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IN THE COURTS

Rosenbaum v. CytoDyn Inc.: A Review of Advance Notice Bylaws

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In *Rosenbaum v. CytoDyn Inc.*, the Delaware Court of Chancery denied an insurgent group's challenge to the rejection of their notice of director nominations by CytoDyn Inc.[1] The Court's opinion brings some clarity to an area of the law that "may not be as settled as one would think," providing a framework for reviewing actions taken by corporations under their advance notice bylaws.[2] While the Court rejected the plaintiffs' argument in favor of a reflexive application of the onerous "compelling justification" standard under *Blasius*, it also declined to follow the purely contractual approach advanced by the defendants. The Court explained that a board's rejection of a non-compliant nomination notice is reviewed under *Blasius* if the decision is the product of "manipulative conduct"[3] and that, in the absence of such conduct, a board's decision to reject such a nomination notice will only be set aside in equity if the plaintiff proves that "there are 'compelling circumstances' that justify a finding of inequitable conduct."[4]

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Background

CytoDyn is a Washington-based pharmaceutical company that, at the time of the litigation, was in the process of developing a drug, Leronlimab, intended to treat COVID-19, HIV, and cancer. In 2015, CytoDyn reincorporated from Colorado to Delaware, at which time it adopted, with stockholder approval, a new certificate of incorporation and bylaws. Those bylaws contained customary "advance notice" provisions requiring any stockholder or group of stockholders seeking to nominate any persons for election to the board at an annual meeting of stockholders to disclose, during a specified period in advance of the meeting, information regarding the person making the nomination, the proposed nominees, and agreements, arrangements, and understandings among the proponents and other persons in respect of the nominations.

The plaintiffs in the action were three significant stockholders with various connections to CytoDyn. One of the plaintiffs, Paul Rosenbaum, and one of the dissidents' non-party nominees, Bruce Patterson, had ties to another company, IncellDx, Inc., that

had a "complicated relationship" with CytoDyn.[5] Patterson was the founder and chief executive officer of IncellDx and, together with his wife, controlled 34 percent of IncellDx's outstanding stock. Patterson served as a consultant for CytoDyn, but he ended that relationship in May of 2020 when he submitted a proposal to CytoDyn contemplating a transaction in which CytoDyn would acquire IncellDx for $350 million and employ Patterson. Shortly after terminating his consultancy with CytoDyn, Patterson filed an application on behalf of IncellDx for a patent on methods for treating infections that were similar to the Leronlimab methods. In response, CytoDyn attempted to block the filing.

Those relationships and events serve as the backdrop for the proxy contest that the plaintiffs began planning in March of 2021. In preparation for the fight, the plaintiffs started communicating with a group of dissident stockholders, and they formed a company, CCTV Proxy Group, LLC—with CCTV standing for "CytoDyn Committee to Victory"—to solicit "donations" to fund expenses associated with their proxy contest.[6] While the plaintiffs' efforts were underway, CytoDyn expanded its board to elect a new independent director, and it employed a consultant to monitor the activities of the dissident group.

On May 24, 2021, the plaintiffs filed their Schedule 13D with the Securities Exchange Commission (SEC). Roughly one month later—just one day before the expiration of the advance notice period—the plaintiffs submitted their notice of nominations. Pursuant to the advance notice bylaw, the plaintiffs responded to several questions, but they omitted key details, including information with respect to IncellDx's previous proposal to be acquired by CytoDyn, potential future transactions between the CytoDyn and IncellDx they were considering, and the role of CCTV in the proxy contest.

Shortly after receiving the notice, CytoDyn's board met to discuss it, but apparently did not formally reject it. A few weeks after submitting their notice, having received no response from CytoDyn, the plaintiffs' filed their preliminary proxy statement with the SEC. Days later, CytoDyn's board again met to discuss the nomination notice. At that meeting, the board formally rejected the notice on the basis of several identified deficiencies and authorized management to deliver a rejection notice to the plaintiffs. The rejection letter was delivered nearly one month after CytoDyn's receipt of the nomination notice. Despite an exchange of letters—and an effort on the part the plaintiffs' to cure the deficiencies CytoDyn had pointed out—the parties remained at loggerheads.

