Delaware Court Partially Upholds, Partially Invalidates Advance Notice Bylaws

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The Delaware Court of Chancery in *Kellner v. AIM Immunotech et al.*, C.A. No. 2023-0879-LWW (Del. Ch. Dec. 28, 2023), upheld in part and invalidated in part bylaws requiring advance notice of stockholder nominations for a contested election of directors. The case, which according to the court "hints at what coming activism disputes may bring," arose from the efforts of a dissident group of stockholders of AIM Immunotech, a microcap pharma company, to elect directors at AIM's 2023 annual meeting.

The dissident group, which at various times included both a minority owner of an NBA team and a convicted felon who had been permanently enjoined from contacting AIM's business relations, sought to elect three directors to AIM's four-member board at AIM's 2023 annual meeting. The nominations followed a 2022 election effort by some members of the dissident group, which had been stymied by AIM's assertion that they failed to comply with the company's advance notice bylaws—in particular, a bylaw requiring disclosure of arrangements or understandings pursuant to which nominations were to be made. According to the court, it seemed that the nominating stockholder in 2022 was a "facade concealing the identities of individuals responsible for the effort."

The dissidents were again thwarted in 2023 after AIM beefed up its advance notice bylaws and rejected the new nominations for failing to comply with their heightened requirements. AIM's board rejected the dissidents' 2023 nomination notice on the grounds of undisclosed agreements, arrangements and understandings among members of the group; failure to disclose known supporters of the nominations; failure to disclose specific dates of first contact among relevant parties; and failure to disclose other required information, including adverse recommendations from proxy advisors concerning other public company board service.

The Court of Chancery reviewed the bylaws under a *Unocal* analysis, evaluating whether AIM's board faced a threat to an important corporate interest or to the achievement of a significant corporate benefit and whether the board's response was reasonable in relation to that threat and not preclusive or coercive to the stockholder franchise.

At the outset, the court noted the salutary functions served by advance notice bylaws in terms of promoting order and disclosure while acknowledging that "onerous bylaws that stray far afield from these purposes risk frustrating any nomination of alternative director candidates." It observed that many companies have used the occasion of the SEC's adoption of Rule 14a-19, requiring universal proxy cards in contested elections, to revamp their advance notice bylaws—but that some companies "have gone to extremes." Finally, it noted that Delaware courts have been particularly deferential to advance notice bylaws adopted on a "clear day," although in this case AIM's bylaws were adopted under the overcast skies of a looming proxy contest.

While the court ultimately upheld the AIM board's decision to reject the nominations, it found AIM's amended bylaws to be "a mixed bag."

The court had no trouble finding that the AIM board had a legitimate interest in amending the bylaws to increase transparency, particularly after the company's experience with the dissident group in 2022. But it found that a majority of the challenged advance notice bylaws failed the proportionality test required by *Unocal*.

The court upheld a bylaw requiring disclosure of agreements, arrangements and understandings relating to the nominations, including a 24-month lookback period, finding it neither preclusive nor unreasonable. Similarly, it upheld a bylaw requiring disclosure of the dates of first contact among participants in the nomination effort and a bylaw requiring nominees to complete a form of D&O questionnaire—even though AIM amended the questionnaire, adding 14 pages to it, during the five-day period between the time it was requested and the time it was furnished. The court, while characterizing this as "suboptimal," found no evidence of bad faith.

The court invalidated, however, a bylaw requiring "agreements, arrangements and understandings" disclosure from any "Stockholder Associated Person," concluding that this definition caused the bylaw to go "off the rails" because the interplay of various subsidiary terms—"acting in concert," "Associate," "Affiliate" and "immediate family" — resulted in an "ill defined web of disclosure requirements."

The court likewise rejected a bylaw requiring disclosure regarding consulting, investment advice or previous nominations for public companies within the last 10 years both because it encompassed "Stockholder Associated Persons"—and thus was subject to the same flaw as the prior bylaw—and because it imposed "ambiguous requirements across a lengthy term." It also rejected a bylaw requiring disclosure of "known supporters" of the nominations, finding that such a requirement went well beyond a bylaw previously upheld by the court requiring disclosure of known *financial* supporters.

Finally, the court rejected a bylaw requiring disclosure of AIM ownership information, finding its 1,099 words and 13 subparts to be "indecipherable," with any justifiable objectives of such disclosure "buried under dozens of dense layers of text."

As noted in our *2023 Proxy Season in Review*, publicly traded companies are well advised to review their advance notice bylaws, both to ensure compliance with Rule 14a-19 and applicable state corporate law and to ensure that the board is well positioned to respond to election challenges and allow stockholders to vote on an informed basis. As we also noted, advance notice bylaws that impose unduly burdensome requirements may invite challenge. The Court of Chancery in *Kellner* found several of the AIM bylaws indeed to be unduly burdensome, but the court declined to draw a bright line as to when a bylaw goes too far, other than to note that "the discretion afforded a board's adoption of advance notice bylaws is not limitless."

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