

Client Alert

February 2018

Olshan Client Awarded its Attorneys Fees in Suit to Protect Shareholder Nomination Rights

Olshan client, the Stilwell Group, received an award of attorneys fees from the Delaware Chancery Court on February 7, 2018 in connection with its successful challenge to a corporate bylaw limiting director eligibility. The Court's ruling provides some significant guidance on bylaws that establish director qualifications as well as how a Board should (or should not) respond to a director elected through an activist campaign.

Stilwell Group ran a successful proxy contest at HopFed Bancorp, Inc. (the "Company") in 2013, electing Robert Bolton to the Board for a three-year term. In 2015, the Board adopted a "director disqualification" bylaw that rendered certain classes of persons ineligible to serve as directors. It also barred from service any person nominated by a "disqualified" shareholder. In May 2017, our client filed suit in Delaware Chancery Court challenging the bylaw on its face as overbroad and irrational and also arguing that the bylaw represented an unlawful attempt to disenfranchise Stilwell Group, in particular. After months of expedited proceedings, the Company amended the bylaw to address much of the criticism voiced by Stilwell Group. A motion for attorneys fees followed, which was granted in its entirety.

In its ruling, the Court described the original bylaw as a "truly flabbergasting amendment to the company's bylaws that had the effect of disenfranchising entire classes of stockholders from nominating or supporting otherwise qualified candidates." The bylaw had two levels of disqualification. First, the bylaw barred from service any person who lacked banking expertise; had been subject to an enforcement order issued by a financial or securities regulatory agency; or had been convicted of a felony involving dishonesty. Second, the bylaw disqualified any candidate who was nominated by a shareholder who was not eligible to serve on the Board. The infringement on a shareholder's right to nominate an independent, qualified candidate was perhaps the most disturbing aspect of the bylaw. The scope of the bylaw also contained distinctions that made no sense, such as barring individuals subject to consent decrees that might be over a decade old, and barring some types of criminal conduct (fraud) while allowing others (violent crimes). In the amended bylaw, the

Company cleared up these distinctions and also limited the restriction on nominations to persons under the control of a disqualified shareholder.

The Court also offered some colorful language to describe the Board's conduct in responding to Mr. Bolton's election in 2013. Once elected, the Board marginalized Mr. Bolton with conduct that the Court described as "a rather childish series of actions . . . that really should have been embarrassing to them." This included belittling Mr. Bolton behind his back, refusing to reimburse his out of pocket expenses and multiple investigations into his role as a director. In one inquiry, a Board committee examined whether Mr. Bolton was eligible to remain on the Board, conduct that the Court described as "reprising the House Committee on Un-American Activities." After three years of maltreatment, which the Court compared to the "Stanford prison experiment," Mr. Bolton did not run for re-election.

The Court also noted that at the same time, the Board "used corporate funds to repurchase stock at a premium from the second largest outside stockholder" with a "facially potentially entrenching" motive that was "facially consistent with greenmail," and created an ESOP holding a large voting bloc under insider control. The Board's conduct throughout displayed an overall pattern that "supported a very strong inference of bad faith and entrenchment and disloyalty." The Court also criticized as "discourteous, disrespectful and unnecessary" and a "gratuitous power trip" the Board's response to a Section 220 Demand by Stilwell Group in which it required Stilwell Group to travel to Kentucky to view corporate records and asked them to copy the materials by hand.

Please contact Thomas J. Fleming, a Partner in the Litigation Group, or Steve Wolosky or Andrew Freedman, Co-Chairs of the Activist & Equity Investment Group, if you would like to discuss further or have questions regarding this matter.

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