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The Delaware Supreme Court provides clarity for advance notice bylaws

By Maximillian Shifrin, Esq., and Lindy Keown, Esq., BakerHostetler*

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A recent monumental decision of the Delaware Supreme Court (Court) provides clarity for both public companies looking to amend their bylaws and shareholder activists who may face inequitable bylaw provisions.[1]

Background

The dispute began when the Shareholder sought to nominate new directors to AIM Immunotech, Inc.'s (AIM) Board of Directors (Board). Prior to the Shareholder's nomination efforts, in response to what AIM perceived was a looming proxy contest, the Board amended the company's bylaws to adopt strenuous new Board nomination requirements.

The Shareholder subsequently submitted his nomination notice for a slate of Board candidates, which was unanimously rejected by AIM due to an alleged failure to comply with its new bylaws.

At the outset, the Court emphasized the crucial role of advance notice bylaws, which are designed to ensure orderly meetings and election contests.

Shortly thereafter, the Shareholder filed a complaint against AIM seeking, among other things, (i) a declaration that AIM's amended bylaws were invalid and (ii) a declaration that AIM's application of the amended bylaws was unlawful and inequitable.

After an expedited trial, the Court of Chancery found that certain of AIM's advance notice bylaws were facially invalid. The court held, however, that the Board equitably applied other advance notice bylaws to reject the Shareholder's nomination notice. Both AIM and the Shareholder appealed.

The Supreme Court's opinion

In a July 11, 2024 opinion, the Delaware Supreme Court agreed with the Shareholder's arguments on appeal, held that AIM's amended bylaws were unenforceable, and offered clarity on advance notice nomination bylaw requirements.

At the outset, the Court emphasized the crucial role of advance notice bylaws, which are designed to ensure orderly meetings and election contests. But the Court distinguished bylaws amended on a "clear" day — when there is no external threat of a proxy challenge — from those amended on a "cloudy" day — when there is a threat of corporate upheaval.

Advance notice bylaws should never be implemented with the primary purpose of blocking shareholder nomination efforts.

Applying enhanced scrutiny because AIM's bylaws were adopted under the perceived threat of a proxy contest — i.e., on a "cloudy" day — the Court held that AIM's amended bylaws were unenforceable because they were primarily adopted to "interfere with [the Shareholder's] nomination notice, reject his nominees, and maintain control."

The Court credited the trial court's findings that the bylaws "functioned as a 'tripwire' rather than an information-gathering tool," "imposed ambiguous requirements across a lengthy term" and "sought only marginally useful information."

Ultimately, the Delaware Supreme Court concluded that AIM wielded its bylaws unfairly. "The AIM board's motive was not to counter the threat of an uninformed vote," wrote Chief Justice Collins J. Seitz Jr. "Rather, the board's primary purpose was to interfere with [the Shareholder's] nomination notice, reject his nominees and maintain control."

Key takeaways

Shareholder activists and companies alike should be well-apprised of this decision, as it provides useful guidance on the permissible scope of advance notice bylaws. Here are the key takeaways from the Delaware Supreme Court's decision:

- Bylaws are "presumed to be valid." Even advance notice bylaws are generally facially valid if they are "consistent with the certificate of incorporation, not prohibited by law, and address a proper subject matter."

- Advance notice bylaws should never be implemented with the primary purpose of blocking shareholder nomination efforts. The focus should be on information gathering, allowing companies to make informed recommendations about nominees and ensure that stockholders can cast informed votes.
- When bylaw amendments are made on the eve of a proxy battle, the amendments are subject to a higher level of judicial scrutiny and are more likely to be deemed unenforceable.
- Companies should regularly review their bylaws to ensure they remain clear and intelligible. Advance notice bylaws that are overbroad, unintelligible, and/or overly subjective may not withstand a court's scrutiny.

Notes:

1 *Kellner v. AIM Immunotech, Inc., et al.*, Case No. 2023-0879. A cross-office team of BakerHostetler litigators represented the Shareholder in this landmark case both at the trial level and on appeal.

About the authors

Maximillian Shifrin (L) is a partner in **BakerHostetler**'s New York office, specializing in resolving complex commercial disputes for global clients. He can be reached at mshifrin@bakerlaw.com. **Lindy Keown** (R) is an associate in the firm's Orlando, Florida, office, specializing in commercial litigation in state and federal court. She can be reached at lkeown@bakerlaw.com. This article was originally published Nov. 4, 2024, on the firm's website. Republished with permission.

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