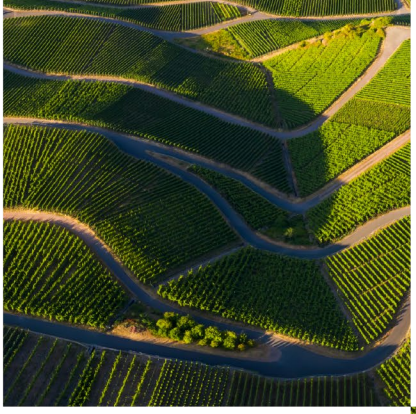

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Shareholder Activism Update: Delaware Supreme Court Strikes Improper Advance Notice Bylaws in *Kellner*

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Delaware Supreme Court Rules Bylaws Unenforceable, Highlighting Judicial Skepticism Toward Overbroad and Unreasonable Advance Notice Provisions

On July 11, 2024, the Delaware Supreme Court in *Ted D. Kellner v. AIM ImmunoTech Inc., et al.*, No. 3, 2024 (Del. Jul. 11, 2024) ("*Kellner*") unanimously struck down several controversial advance notice bylaw provisions that had been wielded by AIM ImmunoTech Inc. ("AIM") to thwart a stockholder's proxy contest and impede its right to nominate directors, finding that the AIM board of directors breached its fiduciary duty of loyalty in adopting the unreasonable bylaws.

The court also took the opportunity to clarify the appropriate standards of review in challenges to advance notice bylaws, distinguishing between two types of challenges:

1. *Facial validity challenges*: whether a bylaw is consistent with the law and a corporation's certificate of incorporation, and if it addresses a proper subject matter; and
2. *Enforceability challenges*: whether a bylaw is enforceable under the circumstances.

The decision reinforces — and perhaps broadens — a judicial skepticism we saw previously with *Politan Capital Mgmt. L.P. v. Kiani*, C.A. No. 2022-0948-NAC (Del. Ch. Oct. 21, 2022) ("*Masimo*"), where the Delaware Chancery Court was poised to reject overaggressive and overbroad advance notice provisions designed to preclude stockholders from making legitimate director nominations.

We believe *Kellner* serves as a warning to companies who wish to adopt bylaws that are not only unreasonable but are also convoluted and "unintelligible," and we expect the decision to serve as a basis for new challenges to advance notice bylaws at companies that fail to heed to the lessons of the Delaware Supreme Court.

Background

Kellner has a fraught history stretching back to 2022, when AIM rejected an activist's nomination notice for failing mention any arrangements or understandings amongst a "nameless group [who] was working together" to launch a proxy contest.[1] That nameless group also included Ted Kellner, a "sophisticated investor with a substantial number of AIM shares."[2] After a lawsuit ensued, Vice Chancellor Will effectively upheld the rejection by the Board in a memorandum opinion.[3] AIM then amended its bylaws to adopt "sweeping new advance notice provisions,"

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[1] *See* *Jorgl v. AIM ImmunoTech Inc., et al*,. 2022 WL 16543834 (Del. Ch. Oct. 28, 2022) ("*Jorgl*").

[2] *See* *Ted D. Kellner v. AIM ImmunoTech Inc., et al.* 307 A.3d 998 (Del. Ch. Dec. 28, 2023) ("*Kellner 2023*").

[3] *See* Jorgl.

couching several defensive changes to its 2016 bylaws' advance notice provisions amongst changes purportedly made in response to the SEC's adoption of the universal proxy card rules.[4]

A year later, in early August 2023, Ted Kellner submitted his own nomination notice, which the Board rejected for, among other things, failing to disclose "agreements, arrangements, and understandings" between and among Kellner and others and failing to disclose "known supporters" of Kellner's nominations. Kellner then sued in the Delaware Court of Chancery, claiming that some of the newly-adopted advance notice bylaws were invalid.[5]

The Chancery Court's Review of the Challenged Bylaws

The Chancery Court's December 2023 decision largely focused on the validity of six particular bylaws that AIM adopted in 2023:

1. **Daisy-Chain AAU Provisions**: The 2023 bylaws required disclosure of all arrangements, agreements or understandings ("AAUs"), "whether written or oral, and including promises," relating to a board nomination with persons "acting in concert" with a nominating stockholder or with certain "Stockholder Associated Persons."
2. **Consulting/Nomination Provision**: The 2023 bylaws required disclosure of AAUs between or among the nominating stockholder party and/or any Stockholder Associated Person to "consult or advise on any investment or potential investment in a publicly listed company" as well to formally or informally nominate their nominees to any publicly listed company in the past ten years.
3. **Known Supporter Provision**: The 2023 bylaws required the names and contact info of other stockholders known to support the nominations or any of the nominating stockholder's proposals.
4. **Ownership Provision:** The 2023 bylaws included a 1,099-word run-on sentence with 13 subsections, requiring convoluted disclosures, including, among other things, disclosure of interests in "any principal competitor" of AIM.
5. **First Contact Provision**: The 2023 bylaws required disclosure of the date of first contact between the stockholder (and any Stockholder Associated Person) and its nominees regarding AIM or the nominations.
6. **Questionnaire Provisions**: The 2023 bylaws required nominees to complete the Company's form of director & officer questionnaire.