In early August, CytoDyn initiated litigation in federal court against the plaintiffs and their nominees for violations of the Securities Exchange Act of 1934. The plaintiffs persisted, filing their definitive proxy statement with the SEC and initiating an action in the Court of Chancery to have the rejection of the notice declared invalid and to force CytoDyn to allow the nominations to proceed.

The Court's Analysis

The Court observed that the plaintiffs and CytoDyn had approached the key issue—what standard should apply to CytoDyn's actions in response to the nomination notice—from dramatically different points. The plaintiffs argued that the rejection should be reviewed under the "compelling justification standard" articulated in *Blasius Industries, Inc. v. Atlas Corp*,[7] while the defendants, relying on principles extracted from the Delaware Supreme Court's opinion in *BlackRock Credit Allocation Income Trust v. Saba Cap. Master Fund, Ltd.*,[8] argued the analysis should be based in contract. Although noting that the plaintiffs' correctly observed that, "'when facing an electoral contest, incumbent directors are not entitled to determine the outcome for the stockholders,'" the Court rejected plaintiffs' attempt to "extend *Blasius* beyond its intended limits."[9] Rather, the Court held that *Blasius* does not apply in every situation in which a board is alleged to have interfered with a stockholder vote and should instead be applied only where '"self-interested or faithless fiduciaries act to deprive stockholders of a full and fair opportunity"[10] to exercise their franchise "'for the sole or primary purpose of thwarting a shareholder vote.'"[11] According to the Court, in

this context, *Blasius* may only be invoked where evidence reveals that the board, in responding to the notice, engaged in some type of manipulative conduct, and it found the plaintiffs had failed to carry that burden.[12]

The Court's finding that *Blasius* did not supply the standard of review, however, did not result in a default to the business judgment rule and a rote contractual analysis. After observing that the stockholder franchise remains the most "'sacrosanct'" of stockholder rights and that directors, when reacting to a notice under an advance notice bylaw, confront a "structural and situational conflict,"[13] the Court invoked the familiar *Schnell* doctrine, under which "'inequitable action does not become permissible simply because it is legally possible.'"[14] Electing to follow *Schnell* rather than *Blasius* essentially meant that, although the defendants were not required to meet the nearly insurmountable burden of demonstrating that they had a "compelling justification" for their actions, the plaintiffs would still be entitled to some form of relief if they were able to meet their burden of proving "'compelling circumstances' that justify a finding of inequitable conduct."[15]

Operating within a *Schnell* framework, the plaintiffs argued that, after submitting their nomination notice, they had remained ready and willing to engage with CytoDyn and to cure any alleged deficiencies in the nomination notice, while CytoDyn refused to engage, relying solely on the fact that the plaintiffs' initial notice was defective and, since the notice period had expired, could not be cured. The Court ultimately rejected this line of the plaintiffs' arguments. First, the Court noted that CytoDyn's advance notice bylaw, unlike other examples, did not contain procedures for curing deficiencies. Next, the Court noted that the plaintiffs had waited until the last day of the advance notice period to submit their nomination notice.

> Had Plaintiffs submitted their Nomination Notice well in advance of the deadline, they might have a stronger case that the Board's prolonged silence upon receipt of the notice was evidence of "manipulative conduct."[16]

The Court suggested that, if that were the case, the defendants would have had a more difficult time justifying their conduct. Since the plaintiffs had waited until the proverbial last minute, they were required to submit a notice that complied with the advance notice bylaw—which they had failed to do. Although the Court acknowledged that the plaintiffs had supplemented their notices, it ultimately found that their efforts came too late.

