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# Reopening of Advance Notice Window Requires Activists to Show “Radical Shift” at Company

In *Sternlicht, et al. v. Hernandez, et al.*, the Delaware Court of Chancery clarified the high standard that activists must overcome to reopen the director nomination window of an otherwise valid advance notice bylaw—namely they must show that there has been a “radical shift” in company position caused by the board after the deadline for director nominations had passed. The court held that the plaintiffs did not overcome this standard, despite numerous alleged “radical shifts” that occurred after the deadline. As a result, in a holding favorable for the company, the court enforced the deadline for nominations established by the company’s advance notice bylaw and prevented the plaintiffs from nominating a competing slate of directors at the upcoming annual meeting. The opinion strengthens advance notice bylaws as a means of providing certainty around the annual meeting and election process for companies and protecting against activist attacks.

The plaintiffs were three of nine Cano Health, Inc. directors who resigned over perceived governance failures, including the full board’s refusal to discipline the CEO for company performance issues and multiple violations of the company’s conflict policies. At the time of the resignations, the bylaw-imposed deadline for director nominations at the company’s upcoming annual meeting had passed, and plaintiffs sent a letter to the company’s outside counsel arguing that certain events that occurred after the deadline constituted material changes that required the board to reopen the nomination window, including, among others, the appointment of a new board chair and failure to disclose a company-commissioned report revealing CEO performance issues. The company did not respond, and the plaintiffs sued, seeking to enjoin the company from enforcing the deadline and to adjourn the upcoming annual meeting so that they could nominate a competing slate of directors.

## Court’s Ruling

In an opinion by Vice Chancellor Fioravanti, the court cited the long-standing principle from *Schnell v. Chris-Craft Industries, Inc.* that “inequitable action does not become permissible simply because it is legally possible.” Cases challenging the application of an otherwise valid advance notice bylaw present a context-specific application of *Schnell*. These include *Hubbard v. Hollywood Park Realty Enterprises, Inc.*, in which the court held that a board has a duty to waive an advance notice bylaw under *Schnell* where a “radical shift in position, or material change in circumstances” occurs after the deadline for nominations. Later, the court in *AB Value Partners, LP v. Chrysler Manufacturing Corp.* distilled the *Hubbard* test into three determinations: (i) whether the change in circumstances occurred after the advance notice deadline, (ii) whether the change was “unanticipated” and “material” and (iii) whether the change was caused by the board of directors. *AB Value* further clarified that a “material” change in circumstances requires a “radical shift in position.”

The court in *Sternlicht* considered what is required by the “radical” standard from *Hubbard*. It rejected plaintiffs’ argument that the showing only required the same materiality standard governing proxy disclosures to stockholders (i.e., that there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the total mix of information made available). Rather, the court concluded that the standard was higher, requiring that the board and material actions taken by the board must “substantially alter the direction of the company.” The

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court concluded that each of the following, either considered together or separately, did not constitute a “radical shift” justifying the reopening of the advance notice window because, among other things, there was no board-level action or changes in board allegiances:

- A failure to notify plaintiffs about a meeting among board committee chairs that had occurred several months prior to the nomination deadline to discuss a loan that the CEO received from the later-appointed COO. Plaintiffs alleged not to have known about the meeting until after the advance notice deadline, but the court concluded that the evidence suggested that at least one plaintiff knew about it;
- Creation of a “shadow board” prior to the advance notice deadline that determined not to renominate one of the plaintiffs to the board and allegedly concealed the results of a company-commissioned report on the CEO’s performance from the plaintiffs until after the advance notice deadline;
- Creation of a board special committee after the advance notice deadline that was formed in response to one of the plaintiff’s threatened noisy resignation if the CEO was not removed and adoption of the committee’s recommendations;
- Appointment of a new board chairman after the advance notice deadline who plaintiffs alleged was beholden to the CEO; and
- A potential sale by the CEO’s wife of her interest in a dental business that was abandoned several months prior to the advance notice deadline, with which company Cano had a dental services administration agreement.

### Key Takeaways

- *The burden of demonstrating a “radical shift” in business or management of the company required to reopen an advance notice nomination window is significant.* Even if an activist plaintiff can demonstrate that the alleged radical shift was taken by the board, and not some subset thereof or management, and was taken after the close of the advance notice window, he or she must still demonstrate a clear showing of a radical change in the direction of the company. This will be heavily dependent on the facts and is more onerous than the materiality standard applicable to proxy disclosures to stockholders.
- *Advance notice bylaws are critical defensive tools for public companies and Delaware courts remain willing to enforce the terms of otherwise valid advance notice bylaws.* The *Sternlicht* decision is a clear indication that Delaware courts will enforce these provisions and only reopen the nomination window upon the showing of inequitable board conduct that leads to a substantial alteration in the direction of the company. Therefore, they can provide significant certainty around the director election process and protections for public companies against attacks from activists.

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