

INSIGHTS

The Corporate & Securities Law Advisor

VOLUME 33, NUMBER 9, SEPTEMBER 2019

STATE CORNER

Delaware Court of Chancery Addresses Director Questionnaire Requirements in Advance Notice Bylaws

By John Mark Zeberkiewicz and Robert B. Greco

In *Saba Capital Master Fund, Ltd. v. Blackrock Credit Allocation Income Trust*,¹ the Delaware Court of Chancery held that the failure by a shareholder seeking to nominate a competing slate of directors in a proxy contest to timely complete and return director questionnaires pursuant to the board's request for additional information regarding the nominees under the company's advance notice bylaw could not serve as a basis for invalidating the nominations under circumstances where the questionnaire was found to be overbroad and to have exceeded

the scope of the bylaw's information requirements. Despite its key finding, however, the *Saba* opinion suggests that director questionnaire requirements in advance notice bylaws are not facially invalid and, depending on their terms and the circumstances in which they are adopted and applied, may withstand equitable challenges.

Although shareholders of a Delaware corporation have fundamental rights to nominate directors and present other proper matters for business at an annual meeting, the Delaware courts have held that a board, through the bylaws, may adopt procedural restrictions on the shareholders' exercise of those rights,² observing that advance notice bylaws may

serve[] the proper purpose of assuring that stockholders and directors will have a reasonable opportunity to thoughtfully consider nominations and to allow for full information to be distributed to stockholders, along with the arguments on both sides.³

Because advance notice bylaws may impinge on core shareholder rights, however, the Delaware courts will scrutinize them to ensure they do not impermissibly interfere with the shareholders' rights to nominate directors or present other proper matters for shareholder action at an annual meeting.⁴ In recent years, advance notice bylaws have become increasingly more complex, requiring more extensive

John Mark Zeberkiewicz is a director, and **Robert B. Greco** is an associate, of Richards, Layton & Finger, P.A. in Wilmington, DE. Although Richards, Layton & Finger may have been involved in some of the cases mentioned in this article, the views expressed herein are the views of the authors and are not necessarily the views of the firm or its clients.

information regarding the shareholder making the nomination and the director nominees, including in some cases by requiring nominees to complete and submit the company's form of director questionnaire. Although director questionnaire requirements have become more prevalent in advance notice bylaws, *Saba* is the first opinion in which the Delaware Court of Chancery has explored in detail any such requirement.

Background

In *Saba*, the plaintiff, a shareholder of two closed-end investment funds (Trusts), sought to propose a competing slate of nominees to challenge the reelection of the incumbent members of the Board of Trustees of each Trust (together, Boards).⁵ The Trusts' bylaws included "an expansive list of qualifications that prospective trustees must meet to serve on either of the Boards," at least some of which corresponded to parallel requirements under the Investment Company Act of 1940, which applied to each of the Trusts.⁶ The Trusts' bylaws also contained advance notice provisions requiring shareholders to provide timely written notice of any nominations they sought to present at an annual meeting. Under the bylaws, the notice had to include "information to establish to the satisfaction of the Board" that the proposed nominee satisfied enumerated qualifications (Qualifications Requirement).⁷ The bylaws further required that the nominating shareholder "update and supplement such notice, if necessary so that . . . any subsequent information reasonably requested by the Board" could be used to assess whether the nominee satisfied the Qualifications Requirement.⁸ Such supplemental information was required to be furnished within five business days after the Board's request.

On March 30, 2019, the shareholder-plaintiff delivered timely notices of its intent to nominate four individuals for election to each of the Boards. While these notices included information regarding the nominees' satisfaction of the Qualifications Requirement, they did so "at a high level and without

much context or explanation."⁹ On April 22, 2019, counsel for one of the Trusts sent an email to the nominating shareholder requesting additional information regarding the proposed nominees—and asking that each proposed nominee complete and sign an attached director questionnaire that spanned over 47 pages and included at least 95 questions. When completed questionnaires were not returned by May 1, 2019, the Boards emailed the nominating shareholder to announce that its notice was invalid under the bylaws. The following day, the nominating shareholder submitted the completed questionnaires and lodged its objection to the Boards' determinations.