The fact that the nomination notice was delivered at the last minute, along with the nature of the omissions in the disclosures, persuaded the Court that there was no need to invoke *Blasius* or *Schnell.* Instead, the Court found that the plaintiffs' failure to disclose in their nomination notice matters at the heart of a proxy contest—including information regarding the nominee group, its source of support, and the intent of the proponents and nominees to engage in conflicted transactions post-election—supplied sufficient support for the board's determination to reject the nomination notice.[17]

Conclusion

The Delaware Court of Chancery's opinion in *CytoDyn* appears to be the latest installment in a series of recent opinions in which the Delaware courts have rejected attempts to allow nominations to proceed in the face of non-compliance with the advance notice bylaw. The opinion, however, should not be read for the proposition that a proponent's mere foot-fault in a nomination notice or proposal, of itself, will entitle incumbent boards in all cases to declare the nomination invalid. Although rejecting the overbroad proposition that *Blasius*-style review will apply to all actions that a board takes in response to a notice of nomination or proposal, the Court recognized that there may be circumstances, such as where there is evidence that the board is engaging in manipulative conduct to disenfranchise stockholders, that might warrant that type of exacting review.

Moreover, even though it declined to apply *Blasius* in this case, the Court was not willing to review the matter for the sole purpose of determining whether the proponent had complied with the provisions of the advance notice bylaw as a contractual matter, opting instead for a more nuanced *Schnell*-style review. In addition, because the bylaw in question was "commonplace," the plaintiffs did not argue—and the Court was not required to address—questions regarding the reasonableness of the bylaw itself.

The Court's opinion signals to stockholders seeking to present nominations and proposals that there may be material advantages to acting as promptly as possible after the advance notice window has opened. Notably, if a nomination notice or stockholder proposal is submitted at the outset of the window provided under an advance notice bylaw, the stockholder would stand to have a greater opportunity to cure any defects in its initial notice of its nomination or proposal. Conversely, corporations are well within their rights to require stockholders to provide information that is material to the matters that will be presented to stockholders at the meeting, including any facts relating to potential conflicts of interest and future plans, and to reject nomination notices that lack any such information required under an advance notice bylaw or any supplements thereto provided after the advance notice window has expired.

Notes

1. Rosenbaum v. CytoDyn Inc., 2021 WL 4775140 (Del. Ch. Oct. 13, 2021).
2. *Id.* at *1.
3. *Id.* at *14 (*quoting* BlackRock Credit Allocation Income Trust v. Saba Capital Master Fund, Ltd., 224 A.3d 964, 981 (Del. 2020)).
4. *Id.* *15 (*quoting* AB Value P'rs, LP v. Kreisler Mfg. Corp., 2014 WL 7150465, at *5 (Del. Ch. Dec. 16, 2014)).
5. *Id.* at *6.
6. *Id.* at *7.
7. Blasius Industries, Inc. v. Atlas Corp, 564 A.2d 651, 660 (Del. Ch. 1988).
8. BlackRock Credit Allocation Income Trust v. Saba Cap. Master Fund, Ltd., 224 A.3d 964.
9. *CytoDyn*, 2021 WL 4775140, at *13–14 (*quoting* Pell v. Kill, 135 A.3d 764, 769 (Del. Ch. 2016)).
10. *Id.* at *14 (*quoting* In re MONY Gp. Inc. S'holder Litig., 853 A.2d 661, 674 (Del. Ch. 2004)).
11. *Id.* (*quoting* Kallick v. SandRidge Energy, Inc., 68 A.3d 242, 258 (Del. Ch. 2013)).
12. Notably, the Court stated that the plaintiffs "wisely" did not argue that the adoption of the advance notice bylaw—which occurred years before the action—was subject to *Blasius* review and that the plaintiffs were "wise" in declining to argue that the terms of CytoDyn's advance notice bylaw—which the Court found to be "commonplace"—were unreasonable. *Id.* at *14.
13. *Id.* (*quoting* EMAK Worldwide, Inc. v. Kurz, 50 A.3d 429, 433 (Del. 2012)).
14. *Id.* at *15 (*quoting* Schnell v. Chris-Craft Indus., Inc., 285 A.2d 437, 439 (Del. 1971)).
15. *Id.* *15 (*quoting Kreisler*, 2014 WL 7150465, at *5).
16. *Id.* at *17 (*quoting Saba*, 224 A.3d at 981).
17. *Id.* at *21.