IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

NED L. SHERWOOD and ZS EDU, L.P., Directly and Derivatively on Behalf of ChinaCast Education Corporation, Plaintiffs, v. RON CHAN TZE NGON, MICHAEL J. SANTOS and JUSTIN TANG, Defendants, and CHINACAST EDUCATION CORPORATION, Nominal Defendant.	)	C.A. No. 7106-VCP

MEMORANDUM OPINION

Submitted: December 16, 2011
Decided: December 20, 2011

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PARSONS, Vice Chancellor.

Plaintiffs, Ned L. Sherwood and ZS EDU, L.P. ("ZS"), have moved for a temporary restraining order ("TRO") to enjoin ChinaCast Education Corporation ("ChinaCast" or the "Company") from holding its annual shareholder meeting (the "Annual Meeting") scheduled to take place on Wednesday, December 21, 2011 at 9:00 am in Beijing, which is Tuesday, December 20 at 8:00 pm Eastern Standard Time. Sherwood currently is a director of ChinaCast and, until recently, had been among the Company's nominees for reelection to the board. On December 8, however, the board publicly disclosed that it had removed Sherwood from the Company's slate and no longer recommends his reelection. Plaintiffs claim, among other things, that the board breached its fiduciary duty of disclosure when communicating its reasons for taking that action. Plaintiffs argue that this TRO is necessary to provide ChinaCast's shareholders sufficient time to consider corrective disclosures and Plaintiffs' competing slate of nominees.

Defendants Ron Chan Tze Ngon ("Chan"), Michael J. Santos, and Justin Tang (collectively, the "Individual Defendants") along with Nominal Defendant ChinaCast oppose Plaintiffs' Motion on various grounds. While they deny that any disclosure violation occurred, Defendants primarily argue that Plaintiffs cannot show any irreparable harm sufficient to justify a TRO because, among other things, the Company's bylaws preclude Plaintiffs from initiating a proxy contest so soon before the Annual Meeting. According to Defendants, because there can be no competing slate for shareholders to consider, there is no risk of a harmful, uninformed shareholder vote. Furthermore, Defendants raise the defenses of laches and unclean hands, contending that Plaintiffs had ample opportunity to initiate their proxy contest earlier and that the

Company's delay in removing Sherwood from its slate of nominees resulted solely from a last resort, good faith, but ultimately unsuccessful attempt by all parties to resolve their differences amicably. Defendants aver that their failed efforts to negotiate a mutually acceptable arrangement with Sherwood does not warrant the extraordinary remedy of postponing an otherwise ordinary annual meeting.

At this early stage in the proceedings, it appears that this action essentially is a dispute between two directors—Chan and Sherwood—who disagree about the best way to advance the interests of ChinaCast's shareholders. That disagreement, moreover, has culminated in an impasse in their working relationship. It is not, however, the place of a company's incumbent management or this Court to decide whether one candidate is preferable to another for election to the board of directors. Rather, our corporate law emphatically vests that power in the shareholder franchise. For that and the following reasons, Plaintiffs Motion for a TRO is granted so that ChinaCast's shareholders receive a fair opportunity to vote *their* preference on the future direction of the Company.

I. BACKGROUND

A. The Parties

Sherwood beneficially owns, directly and indirectly through his membership interest in ZS, approximately 7% of ChinaCast. He also has been a director of ChinaCast since December 2009. Chan has been the Company's Chairman and CEO since 2007. Defendants Santos and Tang also are ChinaCast directors, and they have held those positions since 2009 and 2007, respectively.

ChinaCast is a publicly traded Delaware corporation with its principal place of business in Hong Kong, China. Established in 1999, the Company is a leading post-secondary education and e-learning services provider in China, offering three- and four-year bachelor's degree and diploma programs through its three accredited universities. ChinaCast is listed on the NASDAQ Global Market Exchange with the ticker symbol "CAST." In addition to Sherwood and the Individual Defendants, ChinaCast's board of directors also includes Stephen Markscheid, Hope Ni, and Daniel Tseung Kar Keung ("Tseung"). Directors Markscheid, Ni, and Tseung are not parties to this action.

B. Facts[1]

Sherwood's appointment to ChinaCast's board resulted from the exercise of certain warrants by various affiliates of Fir Tree, Inc. (collectively, "Fir Tree"). In connection with that transaction, the Company and Fir Tree entered into the "Fir Tree Agreement," which grants Fir Tree the right to designate one person to be elected or appointed to the Company's board of directors, subject to that designee being a person whom the board "reasonably determines meets applicable legal, regulatory and governance requirements and who at all times complies with the policies and procedures of the Company that are applicable to all of its directors (a 'Suitable Person') . . . ."[2]

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[1] The following facts are drawn from the allegations in the Verified Complaint (the "Complaint") and the affidavits and declarations submitted by the parties. Unless otherwise noted, matters not in dispute for purposes of this Motion are unaccompanied by citations to the record. Where facts are in dispute, I have attempted to present both sides' respective accounts with accompanying citations.

[2] Hannigan Aff. Ex. B [hereinafter Proxy Supplement], at 2.

Sherwood, who "has more than 26 years of experience in mergers and acquisitions and as a private equity investor,"[3] currently is Fir Tree's designee under the Fir Tree Agreement.

On March 16, 2011, the Company publicly announced a "Buyback Program" to repurchase up to $50 million of its common stock over the next twelve months. The parties have advanced somewhat divergent characterizations of the Buyback Program. Plaintiffs suggest that the board committed, firmly and publicly, to repurchase all $50 million at regular intervals during the year. In contrast, Defendants have cautioned that the $50 million figure was a ceiling, not a requirement, and any individual repurchase transaction requires deliberate consideration of the currency control and tax issues that arise whenever a Chinese-based company such as ChinaCast executes trades in U.S. dollars.[4] In any event, there is no dispute that the Company has repurchased $5 million of its common stock since March, that no repurchases have occurred since the Company imposed a blackout on trading on August 17, and that Sherwood has voiced criticism of the pace of the Buyback Program to his fellow directors.

In early June, Chan and Tang held a lunch meeting with the managing director of a private equity firm ("Firm A"). They did not inform the ChinaCast board of that meeting until June 14, 2011. The Complaint alleges that Tang "unilaterally approached Firm A to gauge its interest in investing in ChinaCast and . . . he had no Board authorization to have

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[3] Compl. ¶ 19.

[4] *Compare* Compl. ¶ 32 *with* Defs.' Ans. Br. 7 *and* Chan Decl. ¶ 7.

discussions with Firm A."[5] Plaintiffs also allege that Tang disclosed at the June 14 board meeting that he would have an interest in any transaction involving Firm A. Plaintiffs characterize these events as the start of the Individual Defendants' efforts to take the Company private by an improper process. Tang vigorously contests each of Plaintiffs' allegations in this regard. Specifically, he declared that Firm A contacted him about a possible investment in the Company, that he and Chan reported the lunch meeting at the very next regularly scheduled meeting of the board, and that "[t]here was absolutely no discussion of any financial benefit [he] might receive" in any transaction involving Firm A.[6]

On August 1, the Company received an offer from another company ("Company B") to acquire 100% of ChinaCast's outstanding common shares, contingent on Chan retaining his equity stake in the post-transaction, privately-held company. ChinaCast's CFO, Antonio Sena, informed the board of that offer on August 4, and the following day the board met for approximately two hours to discuss Company B's offer and other matters.[7] At that meeting, Sherwood "expressed his frustration" that the offer price was too low and urged the board to form a special committee of independent directors to negotiate with Company B.[8] Although the board did not form a special committee at that

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5 Compl. ¶ 25.

