Delaware Chancery Court Reviews Advance Notice Provisions

By Elizabeth Kitslaar and Adam Schaeffer

Vice Chancellor Noble of the Delaware Chancery Court recently held that it was unlikely that a 150-day advance notice period for stockholder proposals was unreasonably long or unduly restrictive. In *Goggin v. Vermillion, Inc.*,[1] the court also interpreted the Delaware Supreme Court's recent ruling in *Airgas, Inc. v. Air Products and Chemicals, Inc.*[2], in finding that an annual meeting to be held "a few days" prior to the anniversary of the directors' election did not sufficiently "truncate the directors' term as to constitute a *de facto* removal."[3]

Vermillion, Inc., a developer of diagnostic tests, was initially created and went public in 2000. Pursuant to the DGCL and its charter and bylaws, Vermillion was required to hold an annual stockholders meeting "at a time designated by the board of directors."[4] Vermillion held its stockholders meeting in June of each year from 2002 until 2008. In 2009, the company filed for Chapter 11 protection, emerging in January 2010. While its Chapter 11 case was pending, Vermillion did not hold a stockholders meeting, and its first post-bankruptcy meeting was held in December 2010. In its proxy issued on October 20, 2010 notifying stockholders of the 2010 annual meeting to be held in December 2010, the company notified its stockholders that proposals for the 2011 meeting would need to be submitted by January 1, 2010. The bylaws then in place did not include an advance notice provision. In its February 28, 2011 Annual Report on Form 10-K, Vermillion announced that its 2011 annual meeting would be held in June 2011.[5]

In a January email to the company, the plaintiff, who had acquired Vermillion stock following the commencement of its Chapter 11 case, notified the company of his dissatisfaction with the board and management. He followed this with a March 23, 2011 letter to Vermillion's board requesting an emergency stockholder meeting to consider the CEO's tenure, the adoption of "more shareholder-friendly bylaws," and removal of the company's poison pill. The board declined to take action on any of the action requested in the plaintiff's communications, but did adopt an amendment to the company's bylaws that added an advance notice provision for stockholder proposals and director nominations. Plaintiff sued to enjoin the annual meeting, claiming, among other things, that the 150-day advance notice requirement contained in the 2010 proxy was "unreasonably defensive and entrenching" and that the six month period between the 2010 and 2011 stockholder meetings was unreasonably short.[6] Finding that the plaintiff has little chance of success on the merits, Vice Chancellor Noble denied the plaintiff's motion for preliminary injunction.

The plaintiff argued that the 150-day advance notice requirement was unreasonable and caused his disenfranchisement, and that the later amendment to the bylaws, requiring notice of a shareholder proposal to be submitted 120 to 90 days prior to the first anniversary of the prior annual meeting, demonstrated that the 150-day notice period was unreasonable. Vice Chancellor Noble noted that Delaware law does not require that stockholders provide advance notice of proposals or director nominations to be raised at an annual meeting, "unless the corporation has duly imposed such a requirement."[7]

Notice periods are "commonplace," "frequently upheld as valid," and "useful in permitting orderly shareholder meetings," but notice requirements that "unduly restrict the stockholder franchise or are applied inequitably . . . will be struck down."[8] Vice Chancellor Noble

Elizabeth Kitslaar is a Partner, and Adam Schaeffer is an Associate, of Jones Day, the opinions expressed in this article are those of the authors and not necessarily those of Jones Day or its clients.

held that it was unlikely that at trial the court would determine that the advance notice was unreasonably long or unduly restrictive because the requirement did not operate as an entrenching or defensive tactic because it was enacted on a "clear day"—i.e., prior to the plaintiff's expressing his dissatisfaction with management.[9] The court also noted that the notice requirement was consistent with the corporation's pre-bankruptcy practice. It should be further noted that the court implicitly approved the practice of including notice requirements by proxy (as opposed to bylaws).[10]

The plaintiff also argued that the recent *Airgas* ruling prohibited shortening the term of the directors to be elected at the 2011 annual meeting. In *Airgas*, the Delaware Supreme Court held invalid a bylaw that shortened time between annual meetings to just four months, cutting the tenure of the directors up for election at that meeting by eight months (of a three-year term). The court in that case held that the bylaw amendment constituted "a *de facto* removal" of those particular directors because the company's charter was intended to require three-year terms for directors. The effect of the amendment was to frustrate the purpose of the company's staggered board requirement and constituted a removal without cause that required a two-thirds vote under the charter.[11]

Vice Chancellor Noble rejected the plaintiff's argument, noting that the tenure of the directors in question (one of three groups of directors on the staggered board) was only cut short by a few days since the meeting at which the directors were elected was held in June of 2008. Because the issue was not before him, Vice Chancellor Noble did not examine whether holding an annual meeting in June 2013 (as opposed to December) would truncate the terms of the directors elected in December 2010 so as to act as a *de facto* removal. As the court stated, *Airgas* requires only that directors serve "approximately three years rather than exactly three years."[12] Thus, the court found that shortening the term by just a few days "appears to be permitted under *Airgas*."[13]

For practitioners, *Goggin* provides some guidance with respect to stockholder notice provisions enacted on "clear days." However, just as interesting, it is the first post-*Airgas* court to analyze truncation of directors' terms. There is a world of difference between the eight month term reduction in *Airgas* and the "few days" reduced in *Goggin*, and it will be interesting to see where courts place the line of demarcation between director terms that are "unduly" restricted that those that are permissibly restricted. Vermillion itself may provide the answer, as the court expressed no opinion with respect to the directors elected in 2010 (whose terms will be cut short by six months in 2013).

Notes

1. No. 6465-VCN (Del. Ch. June 3, 2011).
2. 8 A.3d 1182 (Del. 2010).
3. *Goggin*, No. 6465-VCN at *8-9 (quoting *Airgas*, 8 A.3d at 1194).
4. *Id.* at *7.
5. *Id.* at *2-3.
6. *Id.* at *5.
7. *Id.* at *10 (quoting *Levitt Corp. v. Office Depot, Inc.*, 2008 WL 1724244, at *4 (Del. Ch. Apr. 14, 2008)).
8. *Id.* at *10 (quoting *Openwave Sus. Inc. v. Harbinger Capital Partners Master Fund I, Ltd.*, 924 A.2d 228, 238-39 (Del. Ch. 2007)).
9. *Id.*
10. *Id.* at *10-11.
11. *Airgas*, 8 A.3d at 1194.
12. *Goggin*, No. 6465-VCN at *8-9 (citing *Airgas*, 8 A.3d at 1194 n.3).
13. *Id.*