Shareholder Activism Update

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Delaware Chancery Upholds Rejection of Advance Notice; Strikes Down Certain Bylaw Amendments

By Sean Donahue and Eduardo Gallardo

In *Kellner v. AIM Immunotech Inc., et al.* (December 28, 2023), Vice Chancellor Will upheld the company's rejection of an advance notice of nomination finding that the Board acted reasonably and equitably in rejecting the notice and that it did not breach its fiduciary duties in enforcing valid advance notice bylaws. At the same time, in applying an enhanced scrutiny standard of review, the court found that four provisions of the bylaws were invalid as they were disproportionate responses to any threatened corporate objectives. The case shows that Delaware courts will uphold a company's rejection of an advance notice of nomination that does not comply with valid bylaw provisions, while at the same time showing that a court may blue-pencil a company's bylaws by finding certain provisions invalid, thus offering lessons for drafting advance notice bylaws.

The court upheld the rejection of the advance notice of nomination finding that it obscured obvious arrangements or understandings pertaining to the nomination that were required to be disclosed pursuant to the company's advance notice bylaws. Under the company's so-called agreements, arrangements, and understandings provision (the "AAU provision"), a nominating stockholder is required to disclose "all arrangements or understandings between such stockholder and each proposed nominee and any other person or persons (including their names) pursuant to which the nomination(s) are to be made".[1] The advance notice of nomination stated that before July 2023 "no decision was made [by any of the three group members] to work together to advance potential nominations or otherwise take any action with respect to the Company." The court found that this statement was false given that there was evidence that well before July the three group members took measures to prepare for nominations and a proxy contest. The omission and misrepresentation of meaningful AAUs resulted in the court upholding the rejection of

[1] Note that the court analyzed whether the advance notice met the requirements of the AAU provision of the 2016 bylaws. As discussed below, the court found the 2023 AAU provision invalid, but reverted to assessing whether the notice complied with the 2016 AAU provision.

the advance notice. In doing so, the court also observed that the advance notice failed to comply with two additional provisions of the advance notice bylaws.[2]

While the court upheld the rejection of the advance notice of nomination, it also decided to blue-pencil the bylaws adopted in March 2023 finding that four provisions challenged by the investor were invalid and two were valid. In doing so, the court applied an enhanced scrutiny standard of review under *Unocal* with sensitivity to the stockholder franchise that integrates the spirit of *Blasius* and *Schnell*.[3] In addition to analyzing these six provisions the court noted that neither the investor nor the court would quibble with the amendments to the bylaws to address Rule 14a-19 (the universal proxy rule) and to cohere with the DGCL. A summary of the court's analysis on each of the six bylaw provisions at issue in the case and our related commentary is set forth below.

Agreements, Arrangements, and Understandings Provision

- The 24 month lookback period in the AAU provision was found to be permissible. Public companies may want to add a temporal reference to AAU bylaw provisions to eliminate any ambiguity regarding the time period to which such provision applies.

- The AAU provision's requirement to disclose AAUs with persons acting in concert with the nominating stockholder and any Stockholder Associated Person (SAP) were found to be invalid. In striking down the provision, the court stated: *"In the context of the AAU Provision, a nominating stockholder would need to disclose any AAUs that an SAP had with a holder, nominee (and his or her immediate family members, affiliates, or associates), persons acting in concert with any SAP, holder, nominee (and family, affiliates, or associates), and "any other person or entity. It is here that the AAU Provision goes off the rails, undermining an otherwise reasonable and appropriate bylaw. Read literally, the interplay of the various terms—"acting in concert," "Associate," "Affiliate," and "immediate family" within the SAP definition, and SAPs within the AAU Provision—causes them to multiply, forming an ill-defined web of disclosure requirements."* Given the court's ruling and other related legal developments regarding acting in concert provisions, public companies may want to revisit their advance notice bylaws to examine whether they contain references to persons acting in concert or to Stockholder Associated Persons.