6 Tang Decl. ¶ 6.

7 Ladig Aff. Ex. 3 (board meeting minutes of August 5, 2011).

8 Compl. ¶ 30.

time, it did defer taking any action on Company B's offer until the next board meeting. Sherwood alleges that the members of the board were not informed at that time that the offer from Company B constituted, "or even possibly could constitute," material nonpublic information.[9]

On August 12, 2011, Sherwood became aware of a large block of Company stock available for purchase. He specifically asked and received express approval from Sena, who is also the Company's Insider Trading Compliance Officer, to purchase those shares. Because Sena had reported Company B's offer to the board, he knew as much about the details of that offer as Sherwood.[10] Sherwood also advised Chan, Santos, and Tseung of his intent to purchase shares, but no one objected to his purchase. With approval from the Insider Trading Compliance Officer, no objection from his fellow board members, no blackout in place, and in the middle of the publicly disclosed Buyback Program—but aware of Company B's offer—Sherwood purchased ChinaCast stock. Five days later, on August 17, Sena directed members of the board to refrain from trading in ChinaCast stock due to the Company B offer.

The board resumed discussions concerning Company B's offer at an August 30 meeting, ultimately rejecting the offer as inadequate, but also, according to Defendants,

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9 Compl. ¶ 55.

10 Chan has declared that he and Santos disclosed other material nonpublic information, unrelated to the Company B offer, to Sherwood on August 11, but Sherwood made no mention of this additional nonpublic information when he sought approval from Sena on August 12. Chan Decl. ¶ 14.

authorizing Tang and Tseung to continue discussions with Company B.[11] Shortly thereafter, on September 2, Sherwood, who was the Chairman of the Compensation Committee, emailed Chan, Santos, and Tseung proposing changes to management's bonus plan that would, among other things, incentivize management to complete the Buyback Program. Although his email states that "[t]he compensation Committee is willing to award management with an extra bonus" if certain objectives are met, Sherwood had not discussed his proposal with other members of his committee before sending it.[12]

Sometime in the middle of September, the Company commenced an internal investigation into Sherwood's August 12 trading activity. Plaintiffs allege that Defendants did so "in furtherance of their plan to silence Sherwood,"[13] while Chan has declared that the Company acted solely to prepare for likely "scrutiny by the SEC and others into stock purchases during the time that the [Company B] offer was outstanding and non-public" if that offer came to fruition.[14] Around this same time, the board removed Sherwood from the Nominating and Corporate Governance Committee (the

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11 Ladig Aff. Ex. 6, at 3.

12 Ladig Aff. Ex. 7, at 2.

13 Compl. ¶ 57.

14 Chan Decl. ¶¶ 16-17.

"Nominating Committee") and the Audit Committee.[15] According to Plaintiffs, this change to the composition of the board's committees was retaliation against Sherwood for attempting to engage an independent financial advisor in connection with the Company B offer.[16] Defendants assert, however, that the decision was based on the outcome of the internal investigation into Sherwood's August 12 trading activity.[17] Tseung, against whom there is no allegation of insider trading, also supported forming a special committee, and he, too, was removed from the Nominating Committee at that time.

On October 11, the Company reported Sherwood's August 12 trading activity to the SEC. The SEC apparently conducted an initial review of the matter, including at least one interview with Sherwood. Sherwood's personal counsel, Barry Goldsmith, has sworn that, on December 2, he received a telephone call from two SEC Staff Lawyers who informed him that the SEC would not pursue insider trading allegations against Sherwood. The Staff Lawyers also communicated to Goldsmith that they would inform ChinaCast of that same decision.[18] Two days later, the Company's independent counsel, Michael Schachter, contacted the SEC to inquire if it would be accurate to disclose

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15 Sherwood was not removed from the Compensation Committee, presumably because the Fir Tree Agreement requires that its designee also be appointed to that Committee. *See* Proxy Supplement at 2.

16 Compl. ¶¶ 42-43.

17 Ladig Aff. Ex. 9, at 2-3 (board meeting minutes of September 25, 2011).

18 Goldsmith Aff. ¶ 5.

publicly that the SEC does not intend to pursue an investigation of potential securities laws violations against Sherwood. Schachter has sworn that the SEC Staff told him such a disclosure would not be accurate.[19]

By mid October 2011, the board began to focus on ChinaCast's upcoming Annual Meeting. On October 18, the Company issued a press release announcing October 24 as the record date and December 2 as the meeting date. According to Defendants, on October 28, the Nominating Committee first expressed concern about Sherwood's August 12 trading activity and whether, in light thereof, he remained a Suitable Person under the Fir Tree Agreement for reelection to the board. The full board then discussed those concerns at its October 31 meeting, but it took no further official action at that time.[20] At that same meeting, the board finally formed a three-person special committee (the "Special Committee") to negotiate with Company B and consider alternative options.[21] Sherwood was not among the directors appointed to the Special Committee.

Chan declares that, while the board took no official action on the Nominating Committee's concerns regarding Sherwood's suitability, it did attempt to discuss those concerns with Fir Tree. Fir Tree, however, refused to hold any discussions in which material nonpublic information might be revealed and, instead, insisted the parties should

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19 Schachter Aff. ¶¶ 2-3.

20 Ladig Aff. Exs. 14-15.

21 Ladig Aff. Ex. 14.

just try "to work things out."[22] Consequently, "[o]ut of respect for its relationship with Fir Tree," the Company decided to recommend Sherwood for reelection at the Annual Meeting. It did not do so wholeheartedly, however; at least one interim draft of its proxy materials referred to the Nominating Committee's October 28 concerns.[23] In Defendants' account, the Company deleted that statement only after Sherwood refused to sign the proxy statement.[24] Ultimately, the definitive proxy materials filed with the SEC on November 14, 2011 (the "Definitive Proxy") recommends Sherwood's reelection to the board and does not state any concerns regarding his suitability to serve as a director.

Even after issuing the Definitive Proxy, the Company apparently continued to approach Fir Tree regarding its concerns with Sherwood's suitability, but Fir Tree repeatedly declined to get involved.[25] Accordingly, on November 24, the Nominating Committee again brought its concerns about Sherwood's suitability to the attention of the board, this time affirmatively recommending that he be removed from the Company's slate. The board approved that recommendation on November 29, three days before the then-scheduled Annual Meeting. Although the board did not announce immediately that it had removed Sherwood from its slate, it did issue a press release postponing the Annual

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22 Chan Decl. ¶ 19.

23 *Id.*

24 *Id.*

25 *Id.* ¶ 21.

