

Alert

Delaware Court Upholds Record Holder Requirement in Advance Notice Bylaw Provisions

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On Aug. 14, 2019, the Delaware Court of Chancery ruled to uphold the strict application of Barnes & Noble Education Inc.'s ("BNED") advance notice bylaw requiring a shareholder to be a record holder of shares in order to submit a nomination notice to nominate directors to the board. The court denied Bay Capital Finance LLC's ("Bay Capital") preliminary motion for injunction filed in order to permit Bay Capital to run its slate of directors at BNED's 2019 annual meeting of shareholders. The denial was based on Bay Capital's failure to become a shareholder of record of BNED's common stock by the June 27, 2019 nomination deadline as required under BNED's advance notice bylaw. Although Bay Capital submitted its nomination notice by the June 27 deadline, Bay Capital did not become a shareholder of record until June 28, 2019, one day after the deadline. In its ruling, the court upheld BNED's board of directors' decision to declare Bay Capital's nomination notice deficient due to its failure to be a record holder. The ruling demonstrates the court's willingness to uphold the validity of certain advance notice bylaws when they do not "unduly restrict the stockholder franchise" and are not "applied inequitably."¹ The decision also emphasizes the need for any shareholder that is considering nominating directors or submitting shareholder proposals to understand the concept of record ownership and the other requirements under the company's bylaws and to start the process to become a record holder well before the deadline.

Holding Shares in 'Street Name' Versus 'Record Name'

In *Bay Capital*, the court was unmoved by the arguments Bay Capital submitted for its failure to establish record holder status by the June 27, 2019 nomination deadline, particularly when Bay Capital's own advisers had repeatedly reminded Bay Capital of the nomination deadline and the need to be a record holder of BNED shares. The court noted that the principal of Bay Capital, despite receiving targeted advice on the matter, may not have understood the concept of holding shares in record name as opposed to holding the shares indirectly through a bank or broker in what is known as "street name." Whenever shares of a company are purchased, they are typically recorded in the name of the broker-dealer or bank intermediary — this is called owning shares in street name. Shares held in street name still entitle the acquiring party to the economic and voting rights associated with ownership of the securities, though indirectly through the intermediary who holds the shares directly on the company's record of shareholders. However, companies are often entitled to rely on their own books and shareholder register for making certain determinations when specified in the bylaws, and, in order to avail oneself of these rights, a shareholder may need to hold shares in "record name" on a company's books.

¹ *Openwave Sys. Inc. v. Harbinger Capital Partners Master Fund I, Ltd.*, 924 A.2d 228, 239 (Del. Ch. 2007).

To obtain record holder status, a shareholder must instruct its broker or banker to coordinate with a company's transfer agent (sometimes electronically via the Depository Trust Company) to transfer shares into record name, resulting in the shareholder appearing as a direct holder of shares on the company's register of shareholders. The process of transferring shares into record name typically takes some time once initiated, so it is usually prudent to transfer shares into record name well in advance of a nomination deadline to avoid the scenario that disqualified Bay Capital's nomination notice.

Conclusion

Because Bay Capital only began to acquire BNED shares three days before the nomination deadline, it was unable to coordinate the transfer of shares into record name until the day after the deadline. (Importantly, the court did not find that the company played any part in the delay of registering the shares in record name.) In denying Bay Capital's motion, the court stated:

"Needless to say, not even Delaware's strong public policy favoring the stockholder franchise will save Bay Capital from its dilatory conduct. Bay Capital blew the deadline. It then made up excuses for doing so. No record evidence suggests that the company is in any way at fault for that mistake. If this Court required the company to accept the nomination in these circumstances, advance notice requirements would have little meaning under Delaware law."²

The actions of Bay Capital ought to serve as a cautionary tale for all shareholders seeking to satisfy the requirements of an advance notice bylaw in order to make nominations or submit proposals. Shareholders would do well to plan ahead when undertaking the process so that they have the requisite time to fully comply with the requirements of a company's advance notice bylaws by the applicable deadline.

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If you have any questions concerning advance notice bylaws, owning shares in record name or this *Alert*, please contact your attorney at Schulte Roth & Zabel or one of the authors.

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² *Bay Capital Finance, LLC v. Barnes & Noble Education, Inc.*, at *14 (Del. Ch.; 8/19).