Consulting/Nomination Provision

This provision requires "*disclosure of AAUs between the nominating stockholder or an SAP, on the one hand, and any stockholder nominee, on the other hand, regarding consulting, investment advice, or a previous nomination for a publicly traded company within the last ten years*". In striking down the provision, the court stated: "*The provision not only suffers from the same problem as the AAU Provision insofar as it includes SAPs. It also imposes ambiguous requirements across a lengthy term."* … "*The Consulting/Nomination Provision does not stop with the present nomination—or even AAUs about AIM. It implicates a decade of AAUs (including "advice" on "potential investments") involving other publicly traded companies as well."* The court's analysis regarding this provision is a reminder that advance notice bylaw provisions need to drafted with absolute clarity and should not be overreaching.

[2] These provisions were (1) the so-called First Contact Provision that required disclosure of "the dates of first contact between a nominating stockholder and/or [any Stockholder Associated Person], on the one hand, and the Stockholder Nominee, on the other hand" regarding the company or the Board nominations and (2) the provision providing that the D&O questionnaires submitted by nominees be certified as accurate.

[3] In applying this standard of review, the court cited to the Delaware Supreme Court's decision in *Coster (Coster v. UIP Cos., Inc., 300 A.3d 656 (Del. 2023)*.

The Known Supporter Provision

This provision requires the nominator and nominees to list all known supporters of the nomination.

- In striking down the provision the court stated that "*the Known Supporter Provision here seeks disclosure of any sort of support whatsoever, including that of other stockholders known by SAPs to support the nomination. The limits of this provision are ambiguous—both in the terms of the types of support and supporters one must disclose.*"

- The court did indicate that such provisions if drafted differently may be enforceable stating that: "*Had the Board crafted a bylaw mandating the disclosure of known supporters providing financial support or meaningful assistance in furtherance of a nomination, it might have taken a legitimate approach to ensuring adequate disclosure. Instead, it overreached*." In this regard, the court acknowledged that: "*In CytoDyn, Vice Chancellor Slights observed that a bylaw mandating the disclosure of known financial supporters elicited information that is "vitally important" to voting stockholders*". Companies that have these provisions should review them to determine whether they are sufficiently limited in scope such that they would be enforceable or whether they are overly broad and should be revised.

The Ownership Provision

This provision requires a nominating stockholder to disclose, among many other things, a Holder's ownership in AIM stock (including beneficial, synthetic, derivative, and short positions). The requirements extend to SAPs, immediate family members, and persons acting in concert with a nominee. In striking down the provision, the court first acknowledged that such a provision may be legitimate and then explained why the company's provision was not: "*A provision requiring a stockholder to disclose such information seems perfectly legitimate. The problem for AIM is that the Ownership Provision as drafted sprawls wildly beyond this purpose. As one example, it requires the disclosure of "legal, economic, or financial" interests "in any principal competitor" of AIM. The term "principal competitor" is undefined, creating ambiguity. As another example, it calls for disclosure of "[a]ny performance-related fees that each Stockholder Associated Person is entitled to, including interests held by family members."* Public companies should revisit the ownership provisions in their advance notice bylaws in light of the court's interpretation of this provision. In particular, to the extent the advance notice bylaws have a reference to disclosure regarding competitors, a company should consider providing a definition of such term.

The First Contact Provision

This provision requires disclosure of the dates of first contact among those involved in the nomination effort. The court upheld this provision. The investor argued that it is an unusual provision, but the court found that unusualness is not the test and that this provision was tailored to advance a proper objective unique to the company. While this provision is relatively uncommon, companies should feel comfortable including such a provision in their advance notice bylaws.

The D&O Questionnaire Provision

This provision requires completion of a D&O questionnaire. The court found the provision valid and declined to determine whether five business days is a reasonable time period for the company to send the form of D&O questionnaire to the nominating stockholder. Public companies should feel comfortable having an advance notice provision requiring stockholder nominees to complete a D&O questionnaire.

If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings lawyers:

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