

Delaware Court of Chancery Enters Rare TRO Enjoining Annual Stockholder Meeting in Order to Protect Stockholder Voting Rights

BY EDUARDO GALLARDO, BRIAN LUTZ & AARON HOLMES

Eduardo Gallardo is a partner in the New York office of Gibson, Dunn & Crutcher LLP, where he focuses primarily on mergers and acquisitions and corporate governance. Brian Lutz is a partner in the New York office of Gibson, Dunn & Crutcher LLP, where he focuses primarily on securities litigation and corporate control litigation. Aaron Holmes is an associate in the New York office of Gibson, Dunn & Crutcher LLP, where he focuses primarily on mergers and acquisitions. Gibson, Dunn & Crutcher LLP represented Mr. Sherwood in this litigation and the related proxy contest. Contact: egallardo@gibsondunn.com, BLutz@gibsondunn.com or aholmes@gibsondunn.com.

On December 20, Vice Chancellor Donald Parsons of the Delaware Court of Chancery issued an important decision in *Sherwood v. Chan Tze Ngon*,¹ in which the Court granted the extraordinary relief of a temporary restraining order (TRO) to enjoin a public company from holding its annual meeting that was scheduled to take place later that day. The decision, which marks one of the few times that the Chancery Court has enjoined an annual stockholders' meeting, should serve as a reminder to practitioners and boards of directors that while Delaware law provides significant latitude for companies to create processes designed to facilitate orderly annual stockholder meetings and election contests, courts will not hesitate to craft appropriate relief when corporate actions infringe upon the stockholder franchise.

Case Background: A Disagreement among Directors Leads to Competing Slates

The *Sherwood* case arose out of a dispute between two directors of ChinaCast Education Corp., a for-profit Chinese education company incorporated under the laws of Delaware, who disagreed about the best way to advance the interests of ChinaCast's stockholders—Plaintiff Ned Sherwood, who controlled 7% of ChinaCast, and Defendant Ron Chan, who served as ChinaCast's Chairman and CEO. While Sherwood believed that ChinaCast should aggressively acquire its own stock under a Board-approved stock repurchase program, for example, Chan did not share this view.

Notwithstanding these disagreements, when ChinaCast began to prepare for its upcoming annual meeting, Sherwood was among the Company's Board nominees. On November 14, ChinaCast filed its definitive proxy statement for its 2011 annual meeting of stockholders, which included Sherwood on the Company's slate of directors and recommended that ChinaCast's stockholders reelect Sherwood to the Board. The November 14th proxy statement raised no concerns about Sherwood's suitability to serve as a director of ChinaCast.

Then, on December 8, the Board publicly disclosed for the first time that it had removed Sherwood from the Company's slate of nominees and no longer recommended his reelection. In its proxy materials, ChinaCast made assertions about Sherwood's character and claimed that he was not suitable to serve on the ChinaCast Board. The Board also announced the postponement of the 2011 annual meeting, previously scheduled for December 17 until December 21. The following day, Sherwood announced his intention to solicit proxies in favor of the election of a slate of directors that he would nominate at the annual meeting. However, as a result of ChinaCast's 11th-hour removal of Sherwood from the Company's slate and filing requirements under U.S. Securities and Exchange Commission (SEC) rules, absent a delay of the annual meeting, Sherwood could not solicit proxies from ChinaCast's stock-

holders in advance of the annual meeting—meaning that he would be precluded from running a competing slate of directors.

On December 15, Sherwood provided notice to ChinaCast, consistent with the company's advance notice bylaw, of his intention to nominate a slate of directors at the annual meeting. Based on the language of ChinaCast's bylaws, ChinaCast's December 8th public disclosure of the postponement of the annual meeting reopened the advance notice "window" for 10 days.