Legal Analysis

The Parties' Contentions

The Boards maintained that the nominations were invalid on the grounds that the questionnaires had not been completed within the five-business day window for providing supplemental information. The Boards disclosed their determinations in the Trusts' respective proxy statements, which stated that any votes for the shareholder-plaintiff's nominees would not be counted at the Trusts' respective annual meetings. In response, the plaintiff filed suit, alleging that (1) the Boards had breached the Trusts' respective bylaws, and (2) the Trustees had breached their fiduciary duties in applying the advance notice bylaws in a manner that precluded the shareholder's nominations.

As to the claim for breach, the plaintiff argued: that the bylaws only permitted the Boards to request supplemental information in very limited circumstances; that the Trusts, in requesting additional information, did not effectively communicate that the requests were being made under the specific provisions of the bylaws requiring supplemental information to be provided within five business days of the request; that the director questionnaires required information beyond the scope of the information that the Boards were entitled to request under the bylaws; and that the bylaws vested the chairperson of each Trust's annual meeting, and not the Board,

with the sole authority to determine the validity of shareholder nomination notices.

The Court's Determinations

The Court rejected the plaintiff's interpretation of the bylaws regarding the circumstances in which the Boards could request supplemental information, finding that, under the unambiguous terms of the bylaws, "[t]he Boards were entitled to ask for supplemental information and updates . . . to determine that the nominees 'met the director qualifications'" enumerated in the bylaws.¹⁰ The Court also rejected the plaintiff's argument that the email transmitting the questionnaire failed to effectively communicate that it was a request under the specific provision of the bylaws requiring that supplemental information be furnished within five business days of the request. Although the Court acknowledged that the "email was less than transparent when it referred only to a request for 'additional information,'" it noted that the plaintiff was "a sophisticated entity that had already completed the Nomination Letters and understood the structure of the Bylaws" and found that the email could not reasonably have caused any confusion on its part, as there was no other method under the bylaws for the Boards to request additional information about the nominations.¹¹

Nevertheless, the Court held that the Boards could not rely on the five-business day deadline to invalidate the plaintiff's nominations, because the questionnaire was not "reasonably requested," nor was it "necessary" to determine whether the nominees satisfied the Qualifications Requirement.¹² In so holding, the Court noted that at least 30 of the questions set forth on the questionnaire were not tied to the Qualifications Requirement. Despite defendants' assertions that the questionnaire's breadth sought to ensure that the nominees satisfied federal regulations and to elicit other information relevant to the Boards' assessment of the nominees, the Court stated that "the plain meaning" of the provision of the bylaws allowing the Board to request additional information permitted only "inquiries into director

qualifications as confined by" the Qualifications Requirement.¹³ Accordingly, the Court enjoined the defendants from applying the provisions of the bylaws requiring supplemental information to invalidate the plaintiff's nominations based on the late return of the questionnaires, and it required the Trusts to count votes for the plaintiff's nominees at each Trust's annual meeting.

As a result of this ruling, the Court was not required to address the plaintiff's equitable claims. The Court observed, however, that it would have denied the plaintiff's request for a mandatory injunction, noting that the plaintiff had not satisfied the standard for such relief at the particular stage of the proceeding. The Court explained that the plaintiff's equitable claims, which were advanced under *Blasius Industries, Inc. v. Atlas Corp.*¹⁴ and *Schnell v. Chris-Craft Industries, Inc.*,¹⁵ were undermined by the Trusts' adoption of the advance notice bylaw "on a 'clear day' before this proxy contest."¹⁶ That fact served to rebut the plaintiff's claim that the defendants had "acted with the primary purpose of thwarting [the plaintiff's] nominees under *Blasius*, or otherwise acted inequitably under *Schnell*," which could not be established by "merely laying out the timeline of Defendants' conduct and speculating about bad intent or purpose."¹⁷ The Court further noted that the plaintiff's failure to bring suit for several weeks was partly responsible for its inability to make the requisite showing on those matters.

Takeaways

The Court of Chancery's opinion in *Saba* indicates that a shareholder's failure to timely complete and return a director questionnaire may not, in and of itself, serve as a basis to invalidate the shareholder's director nomination unless the questionnaire (or other requested information) is required by, or requested pursuant to and in accordance with, the terms of an advance notice bylaw that does not impermissibly infringe on the shareholders' fundamental right to submit nominations. Accordingly, to

avoid the issue that ultimately prevented the Boards in *Saba* from relying on the plaintiff's tardy delivery of the director questionnaire as a basis to invalidate the shareholder's nominations, boards may consider omitting from their advance notice bylaws narrow and specific limitations on the scope of information regarding nominees required to be furnished. Rather than authorizing the board to request a questionnaire or other information solely for purposes of determining whether a proposed nominee would meet highly specific qualifications, the advance notice bylaw could be drafted to entitle the board to request a questionnaire or other information for more broadly applicable purposes, such as determining generally whether the proposed nominee would be independent or would satisfy legal or regulatory requirements applicable to the company. Moreover, it may be advisable for the advance notice bylaw to make clear that any list enumerating the purposes for which information regarding nominees may be sought is non-exclusive.

