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PROXY FIGHT 'DO OVER' SPARKS DELAWARE DEBATE

The Delaware Court of Chancery's decision to give an activist a second chance to elect directors was equitable, but insurgent fund managers shouldn't assume they'll always get one.

BY JEAN HAGGERTY

A recent Delaware Court of Chancery ruling that gave an activist investor group a director-election "do over" may fan debate on the domicile's "predictability."

Delaware Vice Chancellor Bonnie W. David in a May 21 decision in Veton Vejseli, et al. v. Scott Duffy et al. ruled that Ionic Digital Inc. had to add back a board seat that it removed and reopen its nominations window for 10 days, even though the activists failed to adhere to the bitcoin mining company's advanced notice bylaws when they nominated two director candidates in February.

Ionic Digital's nomination window now closes on June 13, ahead of a July 1 annual meeting — and two board seats are open on the company's classified board.

In some ways Vice Chancellor David's ruling was "conventional" — mostly noteworthy for invoking a remedy used in the 1991 Hubbard v. Hollywood Park Realty Enterprises Inc. case, Lawrence Hamermesh, an emeritus professor at Widener University's Delaware Law School and an expert in the technical aspects of the state's corporate law, said.

But where Hamermesh and others see a demonstration of the Delaware court's ability to deliver quick, flexible and consistent decisions on shareholder rights, others might see further evidence of the jurisdiction's lack of predictability.

Historic District in the state's capital of Dover, Delaware

"The folks in Nevada and Texas that are vying for Delaware's business may try to seize upon it and say that this [decision] is an example of the [Delaware Chancery] court exercising equity in an unpredictable way," Rollo Baker, founding partner at Elsberg Baker & Maruri PLLC, said.

The court, Baker added, could have told the activists they didn't comply with the advance notice bylaws and thus they no longer were eligible to nominate directors. "On the other hand, others would say this is a good example of the Delaware Chancery Court applying equity in a common-sense way to avoid an inequitable result — otherwise the defendants would have benefited from what the court found to be fiduciary breaches," he explained.

The Backstory

Last August, some shareholders started publicly expressing frustration with Ionic Digital's leadership because they felt that the company, which emerged from the bankruptcy of cryptocurrency lender Celsius Network LLC, was slow to list its shares.

Then, in February, Ionic Digital shareholders Tony Vejseli, Chris Villinger and Brett Perry launched a contest pitting dissident candidates Oliver Wiener and Michael Abbate against board chair Elizabeth La Puma and a vacant seat.

Ionic, on March 3, rejected the activists' nomination notice, on grounds that it didn't comply with its advance notice bylaws. Specifically, it argued that the activists failed to attach a copy of the funding agreements between the dissident shareholders and the non-stockholders financially supporting them.

On March 5, the activist group filed a class action complaint in Delaware Court of Chancery alleging that Ionic Digital's board breached their fiduciary duty because they reduced the size of the company's board by one without disclosing it and then calling its annual meeting, which set in motion the 10-day timeline for nomination submissions.

The Big Picture

While the case included an unusual set of facts, none of them change the big picture, experts said. "And that is that you can't fool around with the electoral machinery," Hamermesh said, adding that the board reduction wasn't done on a "clear day."

In the broader context, the court's decision to give the activist a second chance was equitable — but activists shouldn't assume they'll always get one, explained Lawrence Cunningham, director of the Weinberg Center for Corporate Governance.

Vice Chancellor David's opinion underscores that, while Delaware continues to uphold the stability and legitimacy of advance notice bylaws, those protections aren't absolute, he added.

"The court found that the incumbent board breached its fiduciary duties by reducing the size of the board for pretextual reasons aimed at frustrating the activist's efforts — and, by extension, the shareholder franchise," Cunningham added.

While the activist did fail to comply with the letter of the advance notice bylaw, including the disclosure of arrangements and understandings with third parties, the court concluded that denying the activist a second chance would, in effect, allow a breaching board to dictate who can and cannot stand for election, Cunningham explained. That outcome, as the court put it, would have "let a breaching board determine who can be voted on," he said.

The court's decision is a reminder to companies that they need to be thoughtful about the records they build and that when they take action that could be construed as defensive measures, explained Pallas Partners LLP partner Shireen Barday.

Baker said it was a bit surprising that the company didn't settle. "I'm sure that the directors viewed their advance bylaw argument as strong and [that] the activists believed their fiduciary breach claim, based on the board reduction resolution, was likewise strong," he said.

One lesson from the decision is that if directors are considering reducing the number of board seats up for election for legitimate corporate reasons, such as to reduce expenses or to avoid a potential deadlock caused by an even number of board seats, they should do so on a "clear day," with appropriate documentation, "rather than in the thick of an activist campaign and then offer post hoc explanations," he said.

The activists, meanwhile, lost their argument on the validity of their nominations notice, Barday said. That should serve as a reminder to activists that they should disclose all material agreements as directed by the bylaws and that the court isn't going to accept "these very technical arguments" about agreements superseding each other and how that explains why the activist disclosed only one agreement, she continued. "The court expects you to give a full and complete packet of information," she said.

According to Hamermesh, the proxy fight "do over" remedy Vice Chancellor ordered isn't particularly disruptive. The idea behind it seems to be to get things back to where they should have been had all parties behaved as they should have, he added. ■

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