Meeting to December 17. Over the following week, according to Chan, the board attempted "to negotiate a dignified exit" for Sherwood, but to no avail.[26]

On December 8, the board issued supplemental proxy materials (the "Proxy Supplement"), announcing that it had decided to remove Sherwood from the Company's slate of nominees based on a recommendation of the Nominating Committee. The board also announced a second postponement of the Annual Meeting until December 21. The Proxy Supplement identifies four reasons for the Nominating Committee's November 24 recommendation to remove Sherwood from the Company's slate: (1) that his August 12 trading activity violated Company policies; (2) that his September 2 email proposing changes to the bonus plan was inappropriate; (3) that he further violated the Company's Code of Business Conduct and Ethics and its Regulation FD and Shareholder Communications Policy, although no specific violations were disclosed; and (4) that his general behavior, personal attacks, and unwillingness to consider contrary views are not conducive to a productive and professional working relationship.[27] In connection with the allegations of insider trading, the Proxy Supplement also discloses that the Company reported Sherwood's trading activity to the SEC, but it does not disclose further the status of any SEC investigation. The Proxy Supplement also does not disclose that Sherwood had criticized how the board conducted the Buyback Program, the negotiations with Company B, or any other corporate policy, either specifically or generally.

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26 *Id.* ¶ 22.

27 Proxy Supplement at 2-3.

C. Procedural History

Plaintiffs filed this action on Monday, December 12, 2011, and moved concurrently for a TRO and expedited proceedings. The following day, the Court set an expedited briefing schedule and hearing date regarding the TRO. On December 16, the Court heard argument on Plaintiffs' Motion for a TRO. This Memorandum Opinion constitutes the Court's ruling on that Motion.

D. Parties' Contentions

The Complaint asserts three claims for breach of fiduciary duty (Counts I and II) and for defamation (Count III) against the Individual Defendants. Only Plaintiffs' direct claims for breach of the Individual Defendants' duty of disclosure, however, relate to the Proxy Supplement and would warrant a TRO.[28] In particular, Plaintiffs assert that the Proxy Supplement is deficient in two primary respects. First, it fails to disclose the genuine policy disputes between Sherwood and the Individual Defendants related to the Buyback Program and Company B's offer that they contend motivated the board's removal of Sherwood from the Company's slate. Second, Plaintiffs assert that the Proxy Supplement is materially misleading with respect to its discussion of Sherwood's August 12 trading activity and his September 2 proposed changes to the bonus plan because it omits the material facts that the SEC allegedly has decided not to pursue an investigation

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[28] Although Plaintiffs argue in their briefs that the allegedly defamatory statements made about Sherwood in the Proxy Supplement support their Motion for a TRO, such a claim may be remedied at law and does not require enjoining the Annual Meeting. Accordingly, I do not address Plaintiffs' defamation claim any further in this Memorandum Opinion.

and Sherwood proposed changes to the bonus plan in his capacity as Chairman of the Compensation Committee, respectively. Absent a TRO, Plaintiffs argue, shareholders will have insufficient time to consider corrective disclosures made by the Company or Plaintiffs' proxy materials nominating a competing slate of candidates, thus rendering the shareholder vote uninformed and causing irreparable harm to ChinaCast's shareholders. Moreover, Plaintiffs assert that such harm outweighs the hardship the Company would endure if the Annual Meeting were postponed briefly, especially given that management has postponed the meeting twice already.

For their part, Defendants deny that the Proxy Supplement is misleading. They contend it accurately states the Nominating Committee's reasons for recommending Sherwood's removal from the slate: violations of the Company's policies regarding, among other things, trading in ChinaCast stock while in possession of material nonpublic information (regardless of whether such trading also constitutes a violation of federal securities laws) and his generally disruptive and vitriolic behavior (irrespective of the merits of the positions for which he advocated). Furthermore, Defendants deny that there is any risk of irreparable harm in this case because an advance notice provision in the Company's bylaws prevents Plaintiffs from mounting their proxy contest. Essentially raising a laches defense, Defendants argue that the advance notice bylaw causes no unique harm to Plaintiffs because Sherwood was aware of all of the events now motivating his prospective proxy contest at least by the end of June and could have complied with the Company's bylaws in a timely fashion had he not delayed. With only one slate of directors eligible for election, shareholders cannot be harmed by the lack of

time to consider Plaintiffs' allegedly deficient proxy materials. Defendants also aver that a TRO would cause material harm to the Company, particularly with respect to a NASDAQ rule that, in the Company's case, requires the Annual Meeting to occur no later than December 31. Finally, Defendants contend that Sherwood seeks this TRO with unclean hands because he was at least equally complicit in the events that caused the board to issue the Proxy Supplement removing Sherwood from the Company's slate.

II. ANALYSIS

A. The Applicable Standard

A TRO is a special remedy of short duration designed primarily to prevent imminent irreparable injury pending a preliminary injunction or final resolution of a matter.[29] "To obtain such an order, a party must demonstrate three things: '(i) the existence of a colorable claim, (ii) the [existence of] irreparable harm . . . if relief is not granted, and (iii) a balancing of hardships favoring the moving party.'"[30] When deciding whether to issue a TRO, the Court's focus usually is less upon the merits of the plaintiff's legal claim than on the relative harm to the various parties if the remedy is or is not granted.[31] Indeed, if imminent irreparable harm exists, "the remedy ought ordinarily to issue" unless: (1) the claim is frivolous; (2) granting the remedy would cause greater

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29 *Arkema Inc. v. Dow Chem. Co.*, 2010 WL 2334386, at *3 (Del. Ch. May 25, 2010) (quoting *CBOT Hldgs., Inc. v. Chicago Bd. Options Exch., Inc.*, 2007 WL 2296356, at *3 (Del. Ch. Aug. 3, 2007)).

30 *Id.* (quoting *CBOT Hldgs., Inc.*, 2007 WL 2296356, at *3); *see also Newman v. Warren*, 684 A.2d 1239, 1244 (Del. Ch. 1996).

31 *Cottle v. Carr*, 1988 WL 10415, at *2 (Del. Ch. Feb. 9, 1988).

harm than denying it; or (3) the plaintiff has contributed in some way to the emergency nature of the need for relief.[32] This "less exacting merits-based scrutiny"[33] derives from a realistic appreciation of the short-term duration of the remedy and the limited factual record generally available at such an early stage in the proceeding.[34] Where, however, the factual record is more fully developed, "the traditional temporary restraining order standard does [not fully] apply," and the Court considers whether there is a probability of success on the merits.[35]

Defendants' counsel contended at argument that there has been sufficient development of the record in this case for the probability of success standard to apply.[36] Although the parties have developed the available record with great alacrity over the past week, the record nevertheless remains skeletal in several critical respects. Most notably, while numerous factual witnesses have submitted sworn affidavits and declarations, those witnesses have not been deposed or otherwise subjected to the truth-testing inquiry of cross-examination. Additionally, the emergency nature of Plaintiffs' Motion arguably derives from the Company's insistence on proceeding with the Annual Meeting as

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32 *Id.* at *3 (footnote omitted).

33 *CBOT Hldgs., Inc.*, 2007 WL 2296356, at *3.

34 *Cottle*, 1988 WL 10415, at *2.

35 *CBOT Hldgs., Inc.*, 2007 WL 2296356, at *3 (citing *Insituform Techs., Inc. v. Insitu, Inc.*, 1999 WL 240347, at *7 (Del. Ch. Apr. 19, 1999) and *Cochran v. Supinski*, 794 A.2d 1239, 1247 (Del. Ch. 2001)).

36 Hr'g Tr. 44.

currently scheduled and, as a result, the extremely limited timeframe for the Court's decision: unless enjoined, the Annual Meeting in Beijing effectively will take place tonight at 8:00 pm Eastern Standard Time. Under these circumstances, I conclude that less exacting merits-based scrutiny should apply.

