



## Delaware Supreme Court on Advance Notice Bylaws and Proxy Contests

In *Kellner v. AIM ImmunoTech Inc. et al.* (July 11, 2024), the Delaware Supreme Court (the “**Court**”) reviewed advance notice bylaws adopted by AIM ImmunoTech, Inc. (“**AIM**”) in anticipation of a proxy contest and held that although all but one of the bylaws were facially valid, they were all ultimately unenforceable. The Court reasoned that the board of directors of AIM (the “**Board**”) acted inequitably when it adopted the amended bylaws for the purpose of maintaining control. However, the Court concluded that no further action was warranted with respect to the plaintiff’s rejected director nominations notice given his and his nominees’ own deceptive conduct. The Court’s opinion clarifies how Delaware courts will consider and review challenges to the validity and enforceability of a Delaware corporation’s advance notice bylaws.

### Background

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AIM is a publicly traded pharmaceutical company incorporated in Delaware. In 2020, a group of AIM stockholders sought to nominate new directors through an activist campaign and proxy contest claiming that the Board was mismanaging the company. The activist campaign involved two felons convicted of financial crimes and resulted in two nominations notices. AIM rejected these notices for failure to comply with AIM’s existing advance notice bylaws. In response to the nomination efforts, the Board adopted six new advance notice bylaws (the “**Amended Bylaws**”) that required extensive disclosures by potential board nominees.

Later in 2022, Ted D. Kellner (“**Kellner**”) led a third initiative to nominate new directors to the Board at AIM’s 2023 annual meeting. The Board ultimately rejected Kellner’s nomination notice for failure to comply with the Amended Bylaws. Kellner sued AIM and the Board. The Court of Chancery invalidated four of the Amended Bylaws, reinstated a 2016 version of one of the invalidated bylaws, and still upheld the Board’s rejection of Kellner’s nominations notice because the notice failed to comply with the remaining Amended Bylaws. On appeal, Kellner argued, among other things, that the two Amended Bylaws not invalidated by the Court of Chancery should have failed enhanced scrutiny review. The defendants counterclaimed.

### Court’s Analysis

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The Court held that while all but one of the Amended Bylaws were facially valid, the Amended Bylaws were unenforceable as the Board had acted with the improper purpose of maintaining control and interfering with

the stockholder franchise when it adopted the Amended Bylaws. The Court still declined to reinstate Kellner's proxy nominations because of his and his nominees' deceptive conduct, which included providing false and misleading information during the proxy nomination process.

The Court began its analysis by acknowledging that the General Corporation Law of the State of Delaware (the "DGCL") permits bylaws to contain any provision "not inconsistent with law or with the certificate of incorporation relating to the business of the corporation, the conduct of its affairs, and its rights or powers or the rights or powers of its stockholders, directors, officers, or employees." However, the Court stated that even though the DGCL minimally restricts the enactment of new corporate bylaws, Delaware courts will closely scrutinize corporate acts that may affect stockholder voting.

### ***Facial validity and enforceability challenges are distinguished***

The Court held that challenged corporate actions are subject to a two-step analysis: first, for legal authorization, and second, for equity. The Court then distinguished facial, or validity, challenges from as-applied, or enforceability, challenges to bylaws. The Court clarified that facially valid bylaws are "authorized by the DGCL, consistent with the corporation's certificate of incorporation, and not otherwise prohibited". To succeed with a facial challenge against a corporate bylaw, the Court continued, a plaintiff must show that the bylaw "cannot operate lawfully under any set of circumstances."

Even if a bylaw is facially valid, the Court stressed the importance of its review under equitable principles. The Court held that enhanced scrutiny review framed by the two-part test in *Coster v. UIP Companies, Inc.* would be used to examine the equity of advance notice bylaws adopted, amended, or enforced during proxy contests.

For such bylaws to succeed:

- > a corporation's board of directors must have faced a real and not pretextual threat to "an important corporate interest or to the achievement of a significant corporate benefit" and the board's motivations must be proper and not selfish or disloyal; and
- > if the board's actions passed part (1) above, then the court will consider whether the board's response to the threat was reasonable and not preclusive or coercive to the stockholder franchise.

### ***All but one of the Amended Bylaws were valid***

The Court first found that the Court of Chancery wrongly applied enhanced scrutiny review to a validity challenge to the Amended Bylaws. AIM's certificate of incorporation granted directors the "power to adopt, amend or repeal bylaws," and the DGCL grants wide latitude to the provisions that bylaws may contain. Since the plaintiff failed to show that the challenged bylaws could not be valid under any circumstances, the Court ruled that all but one of the Amended Bylaws were facially valid. The only invalid bylaw was a nonsensical "1,099-word single-sentence provision."

### ***The Amended Bylaws failed enhanced scrutiny***

The Court then subjected the remaining Amended Bylaws to enhanced scrutiny review. Given the prior proxy nominees' criminal backgrounds, the Court agreed that the Board reasonably assessed that AIM's prior

advance notice bylaws were insufficient to fulfill the important corporate objective of ensuring a transparent proxy contest. However, the Court also agreed that in adopting the Amended Bylaws the Board acted with the improper purpose to thwart Kellner's proxy contest and maintain control and was therefore in breach of the duty of loyalty. The Court held that the Amended Bylaws failed *Coster* enhanced scrutiny review and were unenforceable. Nevertheless, given Kellner's and his nominees' dishonest conduct in the nominations notice provided, the Court affirmed the lower court's rejection of Kellner's proxy notice.

## Our Take

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*Kellner v. AIM ImmunoTech Inc. et al.* clarifies the distinction between “validity” challenges and “enforceability” challenges to a corporation's bylaws and the different standards of review applicable to each challenge. In “validity” challenges, Delaware courts will presume the challenged bylaws to be valid and the burden of proof will be on the plaintiff to show that such bylaws cannot operate lawfully under any set of circumstances. In “enforceability” challenges to bylaws adopted in anticipation of a proxy contest, Delaware courts will apply enhanced scrutiny review and conduct a two-step inquiry. In amending their bylaws, Delaware corporations should consider the circumstances in which such bylaws could be challenged and how the courts will review them.

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