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Legal Updates

JANA Master Fund, Ltd. v. CNET Networks, Inc.

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In a decision issued on March 13, 2008, the Delaware Chancery Court in *JANA Master Fund, Ltd. v. CNET Networks, Inc.*, No. 3447-CC (2008 Del. Ch. LEXIS 35), held that the advance notice provision in the bylaws of CNET Networks, Inc. ("CNET") applied only to stockholder proposals that are sought to be included in the company's proxy materials pursuant to Rule 14a-8 under the Securities and Exchange Act of 1934 and therefore did not apply to independently financed stockholder proxy solicitations.

The case is significant because it provides a narrow interpretation of an advance notice bylaw provision. Such provisions are common tools used by public companies to provide an orderly, balanced process should an insurgent stockholder propose to nominate competing slates of directors or seek to conduct other business at a stockholder meeting. By construing the CNET bylaw as only applicable to stockholder proposals submitted pursuant to Rule 14a-8, the *JANA* decision limited the scope of the provision by placing no limitation on stockholder proposals made by independent proxy solicitation or on the floor at the annual meeting.

The case has been appealed and is scheduled to be argued before the Delaware Supreme Court on April 16, 2008. It is reasonable to expect a decision shortly thereafter. Unless the Delaware Supreme Court reverses the decision of the Chancery Court or affirms on different grounds, Delaware corporations should review their advance notice bylaws with legal counsel and consider revising such bylaws to make clear that the requirement for advance notice of stockholder proposals applies to all proposals, whether or not submitted pursuant to the SEC proxy rules.

The background of the case is as follows. JANA Master Fund ("JANA") is an investment fund that owns, along with its affiliates, approximately 11% of the outstanding stock in CNET. In December 2007, JANA informed CNET that JANA intended to put before CNET stockholders at CNET's upcoming annual meeting, resolutions to (1) elect two dissident nominees to fill the two slots up for election on CNET's classified board, and (2) expand the board from eight to 13 members and elect five more dissident nominees to fill the new seats, thereby gaining JANA majority control of the CNET board. JANA planned on soliciting its own proxies in support of these resolutions. CNET's board refused to provide JANA with stockholder information, taking the position that JANA could not show a proper purpose under Section 220 of the Delaware General Corporation Law because JANA had not owned CNET stock for a full year as provided in CNET's advance-notice bylaw (at the time of CNET's 2008 annual meeting, JANA would have held such stock for only eight months).

The advance-notice bylaw provision at issue in the *JANA* case reads as follows:

Any stockholder of the Corporation that has been the beneficial owner of at least \$1,000 of securities entitled to vote at an annual meeting for at least one year may seek to transact other corporate business at the annual meeting, provided that such business is set forth in a written notice and mailed to the Secretary of the Corporation and received no later than 120 calendar days in advance of the date of the Corporation's proxy statement released to security holders in connection with the previous year's annual meeting of security holders (or, if no annual meeting was held in the previous year or the date of the annual meeting has been changed by more than 30 calendar days from the date contemplated at the time of the previous year's proxy statement, a reasonable time before the solicitation is made).

Notwithstanding the foregoing, such notice must also comply with any applicable federal securities laws establishing the circumstances under which the Corporation is required to include the proposal in its proxy statement or form of proxy.

In its motion for summary judgment, JANA argued that the restrictions set forth in CNET's advance-notice bylaw were inapplicable to proposals submitted via independently financed proxy materials. JANA contended that the restrictions in the bylaw applied only to nominations and proposals a stockholder attempted to include on management's form of proxy pursuant to Rule 14a-8 promulgated under the Exchange Act of 1934. JANA also contended that, if this bylaw was read to apply, it is invalid under Delaware law because it is an unreasonable restriction on the stockholder franchise.

Although declining to consider the validity of the bylaw itself, Chancellor Chandler held in favor of JANA and interpreted the advance-notice bylaw to not apply outside the context of Rule 14a-8. In other words, because JANA was not requesting that CNET include its proposals or nominations in CNET's proxy materials, JANA was not required to comply with the advance-notice bylaw's requirements.

In its decision, the Chancellor Chandler identified three reasons for concluding that the advance-notice bylaw can be read only to apply to proposals made pursuant to Rule 14a-8:

First, he concluded that the language in CNET's advance-notice bylaw, which states "a stockholder...may seek to transact other corporate business at the meeting" does not make sense outside the context of Rule 14a-8. Under Delaware law, stockholders are entitled to make proposals without seeking the approval of management. It is only where a stockholder wishes to include its proposal in management's proxy materials, and avoid the costs of a proxy solicitation, that the stockholder must seek inclusion under Rule 14a-8. Chancellor Chandler noted that the other federal proxy rules do not give management the ability to restrict stockholder proposals or nominations when the stockholder proponent is not seeking to avail itself of management's proxy. Thus, he concluded that the phrase "may seek" suggests the stockholder must ask for permission or approval to make a proposal, which only occurs under Rule 14a-8, and that because JANA intended to finance its own proxy solicitation and thus did not need management permission or approval to make a proposal, the bylaw did not apply to JANA's proposals.

Second, Chancellor Chandler noted that the deadline for stockholder proposals keyed off the mailing of proxy materials the previous year. He reasoned that a deadline relating to mailing of proxy materials only made sense if the provision covered only proposals to be included in management's proxy materials. The Chancellor noted that no advance-notice bylaw previously approved by Delaware courts had a proxy-mailing deadline. Instead, they had deadlines keying off the meeting date.

Third, Chancellor Chandler found the final sentence of CNET's advance-notice bylaw ("Notwithstanding the foregoing, such notice must also comply with any federal securities laws establishing the circumstances under which [CNET] is required to include the proposal in its proxy statement or form of proxy") to be the most compelling evidence that the provision was intended to apply only in the context of Rule 14a-8. He determined that this last sentence "purportedly grafts onto the bylaw all of the requirements of Rule 14a-8." Noting that the bylaw at issue already "incorporate[d] all of the requirements of Rule 14a-8," he deduced that no reason could have existed for CNET "to have grafted Rule 14a-8's burdensome requirements onto its Notice Bylaw if that bylaw applied outside the context of [Rule] 14a-8 proposals."

CNET has announced that it will pursue an appeal of this decision to the Delaware Supreme Court.

As a result of the *JANA* decision, companies should, in consultation with counsel, take steps to ensure that their bylaws contain advance-notice and advance-nominations provisions that are unambiguous, clear as to the circumstances and situations to which they apply, and not susceptible to being interpreted in a similar fashion to the way in which the Delaware Chancery Court interpreted CNET's advance-notice bylaws.