The Chancery Court found that four of the six challenged bylaws were unenforceable: (1) the Daisy-Chain AAU Provision, which was "more akin to tripwire than an information gathering tool"[6] and which, together with the Stockholder Associated Person definition, resulted in vague and overbroad disclosure requirements ripe for subjective interpretation by the board; (2) the Consulting/Nomination Provision, the Known Supporter Provision, and the Ownership Provision

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[4] *See* Kellner.

[5] *See* Kellner 2023.

[6] Id.

to be either ambiguous, onerous, "indecipherable,"[7] or a combination of the three. The Chancery Court found that the First Contact Provision and the Questionnaire Provisions, unambiguous, reasonable and enforceable. Both Kellner and AIM appealed the decision.

The Supreme Court's Decision

The Delaware Supreme Court reinforced that advance notice bylaws are intended to provide boards of directors with prior notice of, and information about, stockholders' director nominations in order assist boards with "information-gathering and disclosure functions."[8] It also articulated stockholders can raise two distinct types of challenges to bylaws: (1) facial validity and (2) enforceability, and proceeded to analyze AIM's challenged 2023 bylaws under this framework.

Facial Validity Challenge: Is the bylaw valid and intelligible?

When a validity challenge is raised, the Delaware Supreme Court noted that bylaws are presumed to be valid so long as they are not contrary to law or the company's certificate of incorporation and address a proper subject matter. To challenge to the validity of an advance notice bylaw, a stockholder must demonstrate that the bylaw cannot be valid under *any* circumstances. For this analysis, a court will not consider hypotheticals or speculate whether a bylaw might be invalid under a certain fact pattern. For this reason, the Supreme Court found all of the 2023 bylaw provisions valid except for the convoluted Ownership Provision, which was "excessively long" and contained "vague terms" that imposed "virtually endless requirements on a stockholder seeking to nominate directors."[9]

Enforceability Challenge: Is the adoption, amendment or enforcement of a bylaw properly motivated and reasonable under the circumstances?

The Delaware Supreme Court clarified that a board's adoption, amendment or enforcement of advance notice bylaws during a proxy contested would be subject to heightened scrutiny if challenged under the two-step test recently described in *Coster v. UIP* 300 A.3d 656 (Del. Jun. 28, 2023) ("*Coster*").

1. Under the first step, the board must have faced an actual threat to an important corporate interest or the achievement of a significant corporate benefit, and its motivations must be proper and not selfish or disloyal. The fact that a board thinks it knows what is in the best interest of stockholders is not a sufficient justification.
2. If a board's actions pass this first step of analysis, then a court will consider whether the advance notice bylaws are "reasonable" (and limited to only what is necessary) in relation to the specific threat posed and not preclusive or coercive to the stockholder franchise.

The Delaware Supreme Court found that AIM's 2023 bylaws failed to meet the first step of this test, and therefore all of the new advance notice provisions in the 2023 bylaws were unenforceable. The court found that the bylaws were motivated by an improper purpose — to

[7] Id.

[8] *See* Kellner 2023.

[9] *See* Kellner.

interfere with Kellner's nomination notice, reject his nominees, and maintain control. This was an impermissible breach of the board's duty of loyalty.

Regardless, the Delaware Supreme Court's opinion upheld the Chancery Court's rejection of Kellner's nomination notice, in large part because Kellner submitted "false and misleading responses" to certain information requests.

Observations and Takeaways

The Delaware Supreme Court's decision is not terribly surprising. As the Chancery Court observed in December 2023, Delaware courts accept that activism now takes place in an age of "second generation bylaws" where advance notice provisions contain onerous mandates for complex disclosure for information such as: stockholder derivative positions, the identities and stockholdings of "Stockholder Associated Persons" and persons "acting in concert," and they often also require nominees to complete lengthy nominee questionnaires with laserlike precision. As new regulations give companies a convenient reason to take a fresh look at their advance notice bylaws and as activism case law develops, we expect to see companies take bolder steps with advance notice bylaws unless checked by the threat of litigation.

Kellner provides some helpful guidance on the outer bounds of what types of advance notice bylaws are invalid or unenforceable. Given that courts will generally presume bylaws to be valid, we expect future challenges to most focus on "enforceability" challenges. And as a result of the Supreme Court's decision, we expect many companies with bylaw provisions similar to the Daisy-Chain AAU Provisions, Consulting/Nomination Provision and Known Supporter Provision to remove or pare back such bylaws to address some of the concerns raised in *Kellner*.

We anticipate that this decision will also serve as the basis for new challenges by activists to other advance notice bylaws, including those that implicate the second step of Coster's two-step test. As it stands, Delaware judges have yet to fully grapple with how specific bylaw provisions should be properly tailored to what is necessary to ensure transparency in board elections.

In the meantime, stockholders should carefully evaluate how to properly comply with increasingly complex advance notice bylaws and how to position best position themselves for legal challenges relating to bylaws and nominations.

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If you have any questions concerning this *Alert*, please contact your attorney at Schulte Roth & Zabel or one of the authors.

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