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Shareholder Activism Update

Recent Rulings from Delaware Chancery Favorable to Companies in Shareholder Activism Context

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Two recent rulings from the Delaware Court of Chancery relating to matters that arose in shareholder activism campaigns were favorable to companies. In *Paragon Technologies, Inc. v. Terence J. Cryan, et al.* (November 30, 2023), Vice Chancellor Will denied an investor's request for a preliminary injunction that would have (1) required the board to let its candidates stand for election after the company rejected its advance notice of nomination and (2) permitted the investor to purchase more shares of the company pursuant to a request for an exemption to make such purchase under the company's net operating losses (NOL) rights plan.

In *Texas Pacific Land Corporation v. Horizon Kinetics LLC, et al.* (December 1, 2023), Vice Chancellor Laster ruled that the investor should have voted with the board's recommendation on a proposal in the company's proxy statement to increase the number of authorized shares of common stock pursuant to the terms of a stockholders agreement entered into connection with an activism campaign, and deemed the shares to have been voted in favor of the proposal and declared the proposal approved. These cases show that Delaware courts continue to recognize the enforceability of advance notice bylaw provisions, the legitimacy of NOL rights plans, and the enforceability of contractual provisions in activism settlement agreements.

Paragon Technologies, Inc. v. Terence J. Cryan, et al.

In *Paragon Technologies*, the company adopted bylaw amendments after it learned that the investor had become a significant stockholder and that the investor may wage a proxy contest. The investor submitted an advance notice of nomination and the company rejected the advance notice. The court found that the advance notice did not comply with the disclosure requirements of the bylaws, particularly the provision that required the investor to disclose any plans or proposals that it had with respect to the company that would require disclosure pursuant to Item 4 of Schedule 13D. The court also recognized that the Board's enforcement of provisions requiring the disclosure of potential conflicts of interest and substantial interests by the parties making the nomination were also justifiable.

The court ultimately ruled in favor of the company under an enhanced scrutiny standard of review denying the motion for a preliminary injunction that would have forced the company to accept the investor's nomination and include its director candidates on its universal proxy card. Even though the court ruled in favor of the company, it did take issue with the way in which the advance notice was rejected. For example, the court observed that even though the investor submitted its advance notice with three weeks left in the nomination window, the board did not reject the notice until five weeks after receiving it, and that the board continuously declined to provide a complete list of deficiencies when it rejected the notice. Further, the court characterized some of the shortcomings that the board identified in the notice as nitpicky and others as suspect. Nevertheless, the court ruled in favor of the company as there were indications that the investor had plans for the company's business that were not disclosed in the advance notice and thus the court ultimately was unable to conclude that the investor fully complied with the bylaws.

With respect to the NOL rights plan, the court was asked to consider whether the company was required to grant the investor's exemption request that would have permitted the investor to purchase 19.9% of the stock, which was in excess of the 4.99% trigger of the NOL rights plan. The court found that even though the company appeared to develop a heightened concern with protecting its NOLs only after engaging with the investor on activism matters, there was evidence that the company's board undertook a good faith and reasonable investigation regarding the adoption of the NOL rights plan and the evaluation of the exemption request. Specifically, in evaluating the exemption request the board held two meetings with outside counsel and its outside tax advisor. The court also found that the company acted reasonable in relation to the threat by concluding that granting the exemption request could threaten the company's ability to raise capital and that the failure to grant the exemption request was not preclusive as it did not render a successful proxy contest realistically unattainable.

Texas Pacific Land Corporation v. Horizon Kinetics LLC, et al.

In *Texas Pacific Land Corporation*, the company and the investors entered into a stockholders' agreement as part of an activism settlement that contained a voting commitment obligating the investors to vote in favor of certain proxy statement proposals. The company's board included a proxy statement proposal to amend the company's certificate of incorporation to increase the company's number of authorized shares and recommended that stockholders vote in favor of such proposal. The investors voted against the proposal and the vote was outcome determinative in that it caused the proposal not to pass. The court held that the investors breached their voting commitment and deemed their shares voted in favor of the proposal and declared the amendment to the certificate of incorporation approved.

The court in reaching its decision found that the language in the stockholders' agreement was ambiguous but that the extrinsic evidence bound the investors to vote with the board. The court relied on extrinsic evidence that before the litigation began the investors acknowledged that they were obligated to vote in favor of a proposal to increase the number of authorized shares.

Notwithstanding the fact that the company prevailed, companies should incorporate the drafting lessons from this case in preparing and negotiating activism settlement agreements. The provisions in these agreements, particularly the standstill and voting commitment provisions, need to be drafted as precisely as possible to reduce the likelihood of a court later finding that such provisions were ambiguous.



If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings lawyers:

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