

INSIGHTS

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The Bylaw Groundswell: Advance Notice Provisions in the Wake of CSX

Companies are rushing to amend their bylaws' advance notice provisions before the 2009 proxy season. Outdated securities regulations, in combination with recent pro-shareholder judicial decisions, have spurred companies to take matters into their own hands to protect themselves from activist shareholder tactics. The Second Circuit's holding in CSX Corporation v. The Children's Investment Fund is the most recent in the line of judicial decisions that have catalyzed advance notice revisions.

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The September 15, 2008, decision from the Second Circuit Court of Appeals requiring CSX Corporation to seat the proxy-elected board members nominated by the Children's Investment Fund (*CSX II*) reaffirms for companies that they may not be able to rely on the judiciary or their existing bylaws to prevent activist shareholders from ambushing their boards with proposals and director nominations.¹ These types of proxy battles waged by hedge funds have been successful approximately 60 percent of the time, based on demands disclosed in initial Schedule 13D filings and there are over 75 hedge funds

dedicated to this event-driven, activist-style of investing.² In total, these funds manage more than \$50 billion (US) in assets, and their "wolf pack" behavior enhances their resources.³ The possibility of losing control of the company's future business decisions should be of paramount importance to boards, especially in the context of recent jurisprudence.

Background

The Securities Exchange Act of 1934 and federal securities regulations fail to require shareholders to disclose their true ownership interests in companies. In addition, activist funds have shown little regard for the spirit of the regulations in their quest to mold corporate activities to their agendas. These funds have used a deficiency in Rule 13d-5(b): The definition of "beneficial ownership," is less than comprehensive in identifying: (1) what constitutes the formation of a "group" of shareholders who act in concert; and (2) what disclosable interests accompany derivative positions.⁴ When coupled with a disregard for advance notice provisions and the unclear scope of Rule 14a-8 (the shareholder proposal rule), activist funds have powerful tools to veil the strength of their positions until immediately before taking action.⁵

The manner in which federal securities regulations have permitted the indirect accumulation of significant ownership positions and tacit agreements among shareholders provides little solace to companies who want to avoid expensive and protracted proxy battles. In addition, the Delaware judiciary is recently on record as construing ambiguities in corporate bylaws in favor of shareholders and their proposals.⁶ Companies are left with one avenue to protect

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