

# Sunshine Breaking Through the Clouds: Delaware Supreme Court Sheds Light on Standard of Review for Challenges to Advance Notice Bylaws

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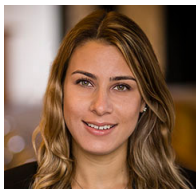
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On July 11, 2024, the Delaware Supreme Court issued a long-awaited decision regarding the validity and enforceability of certain provisions in a company's advance notice bylaws. The *Kellner v. AIM Immunotech Inc.*, No. 3,

2024, 2024 Del. LEXIS 236 (July 11, 2024) decision clarifies how the Delaware courts will evaluate claims challenging an advance notice bylaw. Critically, it confirms that different standards attach when a plaintiff challenges (i) the language of a company's bylaw (a so-called facial or validity challenge) in the abstract, absent a proxy contest versus (ii) a board's decision to adopt, amend, or enforce an advance notice bylaw during a proxy contest (a so-called as-applied challenge). This decision provides helpful guidance to practitioners and will hopefully limit the wave of facial challenge litigation that followed the *Kellner* trial court ruling.

## Background

As outlined in our [prior post](#) regarding the trial court's decision, *Kellner* is the product of a years-long dispute and multiple proxy contests at the same company. In 2022, AIM Immunotech Inc. (AIM) received a nomination notice that was ultimately rejected by AIM's board of directors (the Board) for failure to comply with federal securities laws. That itself led to litigation, in which the company largely prevailed. After that rejection, certain involved stockholders resolved to pursue another proxy campaign in 2023. In early 2023, the Board, anticipating that proxy contest in connection with the upcoming meeting, adopted a number of amendments to AIM's advance notice bylaws.

Months later, *Kellner* submitted the anticipated nomination notice. The Board, advised by counsel, identified several deficiencies therein. After meeting three times, the Board rejected *Kellner*'s nomination notice. *Kellner* filed claims, arguing that (i) certain of AIM's amended advance notice bylaw provisions were facially invalid and (ii) even if the provisions were valid, they had been applied inequitably to reject *Kellner*'s nomination notice.

## The Court of Chancery Decision

The Court of Chancery found that (i) certain elements of the advance notice bylaw provisions were invalid because they “inequitably imperil the stockholder franchise to no legitimate end,” but (ii) the Board’s rejection was nevertheless ultimately proper because Kellner’s nomination notice did not comply with other, valid advance notice bylaw provisions.

On the first, the Court of Chancery held that four provisions—(i) the agreement, arrangements, and understanding provision, (ii) the consulting/nominating provision, (iii) the known supporter provision, and (iv) the ownership provision—were unenforceable. In so holding, the trial court applied enhanced scrutiny, Delaware’s intermediate standard of review. This was because the Board amended AIM’s advance notice bylaws on a “cloudy day,” rather than a “clear day” (i.e., a proxy contest was known to be imminent). Two other provisions survived enhanced scrutiny review: the “first contact” and questionnaire provisions, which the court held reflected a proper objective and were not overly burdensome.

On the second, after invalidating those portions of the amended advance notice bylaw provisions, the Court of Chancery affirmed the Board’s rejection of the nomination notice for its failure to comply with AIM’s other advance notice bylaw provisions. The trial court held that the stockholder had failed to be forthright and provide required information (e.g., the date that the stockholder contacted others regarding the planned nomination pursuant to the “first contact” provision). The trial court consequently concluded that the stockholder had failed to provide required information, and that the Board had acted reasonably in rejecting the nomination notice.

## The Appeal

On appeal, Kellner argued that the Court of Chancery erroneously invalidated his nomination notice by concluding that certain bylaw amendments satisfied enhanced scrutiny and that the notice had not complied with them. On cross-appeal, AIM contended that the trial court (i) “misconstrued Kellner’s as-applied challenge as a facial challenge,” (ii) erred in invalidating certain advance notice provisions by applying enhanced scrutiny instead of presuming that the bylaws were valid and requiring Kellner to demonstrate that the bylaws were facially invalid, and (iii) erred by finding that four advance notice provisions failed enhanced scrutiny review.

## The Supreme Court’s Decision

The Supreme Court reiterated the important purpose of advance notice bylaws: “They are designed and function to

permit orderly meetings and election contests and to provide fair warning to the corporation so that it may have sufficient time to respond to shareholder nominations.” In doing so, advance notice provisions “assist the board’s ‘information-gathering and disclosure functions.’”

The Court then clarified the two standards of review potentially applicable to an advance notice bylaw challenge depending on whether the challenge is facial or as applied.