B. Existence of a Colorable Disclosure Claim

The duty of disclosure is a specific application of corporate directors' fiduciary duties of care and loyalty,[37] requiring directors "to disclose fully and fairly all material information within the board's control when it seeks shareholder action."[38] In duty of disclosure cases, the issue is "whether shareholders have . . . been provided with appropriate information upon which an informed choice on a matter of fundamental corporate importance may be made."[39] Because the considerations "to which the business judgment rule originally responded are simply not present in the shareholder voting context,"[40] "[t]his Court does not defer to directors' judgment about what information is material,"[41] but determines materiality for itself "from the record at the particular stage of a case when the issue arises."[42]

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37 *Malpiede v. Townson*, 780 A.2d 1075, 1086 (Del. 2001).

38 *Stroud v. Grace*, 606 A.2d 75, 84 (Del. 1992).

39 *In re Andreson, Clayton S'holders Litig.*, 519 A.2d 669, 675 (Del. Ch. 1986).

40 *Blasius Indus., Inc. v. Atlas Corp.*, 564 A.2d 651, 659-60 (Del. Ch. 1988).

41 *Crescent/Mach I Pr's, L.P. v. Turner*, 846 A.2d 963, 988 (Del. Ch. 2000).

42 *Id.*

"An omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote."[43] Moreover, an omitted fact that otherwise might not be material may become material where "the omission . . . renders the partially disclosed information materially misleading."[44] "[O]nce defendants travel[] down the road of partial disclosure . . . they . . . [have] an obligation to provide stockholders with an accurate, full, and fair characterization" of whatever they disclose.[45] Thus, although "a board is not required to engage in 'self-flagellation' and draw legal conclusions implicating itself in a breach of fiduciary duty . . . prior to a formal adjudication of the matter,"[46] it nevertheless must "disclose its motivations candidly . . . ."[47]

From the record at this very early stage of the case, I see at least two ways—one general and one specific—in which the December 8 Proxy Supplement may be materially misleading and, therefore, sufficient to find the existence of a colorable disclosure claim. As to the first, general disclosure violation, Plaintiffs allege that the Proxy Supplement

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43 *Rosenblatt v. Getty Oil Co.*, 493 A.2d 929, 944 (Del. 1985) (quoting *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976) and adopting *TSC*'s materiality standard as Delaware law).

44 *Zirn v. VLI Corp.*, 681 A.2d 1050, 1057 (Del. 1996) (emphasis omitted).

45 *Id.* at 1056 n.1.

46 *Loudon v. Archer-Daniels-Midland Co.*, 700 A.2d 135, 143 (Del. 1997) (quoting *Stroud*, 606 A.2d at 84 n.1).

47 *ODS Techs., L.P. v. Marshall*, 832 A.2d 1254, 1261 (Del. Ch. 2003) (citing *In re Pure Resources, Inc. S'holders Litig.*, 808 A.2d 421, 451-52 (Del. Ch. 2002) and *O'Reilly v. Transworld Healthcare, Inc.*, 745 A.2d 902, 919-22 (Del. Ch. 1999)).

fails to disclose the true reason the board removed Sherwood from the Company's slate: *i.e.*, to silence an independent voice. As noted above, the Company identified four reasons for finding Sherwood not to be a Suitable Person to serve on its board. The first three suggest that Sherwood is a bad actor and, perhaps, even a criminal. The first disclosed reason involved allegations of insider trading, the second allegedly inappropriate conduct in Sherwood's role as Chair of the Compensation Committee, and the third a vague allegation that he failed to comply with other Company policies, including the Code of Business Conduct and Ethics. Collectively, these disclosures might cause a stockholder to question the character and ethics of Sherwood and, in that sense, to doubt his fitness to serve on the board. The fourth reason stated by the Company relates to Sherwood's general behavior, personal attacks, and unwillingness to consider contrary views. The Proxy Supplement states that those tendencies have "become a significant distraction to the effective functioning of the Board" and "stifle productive discussion."[48] To a reasonable shareholder, this fourth reason gives the impression that Sherwood is a brash, belligerent, and antagonistic individual who is unprofessional and a negative force on the board. At this preliminary stage of the case, the Court is in no position to evaluate the veracity of these criticisms of Sherwood in the Proxy Supplement.

What may be misleading, however, is the concomitant impression that Sherwood's questionable and disruptive personal behavior was the *only* reason that motivated the

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[48] Proxy Supplement at 2-3.

board to remove him from the Company's slate. Plaintiffs allege that another—and, in their view, the only "true"—reason for Sherwood's removal "is to silence an independent voice."[49] Although that allegation is too conclusory to accept on its own, Plaintiffs make a colorable claim that, to whatever degree Sherwood may have been obstinate, that obstinance relates to sincere policy disputes between him and the Individual Defendants, and a desire to avoid those disputes may have motivated the Individual Defendants to remove him from their slate. For example, on August 12, Sherwood emailed Chan, Santos, Sena, and Tseung that, because the Company had not acted quickly enough to repurchase an available block of stock, "[w]e must have a better procedure" for the Buyback Program.[50] Chan, meanwhile, has stated in this action that the pace of the Buyback Program is justified by other legitimate corporate concerns, and that "the vigor with which Mr. Sherwood has approached his advocacy of the [Buyback Program]" is inconsistent with "the collegial and cooperative spirit with which [the other directors] approach our jobs."[51] Chan's ability to "see both sides to this matter" and the civility that he attempts to bring to the management of ChinaCast's affairs are generally laudable,[52] but it also is important that directors be able to register effective dissent, even if that might offend the sensibilities of some of their co-directors. A reasonable shareholder

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49 Compl. ¶ 5.

50 Hannigan Aff. Ex. I, at 1.

51 Chan Decl. ¶¶ 7, 10.

52 *Id.* ¶ 9.

likely would perceive a material difference between, on the one hand, an unscrupulous, stubborn, and belligerent director as implied by the Proxy Supplement and, on the other hand, a zealous advocate of a policy position who may go to tactless extremes on occasion. That is, conduct that some may perceive as bullying may not be offensive to others.[53]

Although the Individual Defendants are under no duty to adopt Plaintiffs' characterization of the facts,[54] they were aware of Sherwood's "aggressive" advocacy regarding the Buyback Program and negotiations with Company B,[55] and they must have recognized that removing Sherwood from the Company's slate could engender a proxy contest. Until just before the Company issued the Proxy Supplement, Sherwood was a member of the board nominated for reelection. Thus, Sherwood "had no reason to suppose that it would be necessary for [him] to nominate a dissident slate."[56] Under these circumstances, the manner and timing in which Sherwood was removed from the Company's slate—initially nominating him, removing him only days before the Annual Meeting, and arguing in this action that the Company's advance notice bylaw prevents

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53 *See id*. ¶ 10 (characterizing Sherwood's communications with fellow directors as involving "a venom usually reserved for the playground rather than the Board room").

54 *See Brody v. Zaucha*, 697 A.2d 749, 754 (Del. 1997) (affirming Court of Chancery's determination that there is "no duty . . . to adopt . . . opponent's explanation" of disputed facts in disclosure document).

