



Delaware Chancery Court Questions Use of Advance Notice Bylaw

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In *HealthCor Management v. Allscripts Healthcare Solutions*, C.A. No. 7557-CS (Del. Ch. May 25, 2012) (Transcript), the Court of Chancery made a few noteworthy observations regarding the use — and potential limitations — of advance notice bylaws. The court granted the plaintiffs' motion to expedite in a case involving a challenge to Allscripts' use of its advance notice bylaw to prevent the plaintiff from nominating a short slate of directors. The plaintiffs claimed that, due to a fundamental, unanticipated and unforeseeable change in governance at Allscripts — namely, the resignation, shortly before the annual meeting, of Allscripts' chief financial officer and four of its nine directors — they should be excused from complying with the time periods set forth in the bylaw.

In setting forth his reasoning for granting the motion, Chancellor Leo E. Strine Jr. stated, "Advance notice bylaws have long been, frankly, a controversial thing. People do them. The idea that somebody needs to nominate their outside candidate a third of a year before a meeting has become more common than it certainly would have been 20 years ago." Of course, the current prevalence of advance notice bylaws may be traced back to the court's seminal opinion in *Hubbard v. Hollywood Park Realty Enterprises*, 1991 WL 3151, at *11 (Del. Ch. Jan. 14, 1991), where it articulated the basic test used to determine the facial validity of advance notice bylaws as well as their use. Citing to *Blasius Industries v. Atlas*, 564 A.2d 651, 652 (Del. Ch. 1988), and *Schnell v. Chris-Craft Industries*, 285 A.2d 437, 439 (Del. 1971), the *Hubbard* court stated that although the stockholders' rights to exercise their franchise are "fundamental," the fundamental nature of such rights "does not mean that their exercise cannot be restricted for valid corporate purposes by board-created procedural rules."

"More specifically," the *Hubbard* court held, an advance notice bylaw must "on its face and in the particular circumstances, afford the shareholders a fair opportunity to nominate candidates."

With an apparent nod to this precedent, Strine, in ruling on the plaintiffs' motion, stated that "the board is subject to, frankly, a review for how it uses a bylaw and whether it's using it for proper purposes consistent with its duty of loyalty." On that basis, Strine stated that where there was "an extraordinary change" and "the board itself feels a board majority is essentially going to propose to seat a very different board," a "colorable equitable question" was raised regarding "whether the board can hide behind the advance notice bylaw and retain for itself the flexibility to change the shape of the board in a fundamental way shortly before the meeting and deny the other stockholders the ability to react to it."

An additional factor apparently motivating the court's decision to grant the motion to expedite was Allscripts' adoption, not long before the annual meeting, of a stockholder rights plan (or "poison pill") with a 10 percent threshold. Although the court did not express a final view on the validity of the rights plan, it did indicate that "on the traditional rights plan basis" — with "traditional" plans being distinguished from the 5 percent threshold rights plans that have become commonplace for companies seeking to preserve tax benefits under Section 382 of the Internal Revenue Code — "it's at the very lowest tier of the threshold." The court noted that the adoption of the plan at the 10 percent threshold "obviously ... raises questions about whether it was done to essentially constrain the voting power of people who want to run a proxy contest and inhibit their ability to successfully do it." While the court did not offer its final judgment on the merits, it did state that the foregoing issues, at the preliminary stage, were "important" and warranted the scheduling of a preliminary injunction hearing.

In a Form 8-K dated May 30, Allscripts announced that it had agreed to settle the litigation with the HealthCor plaintiffs. As set forth in that announcement, the settlement involved Allscripts' board of directors agreeing to increase its size from seven to nine, effective at the 2012 annual meeting, and to nominate three specified individuals for election at the meeting.

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