

Goodmans^{LLP} Update

Advance Notice By-Laws – A Canadian Shield

In *BlackRock Credit Allocation Income Trust v. Saba Capital Master Fund, Ltd.*, the Delaware Supreme Court recently provided guidance on the validity of supplemental disclosure obligations imposed on shareholders seeking to nominate potential directors in accordance with an issuer's advance notice by-laws. The Court held that two publicly traded, closed-end fund trusts advised by BlackRock Advisors, LLC, were not required to recognize individuals nominated for election by a dissident shareholder due to the shareholder's non-compliance with the trusts' advance notice by-laws (the "**By-laws**"). The shareholder submitted its nominations on time but failed to respond or object to the trusts' requests for additional information about the nominees within the five-day period imposed by the By-laws. The Court held that this failure invalidated the nominations based on the clearly stated response deadline in the By-laws notwithstanding the overly broad nature of many of the supplemental information requests.

The decision demonstrates that the Delaware Supreme Court is prepared to enforce advance notice by-laws in accordance with their terms, even if this means a shareholder is prevented from proceeding with an otherwise valid nomination due to a procedural technicality. Canadian courts have been more reluctant to allow issuers to use advance notice by-laws as a "sword" and might not reach the same conclusion in a similar fact pattern.

Background

The By-laws, which the trusts had adopted "on a clear day" (i.e., at a time when the trusts were not facing a potential proxy contest) set forth certain requirements for shareholders to nominate trustees to the boards of the trusts. In addition to imposing a deadline for making written nominations, the By-laws allowed the trusts to require that the shareholder supplement its nomination with any information "reasonably requested" by the trusts to establish that the proposed nominees satisfy the trustee qualifications enumerated within the By-laws. The supplemental information was required to be disclosed within five business days of the request.

Saba Capital Master Fund, Ltd., a shareholder of both trusts, delivered a trustee nomination notice before the trusts' 2019 annual meetings in compliance with the By-laws. The trusts demanded additional information from Saba through a 50-page questionnaire containing a mix of questions, with a significant number (but not all) of them directly relating to trustee qualifications.

Saba did not respond or object to the information request before the five-day deadline expired and, as a result, the trusts advised Saba that the nomination notice was invalid. It challenged the trusts' decision on the basis that many of the questions did not relate to the nominees' qualifications under the By-laws and that it should be excused from answering them because the questionnaire was overbroad. Before the annual meetings, Saba sought a court order from the Delaware Court of Chancery requiring its nominees be deemed eligible for election and their received votes counted.

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Lower Court Decision

The Delaware Court of Chancery held that the information sought by the questionnaire exceeded the By-laws' scope and was not, as required by the By-laws, "reasonably requested" or "necessary" to determine whether Saba's nominees met the requisite qualifications. The Court granted Saba's request for a preliminary injunction ordering votes for its nominees to be counted at the annual meetings.

Delaware Supreme Court Decision

On appeal, the Delaware Supreme Court reversed the injunction ordering the votes for Saba's nominees to be counted and found that Saba had an obligation to respond to the request before the deadline expired. Although there were questions in the questionnaire that were not tied to nominee qualifications, Saba failed to raise that concern in a timely manner. The Court held that Saba did not have the option to "stay silent, do nothing, and let the deadline pass" and then object to the propriety of the questionnaire after the fact. Recognizing that advance notice by-laws are commonplace, the Court did not want to set the precedent that "it is acceptable to simply let pass a clear and unambiguous deadline contained in an advance-notice by-law, particularly one that had been adopted on a 'clear day'" before the proxy contest. Such a precedent could frustrate advance notice by-laws, which "are designed and function to permit orderly meetings and election contests and to provide fair warning to the corporation so that it may have sufficient time to respond to shareholder nominations." Saba was required to respond and the trusts were within their rights to declare the nomination invalid.

Implications in Canada

The Delaware decision demonstrates the Delaware Supreme Court's willingness to uphold advance notice by-law provisions where they are unambiguous and were adopted on a "clear day" and not as a defensive tactic. However, the Court's decision should not be seen as allowing issuers to make overly broad or irrelevant supplemental information requests of nominating shareholders. In this case, because Saba failed to respond to the trusts' supplemental information requests before the deadline set out in the By-laws, the Court's decision did not turn on whether the trusts' 50-page questionnaire was proper or complied with the terms of the By-laws.

It is not clear that, faced with similar circumstances, a Canadian court would have allowed the trusts to reject Saba's nominees. While Canadian jurisprudence has endorsed the use of advance notice by-laws, our courts have also expressed concerns about them being used to strategically exclude nominations by dissident shareholders. For example, in *Orange Capital, LLC v. Partners Real Estate Investment Trust*, the Ontario Superior Court of Justice stated that advance notice by-laws "are intended to be a shield to protect shareholders or unitholders, as well as management, from ambush; they are not intended to be a sword in the hands of management to exclude nominations given on ample notice or to buy time to develop a strategy for defeating a dissident shareholder group". This suggests a Canadian court might have been inclined to allow Saba's nominations to proceed on the basis that the trusts' 50-page supplemental information request was overly broad and used as an obstructionist tactic rather than a genuine attempt to gather information necessary to evaluate the nominees' qualifications.

It is also notable that both the TSX and Canadian proxy advisors (ISS and Glass Lewis) have raised significant concerns about advance notice by-laws that impose onerous disclosure obligations on nominating shareholders. The TSX has indicated that advance notice by-laws will be contrary to its policies if they impose "unduly burdensome or unnecessary" disclosure requirements on shareholders or require the completion of questionnaires that go beyond what is required of company nominees.¹ Similarly, ISS and Glass Lewis may recommend voting against advance notice by-laws that include any excessive disclosure requirements. For example, ISS will generally not support advance notice by-laws that require nominating shareholders to provide information that goes beyond what is required in a dissident proxy circular or what is necessary to determine dissident nominee qualifications and experience in a manner consistent with what is required for management nominees.

¹TSX Staff Notice 2017-0001.

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Whether or not a Canadian court would have come to the same result, for dissident shareholders the decision in this case emphasizes the importance of scrupulously observing all requirements and deadlines set out in an advance notice by-law to reduce the likelihood the issuer can point to a technical “foot fault” as a basis for declining to recognize a nomination. For issuers, the case is a reminder that overly broad or irrelevant information requests of nominating shareholders are unlikely to be countenanced if challenged, particularly in Canada.

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