55 Chan Decl. ¶ 10.

56 *Hubbard v. Hollywood Park Realty Enters., Inc.*, 1991 WL 3151, at *7 (Del. Ch. Jan. 14, 1990).

him from nominating an opposing slate—arguably supports an inference that "self-interested" reasons also motivated the Individual Defendants' decision to remove Sherwood from the Company's slate.[57] Because, for purposes of the pending Motion, Sherwood conceivably could prove that to be the case, the Proxy Supplement may be materially misleading in its failure to disclose the board's "motivations candidly . . . ."[58]

The second, specific way in which the Proxy Supplement may be materially misleading relates to the accusations of insider trading and, in particular, the statement that management informed the SEC of Sherwood's August 12 trades. Accusations of criminal conduct and the involvement of government authorities create a strong impression that the possibility of a criminal or civil enforcement action is what caused the board to conclude Sherwood was unsuitable to serve as a director. Plaintiffs contend that that impression is materially misleading because, as Sherwood informed the Company, the SEC decided not to pursue the matter. Defendants respond that there is nothing untruthful about the Company's statement that management contacted the SEC and that the SEC would not verify Sherwood's account.

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[57] As this Court noted in *Aprahamian v. HBO & Co.*, a candidate is "interested" in an election "even if the interest is not financial and he seeks to serve from the best of motives." 531 A.2d 1204, 1206 (Del. Ch. 1987). In contrast to the allegations in the Complaint, I use the term "self-interested" only in this narrow way. Thus, even if Chan believes that he and the other members of the Company's board would serve shareholders' interests better than would Sherwood and his slate, that belief makes Chan "self-interested" in a prospective election against Sherwood.

[58] *ODS Techs., L.P. v. Marshall*, 832 A.2d 1254, 1261 (Del. Ch. 2003) (footnote omitted).

Defendants further argue in their Answering Brief that the Proxy Supplement accurately discloses that the Nominating Committee recommended Sherwood's removal from the Company's slate because he violated the Company's Insider Trading Policy. "Thus, whether the SEC was conducting an investigation into Mr. Sherwood was not material."[59] But, if the SEC's actions were not material to the Nominating Committee's recommendation, it begs the question why the Company disclosed their reporting of the August 12 transaction to the SEC at all, except to give shareholders a sense of the severity of Sherwood's misconduct and to distract shareholders from the less extreme basis upon which the recommendation truly was made. In these circumstances, a factfinder ultimately could find that the Proxy Supplement contains one or more materially misleading disclosures.

Because the Proxy Supplement may be misleading, either as to the board's general motivations or specifically regarding any SEC investigation, Plaintiffs have demonstrated the existence of at least a colorable disclosure claim.

C. Existence of Irreparable Harm

"The threat of an uninformed stockholder vote constitutes irreparable harm. '[I]t is appropriate for the court to address material disclosure problems through the issuance of a preliminary injunction that persists until the problems are corrected.'"[60] According

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59 Defs.' Ans. Br. 37.

60 *ODS Techs.*, 832 A.2d 1254 at 1262 (alteration in original) (quoting *In re Staples, Inc. S'holders Litig.*, 792 A.2d 934, 960 (Del. Ch. 2001)).

to Plaintiffs, the Annual Meeting will result in an uninformed shareholder vote if ChinaCast's shareholders are not given time to consider corrective disclosures and Plaintiffs' competing slate of nominees. Furthermore, although Plaintiffs have filed their preliminary proxy materials with the SEC, Plaintiffs' counsel represented at argument that those proxies will not become effective under Rule 14a-6 to the Securities Exchange Act until after December 21.[61] Absent a TRO, therefore, Plaintiffs cannot conduct an effective proxy contest.[62]

I find Plaintiffs' argument convincing and conclude for those same reasons that Plaintiffs have satisfied their burden to show the existence of irreparable harm. Defendants contend, however, that there is no risk of harm here because the Company's advance notice bylaw prevents Plaintiffs (and all other shareholders) from nominating an opposing slate at this time. For the following reasons, I find that argument unpersuasive.

As a threshold matter, a finding of irreparable harm in this case may not require, as Defendants presume, that there be two properly nominated slates of directors up for

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61 Hr'g Tr. 28; *see also* 17 C.F.R. § 240.14a–6 (providing preliminary proxies "shall be filed with the Commission at least 10 calendar days prior to the date definitive copies of such material are first sent or given to security holders").

62 For this reason, I do not address Defendants' argument, citing *Aquila, Inc. v. Quanta Servs., Inc.*, 805 A.2d 196, 208 (Del. Ch. 2002), that a large shareholder group with a numerical advantage over management in terms of the percentage of voting stock it holds cannot suffer irreparable harm when waging a proxy contest. In this case, Plaintiffs' proportional interest in ChinaCast is meaningless because, absent a postponement of the meeting date, federal securities laws proscribe them from soliciting proxies before the Annual Meeting.

election at the Annual Meeting.[63] Even in an uncontested election, shareholders have the choice to return a proxy card but withhold their vote for a director.[64] Although under ChinaCast's plurality voting system,[65] such withhold votes have no legal effect on the outcome of the election itself, they still "represent an important form of shareholder activism."[66] As Professors Kahan and Rock have noted:

> Getting a substantial, but less than a majority, withhold vote is still an embarrassment and often induces board actions. Having, say, 40% of the shareholders withhold their vote from you in order to vote for no one is quite different from having an opponent in a contested election get 40% to your 60%. In the mother-of-all withhold campaigns—the 2004 campaign against Disney CEO Michael Eisner—Eisner received a majority "for" vote but was nevertheless ousted shortly thereafter. This experience is not singular. For example, after some directors received a 25% withhold vote, International Paper decided to heed shareholder requests to dismantle its staggered board. According to proxy solicitors, some companies regard withhold percentages of as low as 15-20% as problematic and will make additional solicitation efforts to increase the "for" votes.[67]

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63 *See* Defs.' Ans. Br. 23-24.

64 *See* 17 C.F.R. § 240.14a-4(b)(2) ("A form of proxy that provides for the election of directors . . . shall clearly provide . . . for security holders to withhold authority to vote for each nominee . . . .").

65 Ladig Aff. Ex. 12 [hereinafter Bylaws] § 2.6.

66 Marcel Kahan & Edward Rock, *The Insignificance of Proxy Access*, 97 Va. L. Rev. 1347, 1374 (2011); *see also* Shareholder Participation, Exchange Act Release No. 34,16356, 1979 WL 173198, at *2 (Nov. 21, 1979) (announcing the adoption of Rule 14a-4(b)(2); "The proposals were designed . . . to provide an opportunity for more meaningful shareholder participation in the corporate electoral and decision-making process.").

