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"On the Record(holder)" — With Universal Proxy on Horizon, Delaware Confirms Importance of Up-to-Date and Unambiguous Advance Notice Bylaws

- In a recent decision, Delaware continued its longstanding practice of enforcing unambiguous bylaws, affirming a company's rejection of an activist nomination notice for failure to comply with requirements of its advance notice bylaws, including that nominations may be made only by a shareholder of record and that a company's required form of nominee questionnaire may be requested only by a shareholder of record
- Advance notice bylaws will have increased importance with the coming implementation of the SEC's new universal proxy rules in September 2022, and companies may want to consider reviewing their bylaws to ensure the benefits of state-of-the-art provisions, including certain modifications tied to the new universal proxy rules

As we have noted before, advance notice bylaws are a near-universal feature of the organizational documents of public companies. These provisions establish informational, timing and procedural requirements that shareholders must satisfy as a condition to nominating directors or making a business proposal at a shareholder meeting. In a string of cases over the last three years, Delaware courts have repeatedly upheld enforcement of these provisions by boards, finding that they are useful in permitting "orderly meeting and election contests," giving companies "sufficient time to respond to shareholder nominations" and "preventing last-minute surprise attacks by third parties for control or board representation."

In a recent decision involving a hostile takeover bid and associated proxy contest targeting one of our clients, the Delaware Chancery Court once again followed this path, affirming our client's rejection of the bidder's nomination notice for failure to comply with the unambiguous requirements of its advance notice bylaws.

In this case, on the Monday before Thanksgiving, activist hedge fund and newspaper owner Alden Global Capital announced a hostile bid to acquire Lee Enterprises, an independent local news and advertising company founded over 125 years ago, and began a process attempting to make director nominations by the long-established deadline that was only four days later (the day after Thanksgiving). Like virtually every public company, Lee's bylaws required that nominations be made only by a shareholder of record. Lee's bylaws also included a requirement that any nomination be accompanied by a completed D&O questionnaire, which had to be requested in advance and would be provided to any shareholder of record within 10 days. Despite having beneficially owned shares for nearly two years, Alden had not moved any shares into record name by the time it launched its bid. Hence, it was not a record holder when it requested the questionnaire that same Monday, and Lee rejected the request the next day on this basis.

This touched off a last-minute scramble at the end of which Alden had nevertheless failed to become a record holder in time. In parallel, Alden attempted to make the nominations through Cede & Co, the record holder of every public company. On the afternoon of the deadline, Alden ultimately delivered a package of documents that included a nomination notice from Alden (not a record holder), a D&O questionnaire that Alden created itself (not the form provided by the company), and a cover letter from Cede indicating that it was aware that Alden was a beneficial holder and that it may be separately submitting materials to the company (but not actually making the nominations or even knowing who the nominees were).

Lee's board rejected the nominations for failing to comply with the bylaws, and Alden sued in the Delaware Chancery Court seeking an injunction to overturn the rejection. The court denied the injunction, endorsing the board's strict application of its advance notice bylaws — which the court noted were adopted over two and a half years earlier on a proverbial "clear day" — including what the court found were reasonable requirements that nominations may be made only by shareholders of record and that a company's form of questionnaire (which must be completed by each nominee) may be requested only by shareholders of record. Importantly, the court rejected what it characterized as Alden's "close enough" argument, holding instead that it was Alden's "own delay" that prevented it from complying with Lee's bylaws, not any actions by Lee's Board, and reinforcing that Delaware courts will continue to construe unambiguous bylaws strictly where they do not find evidence of "manipulative conduct."

Advance notice bylaws will have increased importance with the coming implementation of the SEC's new universal proxy rules in September 2022. By dramatically reducing the cost of admission for running a proxy contest, the universal proxy rules may encourage more activist campaigns, particularly from first-time and non-traditional activists. Ambiguities in certain commonly used advance notice bylaw provisions regularly generate confusion for both companies and shareholders and, if litigated, are generally resolved in favor of shareholders, not companies. Accordingly, public companies may want to consider reviewing their bylaws to ensure the benefits of state-of-the-art provisions that enhance and clarify timing, information and procedural requirements applicable to director nominations, including certain modifications tied to the new universal proxy rules.

If you have any questions about the matters addressed in this *Kirkland M&A Update*, please contact the following Kirkland attorneys or your regular Kirkland contact.

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