn’s stockholders from exercising their franchise in selecting

¹ 224 A.3d 964 (Del. 2020).

² The *Saba Capital* decision was itself consistent with longstanding Delaware case law on the enforcement of advance notice bylaws. See, e.g., *Openwave Sys. Inc. v. Harbinger Capital Partners Master Fund I, Ltd.*, 924 A.2d 228 (Del. Ch. 2007) (post-trial decision holding that insurgent stockholder’s director nominees had not been properly nominated due to noncompliance with deadlines imposed by advance notice bylaw and that, under the circumstances, the corporation was not required to waive compliance with the deadlines).

³ 2021 WL 4775140 (Del. Ch. Oct. 13, 2021).

⁴ 564 A.2d 651 (Del. Ch. 1988).

directors. Plaintiff advocated for *Blasius* to apply “whenever a board of directors deprives the stockholders of their right to elect directors through the wrongful enforcement of an advance notice bylaw.”⁵

The court rejected this approach, holding that that would extend *Blasius* beyond its intended limits and that the court would only employ a *Blasius* review if “the evidence reveals the Board engaged in manipulative conduct in responding to the Nomination Notice.”⁶

Defendants, meanwhile, argued that the business judgment rule applied to their decision to reject the nomination notice. The court held that this approach also went too far and that room existed for equitable review of the application of even validly-enacted advanced notice bylaws under the principles set forth by the Delaware Supreme Court in *Schnell v. Chris-Craft Indus., Inc.*⁷ Therefore, “while the burden may not lie with Defendants to prove a compelling justification for their rejection of the Nomination Notice under *Blasius*, Plaintiffs may still turn to equity for relief by proving there are compelling circumstances that justify a finding of inequitable conduct.”⁸

After confirming that the incumbent board’s decision to reject the nomination notice remained subject to equitable review for manipulative conduct, the court returned to first principles and emphasized that bylaws, including advance notice bylaws, must be strictly construed under Delaware’s highly contractarian public policy. In this case, the court found, the nomination notice was deficient in at least two key respects: (i) It did not disclose who was supporting the dissidents’ proxy contest and (ii) it did not disclose that one proposed board nominee might seek to pursue a self-interested merger transaction if elected to the board.

Having concluded that the nomination notice failed to strictly comply with the unambiguous terms of the advanced notice bylaw, the court concluded that there was no basis for

“*Schnell*-inspired” equitable principles to override the incumbent board’s decision. The court noted that the plaintiffs submitted their nomination notice on the eve of the deadline with full understanding of the potential consequences of doing so and without any guarantee based on the terms of the bylaw that the board would engage with them after the deadline. Even though the incumbent board may have delayed in responding to the nomination notice, the court determined that the notice was rejected on reasonable grounds given the nature of the omissions and that there was no manipulation or inequitable conduct.

Lee Enterprises

A few months later, in *Strategic Investment Opportunities LLC v. Lee Enterprises, Incorporated*,⁹ the Court of Chancery again denied declaratory and injunctive relief on behalf of a dissident stockholder attempting to run a slate of director nominees as part of a takeover attempt. The court held that plaintiff failed to comply with the terms of the bylaw and therefore the company’s rejection of the nomination notice was contractually proper.

The court then conducted an equitable review of the board’s rejection of the nomination notice and applied enhanced scrutiny, ultimately concluding that “the board acted reasonably in enforcing a validly adopted bylaw with a legitimate corporate purpose” and did not engage in manipulative or inequitable conduct.

The court reiterated that, if a bylaw’s language is unambiguous, it will be construed as written. The court concluded that the plaintiff’s nomination notice failed to comply with the unambiguous bylaw in two respects: (i) The nomination was not made by a record holder and (ii) the company’s form of questionnaire was not included with the nomination notice. The company’s rejection of the nomination notice was therefore not a breach of contract.

Moving to the appropriate standard of review of the incumbent board’s decision to reject the nomination notice, the court first noted that the parties agreed that *Schnell* empowers

⁵ *CytoDin*, 2021 WL 4775140, at *13.

⁶ *CytoDin*, 2021 WL 4775140, *14.

⁷ 285 A.2d 437 (Del. 1971).

⁸ *CytoDin*, 2021 WL 4775140, at *15.

⁹ 2022 WL 453607 (Del. Ch. Feb. 14, 2022).

the court to invalidate board action, including action that inequitably manipulates corporate machinery to impair stockholder rights. The parties disagreed, however, about whether the court should undertake an equitable review of the incumbent board's conduct.

Plaintiff argued that the incumbent board's actions failed to satisfy enhanced scrutiny and that the incumbent board members' fiduciary duties required them to waive the bylaw's requirements. Defendants contended that, if a stockholder fails to comply with the unambiguous requirements of an advance notice bylaw, then the court should continue on to an equitable review only if the plaintiff can prove manipulative conduct or compelling circumstances to justify something other than business judgment review.

Rejecting this argument by defendants, the court concluded that enhanced scrutiny, "[w]hether labeled as *Unocal*¹⁰ or *Blasius*,"

was the appropriate standard of review due to the "inherent conflicts of interest" present when conduct by an incumbent board prevents stockholders from replacing incumbent board members in a contested election.

Even under the enhanced scrutiny standard, however, the court concluded that the incumbent directors were justified in rejecting the nomination notice. The court emphasized that the bylaw was validly enacted, had a legitimate purpose and was adopted on a "clear day," before any dissident threat surfaced. Furthermore, there was no evidence of manipulative conduct that suggested uneven enforcement of the bylaw or a lack of good faith. An "overarching point," in the court's words, was that the dissident stockholder's "own delay is what ultimately prevent it from satisfying the Bylaws' record holder (and, by extension, form) requirements."¹¹

¹⁰ *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985).

¹¹ *Lee Enterprises*, 2022 WL 453607, at *18.

Takeaways

- The most recent decisions by the Court of Chancery involving advance notice bylaws reiterate that the starting point for analysis will be the principle that unambiguous bylaws should be enforced according to their terms.
- However, Delaware courts will conduct an equitable review of an incumbent board's decision to reject a nomination notice even if that notice failed to comply with unambiguous terms of the advance notice bylaw. Even when a bylaw's terms are clear and unambiguous, business judgment review is not the appropriate standard given that an incumbent board's enforcement of an advance notice bylaw to reject dissident nominees touches on the stockholder franchise.
- The two Court of Chancery decisions approached the standard of review slightly differently. While the court in *CytoDyn* permitted equitable review, it did not expressly apply enhanced scrutiny. Rather, the court held that, in the absence of manipulative conduct, it was not the incumbent board's burden to provide a "compelling justification" for its conduct; but, under the principles of *Schnell*, a stockholder could still prove "compelling circumstances" justifying a finding of inequitable conduct. In contrast, the court in *Lee Enterprises* expressly applied enhanced scrutiny, which places the burden on the incumbent board to demonstrate it acted reasonably by identifying proper corporate objectives and justifying its actions as reasonable in relation to those objections. In short, both courts agreed some level of equitable review was appropriate, but the exact standard of review remains to be developed.
- Nevertheless, both recent decisions, as well as the Delaware Supreme Court's holding in *Saba Capital*, emphasize that equitable review, whatever its form, will not, without evidence of manipulative board conduct, excuse a stockholder's own conduct when that was responsible for the nomination notice not complying with the bylaw.
- Furthermore, both recent Court of Chancery decisions indicate that, as a practical matter, clear and unambiguous bylaws adopted on a "clear day" in order to achieve the legitimate goal of an orderly corporate electoral process are unlikely to fail equitable review in the absence of specific evidence of inequitable conduct.

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