67 Kahan & Rock, *supra*, at 1419-20 (footnotes omitted).

Assuming the Proxy Supplement is misleading in its failure to disclose the existence of a dispute among ChinaCast's directors about fundamental corporate policies, reasonable shareholders may have given that fact actual significance in deliberating how to vote—not only for Chan or Sherwood in a prospective proxy contest, but also in deciding whether to vote "for" or "withhold" in an uncontested election. Accordingly, a threat of irreparable harm may exist in even an uncontested election where shareholders are not fully and fairly informed.[68]

In any event, Defendants' argument that the advance notice provision of ChinaCast's bylaws precludes Plaintiffs from nominating their opposing slate is less than compelling. Section 3.3 of the Company's bylaws provides in pertinent part:

> [N]ominations [of persons for election to the board of directors] by any stockholder shall be made pursuant to timely notice in writing to the Secretary of the Corporation. . . . [I]n the event that less than seventy (70) days notice or prior public disclosure of the date of the meeting is given or made to stockholders, notice by the stockholder, to be timely, must be received no later than the close of business on the tenth (10th) day following the day on which such notice of the date of the meeting was mailed or such public disclosure was made, whichever first occurs.[69]

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[68] *Cf. N. Fork Bancorp., Inc. v. Toal*, 825 A.2d 860 (Del. Ch. 2000) (holding election results invalid where proxy cards marked "withhold authority" improperly excluded from calculation of "voting power present" for purposes of bylaw requiring election by majority of voting power present at the meeting), *aff'd sub nom. Dime Bancorp, Inc. v. N. Fork Bancorporation, Inc.*, 781 A.2d 693 (Del. 2001) (TABLE).

[69] Bylaws § 3.3.

Initially, the board announced on October 18 that the Annual Meeting would take place on December 2. Because that time span is less than seventy days, there is no dispute that the deadline to give advance notice of an opposing slate is ten days "following the day on which [the] notice of the date of the meeting was mailed or [publicly disclosed], whichever first occurs." Had the Annual Meeting occurred on December 2, there would be no dispute that the relevant deadline would be October 28. There also is no dispute that neither Plaintiffs nor anyone else acting on their behalf gave notice of their intent to nominate an opposing slate on or before October 28. Indeed, because the Nominating Committee only first expressed its concerns about Sherwood's suitability on October 28, Sherwood had no reason to assume he needed to give notice until the deadline had passed.

Defendants' position is that the various postponements of the Annual Meeting are immaterial for purposes of determining whether a stockholder's notice is timely under Section 3.3. In their reading of the bylaw, "*the* meeting" was announced on October 18, the postponements have not negated the fact that the Company has only one annual shareholder meeting, and Plaintiffs did not provide their notice within ten days of October 18.[70] For their part, Plaintiffs dismiss the argument about the existence of only

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[70] In taking this position, Defendants rely on *In re MONY Group, Inc. S'holder Litig.*, 853 A.2d 661, 681 (Del. Ch. 2004), for the proposition that a "postponed" meeting is not a "new" meeting. Without parsing the distinction between the meanings of "postponed" and "new," I find *MONY Group* distinguishable in at least two respects. First, that case did not concern the interpretation of a bylaw, but rather the effectiveness of proxies initially solicited before a shareholder meeting was enjoined and before the company reset the record date. Thus, the

one annual shareholder meeting as a straw man. Rather, their position is that the plain language of the bylaw requires that notice be given within ten days of the announcement "of the *date* of the meeting." Because the date of the Annual Meeting, now scheduled to occur on December 21, 2011, was first announced in the Proxy Supplement on December 8, Plaintiffs contend that notice of their slate is timely so long as the Company's Secretary received it by December 18. In addition, Plaintiffs reported at the argument that notice of the slate they support was given on or about December 15.[71]

Furthermore, Plaintiffs note by way of comparison that other companies' advance notice bylaws clearly address this issue. For example, Hewlett-Packard Co.'s advance notice bylaw states expressly that "[i]n no event will the public announcement of an adjournment or postponement of a stockholders meeting commence a new time period (or

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issue was whether the old proxies continued to evidence an agency relationship conferring authority upon the company to vote on the shareholders' behalf and whether the company would violate any provision of the Delaware General Corporation Law by voting those old proxies. *Id.* at 680 & n.81. Corporate bylaws, by contrast, "are contracts among the shareholders of a corporation and the general rules of contract interpretation are held to apply." *Centaur P'rs, IV v. Nat'l Intergroup, Inc.*, 582 A.2d 923, 928 (Del. 1990) (citations omitted). Therefore, *MONY Group* and this case involve distinct legal issues. Second, because the interpretation of a bylaw is a matter of contractual interpretation, the analysis must start with the plain meaning of the clear and unambiguous contract language that the parties actually employed. *Lorillard Tobacco Co. v. Am. Legacy Found.*, 903 A.2d 728, 739 (Del. 2006). Even if *MONY Group* pertained to a contract, Section 3.3 of ChinaCast's bylaws does not employ the terms "postponed" or "new." Thus, *MONY Group* cannot clarify the predicate inquiry of whether the contract at issue here is clear and unambiguous.

[71] Hr'g Tr. 9-10.

extend any time period) for the giving of a stockholder's notice as described above."[72] The conspicuous absence of similar language from ChinaCast's bylaw suggests that Section 3.3 is at least ambiguous in this regard, and ambiguities in advance notice bylaws are construed "in favor of the stockholders' electoral rights."[73]

Before proceeding further, I note that none of the parties has raised on the merits a question about the interpretation or the validity of Section 3.3 of ChinaCast's bylaws. Nevertheless, I am convinced that, notwithstanding Section 3.3, there is a fair possibility that Plaintiffs can nominate an opposing slate consistent with the Company's bylaws.[74] That possibility, together with the certainty that federal regulations guarantee Plaintiffs will lose their proxy contest absent a TRO, supports my conclusion that Plaintiffs have demonstrated the existence of irreparable harm if a TRO is not granted.

D. Balance of the Equities

Defendants assert a handful of particular hardships they would suffer were a TRO granted. First, Defendants contend that delaying the Annual Meeting would require the

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72 Pls.' Reply Br. 10 n.7 (quoting Hannigan Reply Aff. Ex. O § 2.2(c)).

73 *Openwave Sys. Inc. v. Harbinger Capital P'rs Master Fund I, Ltd.*, 924 A.2d 228, 239 (Del. Ch. 2007).

74 Defendants also argue that Plaintiffs cannot comply with Section 3.3 because only record holders are eligible to make nominations, none of the postponements changed the October 24 record date, and Plaintiffs were not stockholders of record as of October 24. Plaintiffs' counsel represented at argument, however, that an appropriate record holder now has delivered Plaintiffs' nomination package to the Company's Secretary. Hr'g Tr. 9-10. Accordingly, Defendants' argument that Plaintiffs failed to comply with the advance notice bylaw because they are not record holders is moot.

Company to incur approximately $250,000 in additional expenses to prepare and issue revised proxy materials. Plaintiffs, however, offered to post a secured bond in that amount.[75]

Second, because the record date for the Annual Meeting currently is October 24, Defendants claim that any postponement past December 24 (*i.e.*, 60 days from the record date) will violate 8 *Del. C.* § 213(a). Section 213(a) provides in part that "[a] determination of stockholders of record entitled to notice of or to vote at a meeting of stockholders *shall apply to any adjournment* of the meeting; provided, however, that the board of directors *may* fix a new record date . . . ."[76] Thus, so long as the Company opens and adjourns the Annual Meeting before December 24, the October 24 record date will not violate section 213(a). The language of any TRO easily can be drafted to permit the Company to do so.

Third, and relatedly, Defendants maintain that delaying the Annual Meeting past December 31 would violate NASDAQ Rule 5620, which requires the Company to hold its Annual Meeting within one year of the close of its prior fiscal year. Failure to comply with this rule, moreover, could cause NASDAQ to issue a notice of deficiency and, ultimately, result in delisting the Company's stock.[77] This concern is especially grave in ChinaCast's case, according to Defendants' counsel, because NASDAQ "is under

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75 Hr'g Tr. 9, 29-30.