### Facial Challenges: Bylaws are Presumed to be Valid

At the outset, the Court reiterated that “bylaws are ‘presumed to be valid’ and must be interpreted ‘in a manner consistent with the law.’” This means that when challenging a bylaw’s validity in the abstract, without reference to any set of facts surrounding an ongoing proxy contest (the proverbial “clear day”), a plaintiff must show “that the bylaw cannot operate lawfully under any set of circumstances.” In the context of Kellner’s challenge, the Court of Chancery should have presumed that the advance notice bylaws were valid, and should not have entertained “hypotheticals or speculate[d] whether the bylaw might be invalid under certain circumstances.” Otherwise stated, in a facial challenge, if there is *any* “but for” scenario where the challenged bylaw may operate appropriately, the bylaw is valid and the claim should be dismissed. This holding will hopefully abate the rash of litigation commenced in the wake of the trial court’s decision challenging the plain language of advance notice bylaws in the absence of a proxy contest.

On this basis, the Supreme Court concluded that all but one of the challenged bylaw provisions were facially valid. The exception pertained to the ownership provision: a “1,099-word single-sentence” with “thirteen discrete parts.” Here, the Supreme Court agreed with the Court of Chancery: the term was “indecipherable,” and therefore could not be understood and complied with “under ‘any circumstances.’”

### Equitable Challenges: Enhanced Scrutiny Review

The standard changes, however, when a proxy contest is ongoing (the proverbial “cloudy day”). “If a board adopts, amends, or enforces advance notice bylaws during a proxy contest,” then the analysis is governed by the enhanced scrutiny standard as articulated by the Supreme Court most recently in *Coster v. UIP*. This is a two-part test:

1. First, 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.”
2. Then, the Court should 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 higher standard to the facts and circumstances of the case, the Court affirmed the Court of Chancery’s decision regarding the three remaining bylaws held to have been unreasonably adopted. Namely, the Supreme Court agreed that, on these facts, the Board “amended its bylaws for an improper purpose, to thwart Kellner’s proxy contest and maintain control” and therefore certain portions of those amendments were unenforceable.

## **The Result? Nevertheless, an Invalid Nomination Notice**

Although the Supreme Court held that enhanced scrutiny rendered portions of the bylaw amendments inequitable and unenforceable, Kellner still lost the proverbial war.

The Court agreed that Kellner had “submitted false and misleading responses” to valid portions of the advance

notice bylaws. Because of that deceptive conduct, the nomination notice was invalid, and therefore the Supreme Court determined that the case was properly dismissed and no further action was warranted with respect to Kellner’s nomination notice. In so holding, the Court offered a good reminder of the “clean hands” doctrine: a plaintiff who seeks equity must do so with clean hands.

## **Conclusion**

*Kellner* provides helpful clarification of the standards that will be applicable to companies evaluating their current bylaws or considering bylaw amendments. This includes the important distinction in the standard of review depending on whether a plaintiff is challenging a bylaw based on its plain language alone, versus the adoption or application of a bylaw during an ongoing proxy contest. In light of *Kellner*, public companies would be well served to evaluate their advance notice bylaw provisions with counsel.

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BETH BERG has nearly 25 years of experience advising public and privately held companies and boards of directors with respect to public and private mergers and acquisitions, spinoffs, corporate governance, and SEC disclosure matters. In addition, Beth has an active practice advising companies in connection with shareholder activism, proxy contests, and unsolicited tender offers/takeover defense.

Beth stands out for the breadth of her experience and versatility in an era of increasing specialization. She has a talent for presenting complicated matters simply and succinctly and prides herself on taking a practical approach as she guides clients through their most complex M&A, shareholder activism, and other challenges.

Beth has been recognized nationally for her work. She was noted as a key lawyer in the firm’s Tier 1 ranking for Shareholder Activism in *Legal 500* 2023 United States edition. She was named to *The Deal’s* 2022 “Women in Dealmaking” list in May 2022 and *The Dealmaker Quarterly’s* annual “Top Women in Dealmaking” list in January 2021. She was also honored on the 2020 “Notable Women in Law” list by *Crain’s Chicago Business*.

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CHARLOTTE NEWELL focuses her practice on the representation of companies, boards of directors, and senior management in litigation concerning mergers and acquisitions, shareholder activism, corporate governance disputes, and class and derivative actions alleging breaches of fiduciary duty. She regularly collaborates with members of the firm’s activism and corporate defense, investment funds, M&A, and private equity teams, and counsels boards of directors on a variety of corporate governance and litigation issues.

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Charlotte received her B.A. from the Schreyer Honors College at The Pennsylvania State University and her J.D. *magna cum laude* from the University of Pennsylvania, where she was an associate editor for the *Journal of Business Law* and received the Oscar Bregman Prize for Excellence in the Field of Business Law. After law school, Charlotte was a law clerk for the Honorable J. Travis Laster, Vice Chancellor of the Delaware Court of Chancery.

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