

## Delaware Supreme Court Provides Guidance on Advance Notice Bylaws



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On July 11, 2024, the Delaware Supreme Court clarified the proper standard of review for challenges to a board's adoption of advance notice bylaws during a proxy contest. The *Kellner v. AIM ImmunoTech Inc.* decision should inform how both issuers and stockholders evaluate advance notice bylaw amendments that may impact contested nominations and director elections.

The specific dispute arose from AIM ImmunoTech Inc.'s ("AIM") rejection of a stockholder's nomination notice of director candidates for election to AIM's board in 2023. AIM had been targeted by stockholder activists in 2022 as well, and, since that earlier contest, AIM had adopted advance notice bylaws that required detailed disclosures in any stockholder nomination notice, including detailed information regarding the nominating stockholder's relationships. AIM's incumbent board subsequently rejected a stockholder nomination notice as failing to comply with the new bylaws. Kellner, on behalf of the nominating stockholders, challenged the validity of the bylaws and the AIM board's rejection of the nomination notice.

The Court of Chancery found that certain of the newly-adopted advance notice bylaws were invalid and that the bylaw amendments were not adopted on a "clear day" but ultimately sided with AIM in its rejection of the nomination notice. On appeal, the Delaware Supreme Court applied a different, two-step analysis to the challenged bylaws, first looking at whether the new bylaws are invalid on their face and then determining whether enforcement of the bylaws would be equitable in the context of the circumstances in which they were adopted, a test which itself involves two parts. Applying this analysis, the Delaware Supreme Court found just one of the advance notice bylaws facially invalid but that *all* of the challenged bylaw provisions were unenforceable under the second equitable analysis. The Delaware Supreme Court declined to provide Kellner any relief in connection with the rejected nomination notice, but the decision clarified the appropriate framework for assessing a challenge to the validity of advance notice bylaws in the context of an ongoing proxy contest. Specifically, the Delaware Supreme Court distinguished between the evaluation of a bylaw's general legal validity and, as applied in a particular controversy, a further equitable test, which separate analyses the Court of Chancery had conflated.

***Facial Validity:*** Challenges to an advance notice bylaw's validity turn on "whether the bylaw is contrary to law or the certificate of incorporation and addresses a proper subject matter" rather than equitable concerns about the potential for such bylaw's misuse (which is a separate analysis, discussed below). In such analysis, bylaws are "presumed to be valid" and the burden is on the plaintiff to demonstrate that the challenged bylaw cannot be lawful under any circumstance.

The Delaware Supreme Court concluded that all but one of the challenged advance notice bylaw provisions were *facially* valid. The invalid bylaw pertained to a required disclosure regarding ownership by the nominating stockholder of AIM and its competitors, a "1,099-word single-sentence" with "thirteen discrete parts." This provision was "indecipherable," and, as unintelligible bylaws are invalid "under any circumstances," such bylaw was invalid. The other advance notice bylaws were

found not inconsistent with Delaware's broad statutory authorization with respect to corporate bylaws or with AIM's certificate of incorporation.

Equitable Analysis: A separate question is whether the remaining advance notice bylaws were enforceable as a matter of equity in this particular circumstance. In line with Delaware caselaw involving challenges to corporate acts that affected stockholder voting in contests for corporate control, the Delaware Supreme Court applied the enhanced scrutiny standard to the adoption of the advance notice bylaws, as articulated in *Coster v. UIP Companies, Inc.*: "If a board adopts, amends, or enforces advance notice bylaws during a proxy contest," then the action is subject to a two-part test:

1. The court should determine "whether the board faced a threat to an important corporate interest or to the achievement of a significant corporate benefit. The threat must be real and not pretextual, and the board's motivations must be proper and not selfish or disloyal" — meaning for the primary purpose of precluding a challenge to a board's control (bylaws that are so adopted are "inequitable and unenforceable").
2. If a real threat existed and the board was properly motivated in responding, the court should then consider "whether the board's response to the threat was reasonable in relation to the threat posed and was not preclusive or coercive to the stockholder franchise."

Applying this two-part test, the Delaware Supreme Court found that the AIM board's conduct failed the first prong of *Coster's* enhanced scrutiny equitable review. The decision relied on the Court of Chancery's findings regarding the AIM board's motivations for adopting certain of the contested advance notice provisions — that the adoption suggested an intent to block the dissident, and that the provisions were akin to a tripwire and could be draconian in effect. "The unreasonable demands of most of the [newly adopted bylaws] show that the AIM board's motive was not to counter the threat of an uninformed vote." Therefore, the Delaware Supreme Court reasoned, the AIM board "amended its bylaws for an improper purpose, to thwart Kellner's proxy contest and maintain control" and therefore none of the newly adopted advance notice bylaws could be equitably enforced.

Despite this conclusion as to the unenforceability of the new bylaws (and separately that one was facially invalid), the Supreme Court failed to offer any relief to Kellner with respect to the AIM board's rejection of the nomination notice, principally on grounds that Kellner also engaged in improper conduct. Here, the decision relied on the "countervailing" findings of the Court of Chancery with respect to the plaintiff's and the nominee's "deceptive conduct" — specifically that "Kellner submitted false and misleading responses" in the nomination notice and, therefore, the Supreme Court determined that no further action was warranted.