76 8 *Del C.* § 213(a) (emphasis added).

77 Defs.' Ans. Br. 46.

pressure to apply enhanced scrutiny to companies whose principal operations are in China."[78] Plaintiffs reply that this concern is unduly speculative insofar as the Company is entitled to a hearing before any delisting takes place. Furthermore, such a hearing is unlikely to occur within the timeframe of Plaintiffs' requested TRO, which is to say the Company is likely to cure its noncompliance before NASDAQ even considers the matter.[79] Although this worst case scenario may be conjectural at this time, the Court generally does not take lightly the threat of delisting or violations of exchange rules. Thus, this hardship does weigh against granting a TRO, but it does not outweigh the equities in favor of granting a TRO, discussed below.

Additionally, at argument, Defendants' counsel raised a concern that market uncertainty caused by delaying the Annual Meeting could induce short-selling and otherwise adversely affect the Company's stock price.[80] Defendants, however, are not the first parties to make such an argument in this Court. "[I]t is axiomatic that enjoining a shareholder meeting may affect the price of a company's stock. But this concern is not unique to [Defendants]—all previous companies that have had shareholder meetings enjoined undoubtedly faced similar prospects—and is insufficient to allow a tainted

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78 Hr'g Tr. 49.

79 Pls.' Reply Br. 13 (citations omitted).

80 Hr'g Tr. 51.

shareholder vote to proceed."[81] Nothing distinctive about ChinaCast warrants treating it differently in this regard.

Otherwise, as between Plaintiffs and Defendants and before taking into account the importance of the corporate franchise, the balance of the equities is hard to discern and may very well be in equipoise. It is in this regard that Defendants raise their arguments of, essentially, laches and unclean hands. Defendants assert that Sherwood knew of the events now motivating his proxy contest long before December 8, including the "unauthorized" meeting with Firm A in early June 2011, the lackluster pace of share purchases under the Buyback Program as of late June, and the board's hesitancy to form a special committee in response to Company B's offer in August. Sherwood also was aware of the growing acrimony between him and the Individual Defendants before the Annual Meeting was first announced on October 18. In particular, in mid-September, the Company commenced an internal investigation of Sherwood's August 12 trading activity, and he met with the Company's counsel in that regard; on September 25, the board removed him from the Audit and Nominating Committees; and after the Company reported Sherwood's trades to the SEC on October 11, he met with SEC officials. Yet, at no point during these times did Sherwood, a sophisticated individual with professional experience in private equity and mergers and acquisitions, take the necessary steps to prepare for a proxy contest should the need arise. In sum, Defendants' argue that Plaintiffs' inability to present their grievances to shareholders in a timely fashion is a

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[81] *ODS Techs., L.P. v. Marshall*, 832 A.2d 1254, 1263 (Del. Ch. 2003).

"self-inflicted wound" caused by their own complacence, and Plaintiffs should bear the burden of any hardship they might suffer if the Company holds the Annual Meeting as scheduled.[82]

To support that view, Defendants rely on *Lenahan v. National Computer Analysts Corp*.[83] In *Lenahan*, a director had attempted to remove the company's CEO for over a year. After that attempt failed, the company instead "dropped the director from management's slate of directors" for reelection to the board, and the director sought to postpone the annual shareholder meeting for five weeks to enable a meaningful proxy contest.[84] Because "time was obviously of the essence,"[85] the court refused to enjoin the meeting, concluding "the equities in favor of holding the meeting as regularly scheduled outweigh[ed] those implicit in plaintiff's belated efforts to wage a proxy fight designed to preserve his status as a director . . . ."[86]

Despite its seeming similarity, *Lenahan* does not address the issues presented by this case. First, the company dropped the director from its slate on July 26, 1973, which was the same day on which the board gave notice of its annual meeting and fixed the

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82 Defs.' Ans. Br. 47.

83 310 A.2d 661 (Del. Ch. 1973).

84 *Id.* at 663-64.

85 *Id.* at 663.

86 *Id.* at 664 (footnote omitted).

record date.[87] Thus, the dissident director had the same opportunity as any other shareholder to qualify as a record holder and run a proxy contest. Second, the director did not immediately seek emergency relief. Rather, he initially sent a demand letter to the company on July 31 to inspect the stockholder list; when demand was refused, he then filed an action under 8 *Del. C.* § 220 on August 7; and, sometime thereafter, "in a belated move to gain time," he requested a preliminary injunction, the hearing on which did not occur until August 23, 1973.[88] To the extent the director "belatedly decided on a proxy contest," "waited unreasonably," or otherwise was guilty of laches, the fatal delay related to the month he wasted *after* management removed him from its slate.[89] Indeed, but for the reference to the plaintiff's year-long dispute with the CEO, *Lenahan* would be wholly inapposite. That fact apparently reinforced the court's perception of the plaintiff's pattern of behavior as being dilatory, but the gravamen of the court's conclusion turned on the plaintiff's delays in litigating his claims.[90]

Sherwood and ZS, by contrast, had been led by the Company to believe that Sherwood would be on the Company's slate until well after the deadline for notice under the advance notice bylaw had passed. Moreover, Sherwood and ZS acted relatively

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87 *Id.* at 663, 664.

88 *Id.* at 662-63.

89 *Id.* at 664.

90 *Id.* ("[P]laintiff . . . waited unreasonably *before bringing his 8* Del. C. *§ 220 action* . . . ." (emphasis added)). Furthermore, the court dismissed the 220 action because the director was not a record holder and, therefore, lacked standing under the statute. *Id.* at 662.

quickly to preserve their rights after they learned that Sherwood would not be nominated by the Company. Therefore, in the context of this case, the Court would have serious concerns about the policy implications that strict reliance on *Lenahan* would raise.[91]

Turning to Defendants' assertion that Plaintiffs, essentially, come to this Court with unclean hands, there are relevant equities weighing in both directions. In brief, Defendants contend that Sherwood bears much of the responsibility for the timing of his last-minute removal from the Company's slate. As Defendants recount the facts, the Nominating Committee first expressed concerns about including Sherwood on the Company's slate on October 28. Although the Company ultimately included Sherwood on its slate "[o]ut of respect for its relationship with Fir Tree," an interim draft of the definitive proxy materials disclosed the Nominating Committee's October 28 concerns.[92] Sherwood, however, "expressed outrage" at that draft disclosure and, in his capacity as Chairman of the Compensation Committee, refused to sign the draft proxy statement unless the reference to the October 28 concerns was deleted.[93] Again, the board

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91 *See Hubbard v. Hollywood Park Realty Enters., Inc.*, 1991 WL 3151, at *11 (Del. Ch. 1991) ("For example, in corporations having a majority of independent directors, the minority directors might believe themselves compelled (in their capacity as shareholders) to nominate a 'dissident' slate to protect their positions, lest the majority faction suddenly decide to stage a surprise electoral coup after the nomination window had closed. In these circumstances a rule that imposes upon shareholders the burden of anticipating such perfidious contingencies, no matter how remote, and that encourages election-related behavior that may unnecessarily disrupt otherwise harmonious board relationships, is unsound.").