The *Saba* opinion also suggests that, if director questionnaire requirements or open-ended information requirements appearing in advance notice bylaws are adopted on a "clear day," they may be enforced so long as the scope of the questionnaire conforms to what is permitted by the bylaw.¹⁸ Such requirements nevertheless should be drafted with an eye toward the salutary objectives that, based on statements of the Delaware courts, advance notice bylaws are designed to promote, including ensuring that shareholders and the board have sufficient time to thoughtfully consider nominations. Questionnaires should not be needlessly extensive, nor should they require the provision of plainly irrelevant information.

Finally, although the Court was not required to address the question, the plaintiff in *Saba* raised the issue of whether bylaws entitling the chairperson of a meeting to determine the validity of nominations precluded such determinations from being made by the board in advance of the meeting. If only for purposes of eliminating any such potential argument, corporations and practitioners may want to ensure

that their advance notice bylaws expressly vest the Board with the authority to make such determinations in advance of shareholder meetings, along with authorizing the chairperson of the meeting to make any such determination at the meeting.

Notes

1. *Saba Capital Master Fund, Ltd. v. Blackrock Credit Allocation Income Trust*, 2019 WL 2711281 (Del. Ch. June 27, 2019).
2. *Hubbard v. Hollywood Park Realty Enters., Inc.*, 1991 WL 3151, at *11 (Del. Ch. Jan. 14, 1991) (noting the precedent "reaffirm[ing] the fundamental nature of the shareholders' right to exercise their franchise, which includes the right to nominate candidates for the board of directors," but stating "[t]hat those rights are fundamental does not mean that their exercise cannot be restricted for valid corporate purposes by board-created procedural rules" provided that "those restrictions must not infringe upon the exercise of those rights in an unreasonable way").
3. *Id.* at *13.
4. *Id.* at *11 (noting that, based on core principles of corporate law, "it may be inferred that an advance notice by-law will be validated where it operates as a reasonable limitation upon the shareholders' right to nominate candidates for director" and stating, "[m]ore specifically, [that] such a by-law must, on its face and in the particular circumstances, afford the shareholders a fair opportunity to nominate candidates").
5. In addition to being board-managed, the Trusts had other governance features similar to that of a corporation and were governed by their respective declarations of trust and bylaws.
6. *Saba*, 2019 WL 2711281, at *1.
7. *Id.*
8. *Id.*
9. *Id.*
10. *Id.* at *5-6
11. *Id.* at *5.
12. *Id.* at *6.
13. *Id.*
14. *Industries, Inc. v. Atlas Corp.*, 564 A.2d 651 (Del. Ch. 1988).
15. *Schnell v. Chris-Craft Industries, Inc.*, 285 A.2d 437 (Del. 1971).

16. *Saba*, 2019 WL 2711281, at *7.

17. *Id.*

18. The *Saba* Court's statements on this issue conform to other decisions of the Delaware courts indicating that, as a general matter, the technical requirements of advance notice bylaws may be strictly enforced. *See, e.g.*, *Bay Capital Fin., LLC v. Barnes & Noble Educ., Inc.*, C.A. No. 2019-0539-KSJM (Del. Ch. Aug. 14, 2019) (TRANSCRIPT);

Openwave Sys. Inc. v. Harbinger Capital P'rs Master Fund I, Ltd., 924 A.2d 228, 242 (Del. Ch. 2007); *AB Value P'rs, LP v. Kreisler Manufacturing Corp.*, 2014 WL 7150465 (Del. Ch. Dec. 16, 2014); *see also* *TravelCenters of Am. LLC v. Brog*, C.A. No. 3516-CC (Del. Ch. Apr. 4, 2008) (TRANSCRIPT); and *Pignatelli v. Biolase, Inc.*, C.A. No. 9920-VCN, at 42 (Del. Ch. July 24, 2014) (TRANSCRIPT).

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