On December 12, Sherwood filed a verified complaint against ChinaCast and certain of its directors asserting, among other things, that ChinaCast's proxy materials contained false and misleading statements about him. In the complaint, Sherwood asserted that his removal from the company's slate was retaliatory in nature and resulted from his opposition to various actions taken by other Board members, including a slowdown of the company's publicly announced stock repurchase program. Thus, Sherwood asserted that the company's proxy statement filed on December 8, which accused him of various improprieties, failed to disclose the true reason the Board removed him from its slate: to silence an independent voice. Concurrently with his complaint, Sherwood filed for a TRO that, if granted, would enjoin ChinaCast from going forward with the scheduled annual meeting so that ChinaCast stockholders instead could consider: (1) additional disclosures that corrected the false and misleading statements about Sherwood in ChinaCast's proxy materials; and (2) Sherwood's competing slate of nominees.

The Court's Decision: Granting Relief to Protect Stockholder Voting Rights

In its 42-page opinion—issued just eight days after Sherwood filed his complaint and four days after oral argument on the TRO—the Court concluded that Sherwood had met the requirements for granting of a temporary restraining order: that the complaint asserted at least a colorable disclosure claim, that irreparable harm would re-

sult absent a TRO, and that the balance of harms weighed in favor of injunctive relief.

With respect to the existence of a colorable claim, Vice Chancellor Parsons concluded that there were at least two colorable disclosure claims raised in the complaint: (1) that ChinaCast had failed to disclose that its real reason for removing Sherwood from the slate of nominees was to "silence an independent voice"; and (2) that the ChinaCast proxy materials contained materially false and misleading statements about Sherwood's trading activity because the company did not disclose that the SEC had informed Sherwood that it was not conducting an investigation of his trading.

Vice Chancellor Parsons next found that Sherwood had adequately alleged that, absent a TRO, there would be irreparable harm. Specifically, given that "[t]he threat of an uninformed stockholder vote constitutes irreparable harm," (quoting *ODS Techs., L.P. v. Marshall*),² the existence of potentially false and misleading proxy materials was sufficient to satisfy the irreparable harm threshold. Moreover, because SEC rules would have effectively prevented Sherwood from soliciting proxies in connection with a meeting held on the scheduled date, the Court was persuaded that Sherwood adequately pled that the ChinaCast stockholders would be irreparably harmed absent an injunction because they would be prevented from considering a competing slate of directors.

Finally, with respect to the balance of equities, the Court noted that taking into account only Sherwood and the defendants, "the balance of equities is hard to discern and may very well be in equipoise." But what tipped the equities in Sherwood's favor, the Court concluded, was the interest of ChinaCast stockholders. Turning to the importance of the stockholder franchise under Delaware law, Vice Chancellor Parsons found that:

'[t]he corporate election process, if it is to have any validity, must be conducted with scrupulous fairness and without any advantage being conferred or denied to any candidate or slate of candidates. In the interests of corporate democracy, those in

charge of the election machinery of a corporation must be held to the highest standards in providing and conducting corporate elections.' Defendants have not simply expressed their disagreement with Sherwood's positions or dissatisfaction with his personal behavior; they have also excluded him from merely running for election.³

The Court concluded that, by removing Sherwood from ChinaCast's slate of nominees less than two weeks before the scheduled annual meeting, and effectively precluding him from running a competing slate of directors, defendant Chan and the other defendants did not "comport with the 'scrupulous fairness' required of corporate elections." Thus, the Court entered an order enjoining the ChinaCast annual meeting for 20 days so that Sherwood could solicit proxies in support of his slate of directors.

Conclusion

While corporations and their advisors still enjoy significant latitude under Delaware law to create mechanisms for the orderly running of annual meetings and elections, the *Sherwood* decision serves as an important reminder that corporations and boards must carefully monitor and comply with advance notice bylaw requirements and other timing mechanisms that impact the ability of stockholders to run competing director slates at annual meetings. The decision is also a reminder for all Delaware companies to routinely review their advance notice bylaws to ensure they unambiguously reflect the intent of the company and any other recent governance developments.

NOTES

1. *Sherwood v. Chan Tze Ngon*, 2011 WL 6355209 (Del. Ch. 2011).
2. *ODS Technologies, L.P. v. Marshall*, 832 A.2d 1254, at 1262 (Del. Ch. 2003).
3. *Sherwood*, at *15 (quoting *Aprahamian v. HBO & Co.*, 531 A.2d 1204, 1206-07 (Del. Ch. 1987)).

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