92 Defs.' Ans. Br. 17 (citing Chan Decl. ¶ 19).

93 *Id.* at 18.

begrudgingly acquiesced and filed the Definitive Proxy, without the disputed reference, with the SEC on November 15. Meanwhile, members of the Nominating Committee attempted to meet with Fir Tree to discuss their concerns and request Fir Tree to designate an alternative person, but Fir Tree refused to hold any discussions that might reveal nonpublic Company information. Without any input from Fir Tree, the Nominating Committee claims it "was left with no choice" but to recommend that the Company remove Sherwood from its slate of nominees, which recommendation the board accepted on November 29.[94] Still, the Company delayed supplementing the Definitive Proxy while it attempted to negotiate an alternative resolution with Sherwood. Negotiations ensued over the following week, but Sherwood's numerous demands and threats to torpedo the Proxy Supplement undermined the Company's attempt to work out an amicable solution. Out of options, the Company filed the Proxy Supplement on December 8, publicly disclosing Sherwood's removal from the Company's slate of nominees.

Even if I accept Defendants' account as true—which may not be warranted as the record currently stands—the above facts still can support a reasonable inference that both Sherwood and the Individual Defendants pursued an aggressive, but good faith, negotiating strategy to the end. Furthermore, drawing all the inferences in favor of Plaintiffs, these facts arguably support a conclusion that Sherwood believed he was making progress in convincing his fellow directors to keep him on the Company's slate.

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94 *Id*. at 19.

He persuaded the Company not to poison the well by publicly disclosing the October 28 concerns, and the board initially refrained from implementing its November 29 determination to remove him from that slate. The fact that the parties ultimately failed to compromise does not mean necessarily that either Sherwood or the Individual Defendants acted inequitably in this regard. The facts here do demonstrate, however, that the Company's board had to make a tough call regarding Sherwood's place on the Company's slate, and that they did not make that call until after the opportunity for a meaningful and transparent proxy contest arguably had been lost.[95]

In these circumstances, there may be some merit to the equities claimed by both Plaintiffs and Defendants, but the balance of the equities as between Defendants and ChinaCast's shareholders tips decidedly in favor of granting the TRO. In certain respects, this dispute is reminiscent of *Blasius Industries, Inc. v. Atlas Corp.* where a board's "good faith effort to protect its incumbency, not selfishly, but in order to thwart implementation of [a corporate policy] that it feared, reasonably, would cause great injury

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[95] In this regard especially, I find Defendants' arguments about the Company's advance notice bylaw particularly shortsighted. Although it is true that "provisions like Section 3.3 are 'designed and function to permit orderly meetings and election contests and to provide fair warning to the corporation so that it may have sufficient time to respond to shareholder nominations,'" Defs.' Ans. Br. 25 (quoting *Openwave Sys. Inc. v. Harbinger Capital P'rs Master Fund I, Ltd.*, 924 A.2d 228, 239 (Del. Ch. 2007)), that orderly process and response time inure also—if not primarily—to the benefit of shareholders by providing "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." *Hubbard*, 1991 WL 3151, at *13. Here, Defendants seek to use the relatively unique circumstances of this case to frustrate that purpose.

to the Company" nevertheless "constituted an unintended violation of the duty of loyalty" because that effort "interfere[d] with the effectiveness of a stockholder vote."[96] Of course, *Blasius* is distinguishable because the conduct there was "designed for the *primary* purpose" of thwarting a shareholder vote.[97] At this early stage in this litigation, there is no indication that the Individual Defendants' *primary* purpose for removing Sherwood from the Company's slate of nominees was to forestall shareholder opposition to their incumbency. Moreover, the board has not attempted to accelerate a contested vote, as was the case in *Schnell v. Chris-Craft Industries, Inc.*,[98] for example. Rather, Defendants seek only to hold the Annual Meeting as scheduled, and it is Plaintiffs who request the special treatment of postponing the meeting so that shareholders can consider their belated proxy materials. This latter distinction is not dispositive, however, because "occasions do arise where board inaction, even where not inequitable in purpose or design, may nonetheless operate inequitably."[99]

This case presents such an occasion. Here, the ChinaCast board failed to resolve differences among its members and—with the Annual Meeting date rapidly approaching and believing that the window to conduct a meaningful proxy contest long had closed—removed Sherwood from its slate of nominees. It then did nothing to alleviate the effects

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96 564 A.2d 651, 658-59, 663 (Del. Ch. 1988).

97 *Id.* at 663 (emphasis added).

98 285 A.2d 437 (Del. 1971).

99 *Hubbard*, 1991 WL 3151, at *10.

of these circumstances. The board should have foreseen that acting in this manner would generate controversy, and that ChinaCast's shareholders generally, not just Sherwood, would lose the opportunity to express their fully informed views on that controversy via a fair election.

"The corporate election process, if it is to have any validity, must be conducted with scrupulous fairness and without any advantage being conferred or denied to any candidate or slate of candidates. In the interests of corporate democracy, those in charge of the election machinery of a corporation must be held to the highest standards in providing for and conducting corporate elections."[100] Defendants have not simply expressed their disagreement with Sherwood's positions or dissatisfaction with his personal behavior; they also have excluded him from merely running for election. In this way, holding the Annual Meeting on December 21 would not comport with the "scrupulous fairness" required of corporate elections. Thus, the interests of corporate democracy on which Plaintiffs rely have the greatest effect on the balance of the equities in this case. And, that effect favors granting the TRO.

III. CONCLUSION

In *Hubbard v. Hollywood Park Realty Enterprises, Inc.*,[101] then-Vice Chancellor, now Justice, Jacobs enjoined an annual shareholder meeting under somewhat similar

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100 *Aprahamian v. HBO & Co.*, 531 A.2d 1204, 1206-07 (Del. Ch. 1987).

101 1991 WL 3151 (Del. Ch. 1991).

circumstances to those presented here. Despite issuing the injunction, he wrote that his decision

> should not be read to imply any view of this Court that [the facts warranting the injunction] (including the management slate's agenda) are either "good" or "bad" in the business or electoral sense. That judgment is solely for the shareholders to make. All that this Court can decide is whether, in these circumstances, the shareholders can be asked to make that judgment without presently being afforded a fair opportunity to nominate a dissident slate and to consider its opposing views. In my view the answer must be no.[102]

I share that sentiment in this case.

For that and all of the foregoing reasons, Plaintiffs' Motion for a TRO is granted to the extent indicated in the separate Temporary Restraining Order being entered concurrently with this Memorandum Opinion. In summary, that Order (1) temporarily enjoins Defendants from holding the Annual Meeting, currently scheduled for December 21, 2011 at 9:00 am Beijing Standard Time, for twenty days until January 10, 2012 at 9:00 am Beijing Standard Time (January 9, 2012 at 8:00 pm Eastern Standard Time); [103] (2) enables Plaintiffs to solicit proxies for their competing short slate of directors at the Annual Meeting notwithstanding Defendants' contrary construction of Section 3.3 of the Company's bylaws; (3) notwithstanding the injunction in item (1) above, authorizes

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102 *Id.* at *12.

103 In their Motion, Plaintiffs requested a postponement of twenty-eight days. Based on the competing equities, including Plaintiffs' level of sophistication and Defendants' concerns relating to NASDAQ Rules and other considerations, I conclude that a twenty-day continuance is appropriate.

Defendants to open and adjourn the Annual Meeting before December 24, 2011 for the sole purpose of complying with 8 *Del. C.* § 213(a); and (4) requires Plaintiffs to post a secured bond in the amount of $250,000.