

July 26, 2024

Delaware Supreme Court Clarifies Tests for Advance Notice Bylaw Challenges

Recently in [Kellner v. AIM ImmunoTech, Inc.](#), the Delaware Supreme Court clarified the legal tests applicable when stockholders challenge advance notice bylaws. A key aspect of the Supreme Court's ruling is the importance of distinguishing between a facial and an as-applied challenge to a bylaw. The court held that advance notice bylaws, like all corporate bylaws, are presumptively valid under Delaware law and will survive a facial challenge if they (1) are consistent with the company's charter, (2) are not prohibited by law and (3) address a proper subject matter. Stated differently, a bylaw is facially invalid only if it cannot operate lawfully under any circumstance. An as-applied challenge, by contrast, considers whether the board adopted or enforced a bylaw inequitably in a specific circumstance. As-applied challenges are reviewed under enhanced scrutiny and can—if the balance of the equities so require—result in the board being enjoined from enforcing the bylaw against the specific plaintiff-stockholder bringing the challenge.

In *Kellner*, the Supreme Court held that one “indecipherable” bylaw was facially invalid. The remaining advance notice bylaws challenged on appeal were held to be facially valid. However, though the board had identified an important corporate objective in adopting the bylaws due to the past conduct of the particular proxy contestants involved, the court held that the board failed enhanced scrutiny review (i.e., acted inequitably) by adopting those bylaws for the primary, and improper, purpose of thwarting the specific stockholders' proxy contest and maintaining control.

Nevertheless, because of the proxy contestants' own deceptive conduct, the court ruled that no remedy was warranted in equity.

Background

In 2022, a stockholder group made two attempts to nominate directors to AIM's board. AIM rejected both of the nomination notices for noncompliance with federal securities laws and the then-existing advance notice bylaws.

Ahead of the 2023 annual meeting, the AIM board, after consulting outside counsel, amended the company's advance notice bylaws with the express purpose of responding to the dissidents' past improper behavior and ensuring their behavior would not continue to interfere with a fair election process moving forward.

Four bylaw provisions were central in the Supreme Court appeal, summarized (using the court's terminology) as follows:

- The “AAU Provision” required “a complete and accurate description of all agreements, arrangements or understandings” relating to AIM or the nominations between a broadly defined group of people, including the nominating stockholder and any “Stockholder Associated Person” going back two years. The defined term “Stockholder Associated Person” in the bylaws included any person “acting in concert” with the stockholder or with a person controlling, controlled by or under control of the stockholder.
- The “Consulting/Nomination Provision” required the disclosure of agreements, arrangements and understandings between the nominating stockholder or a Stockholder Associated Person, 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 10 years.

- The “Known Supporter Provision” required the disclosure of all known supporters of the nominating stockholder and nominees.
- The “Ownership Provision” was, as described by the Supreme Court, “a 1,099-word run-on sentence of 13 subsections, requiring, among other things, disclosures relating to ownership of any equity interest in AIM and ‘any principal competitor’ of AIM, by a broadly defined group of people,” including Stockholder Associated Persons. The court noted that AIM’s board chair had testified that the bylaw was “written in such a way that no one would read it” and, had the directors read the bylaw “line by line,” they “would still be in the meeting.”

In 2023, Kellner nominated three director candidates (including himself) to the AIM board for consideration at the next annual meeting. The board discussed the nomination notice at three separate meetings and eventually rejected it, finding that it failed to disclose agreements, arrangements and understandings related to the nomination effort among other “material” omissions required by the newly adopted advance notice bylaws.

In considering Kellner’s challenge to the advance notice bylaws, the Court of Chancery held that the AAU, Consulting/Nomination, Known Supporter and Ownership Provisions were “facially invalid” because they did not satisfy enhanced scrutiny review. In the Court of Chancery’s view, the provisions imposed overbroad and preclusive restrictions on director nominations and therefore seemed designed to thwart a proxy contest and entrench the directors rather than further the board’s stated proper purpose of obtaining transparency in elections through disclosure. Nevertheless, the Court of Chancery determined that Kellner’s notice was deficient under the prior version of the AAU Provision and other advance notice requirements.

Supreme Court’s Analysis

On appeal, the Delaware Supreme Court affirmed in part and reversed in part, making the following key holdings:

Bylaws Are Facially Valid If They Comply with the Charter, Are Not Prohibited by Law and Address a Proper Subject Matter

The Supreme Court noted that bylaws are presumed to be valid and that the burden is on the party asserting invalidity to demonstrate that the bylaw cannot be valid under any circumstance. The Supreme Court explained that courts should not consider hypotheticals or speculate whether bylaws might be invalid under certain circumstances when evaluating facial validity claims and noted that advance notice bylaws are facially valid as long as they (1) are consistent with the company’s charter, (2) are not prohibited by law and (3) address a proper subject matter. Applying this analysis, the Supreme Court held that the AAU, Consulting/Nomination and Known Supporter Provisions were facially valid under Delaware law. However, the court determined that the Ownership Provision was “indecipherable,” “excessively long,” “vague” and “impose[d] virtually endless requirements on a stockholder seeking to nominate directors.” Accordingly, the Supreme Court ruled it facially invalid, reasoning that “[a]n unintelligible bylaw is invalid under any circumstances.”

Facially Valid Bylaws Remain Subject to As-Applied Challenges in Equity

The Supreme Court next explained that facially valid bylaws remain subject to as-applied challenges and can be unenforceable if they are applied inequitably, i.e., in breach of the directors’ fiduciary duty of loyalty. The court explained that when a board “adopts, amends or enforces advance notice bylaws” during a proxy contest, Delaware’s “enhanced scrutiny” applies. To survive enhanced scrutiny, the bylaws must be for a proper purpose and respond in a reasonable manner to a legitimate threat to a corporate interest. Bylaws adopted “for a selfish or disloyal motive—meaning for the primary purpose of precluding a challenge to [the Board’s] control”—are inequitable.

Applying this standard, the Supreme Court held that the AAU, Consulting/Nomination and Known Supporter Provisions failed the “motive inquiry” of enhanced scrutiny because they were amended for an “improper purpose—to thwart Kellner’s proxy contest

and maintain control.” Among other things, the court observed that the AAU Provision appeared to serve as a mere “tripwire rather than an information gathering tool,” that the Consulting/Nomination provision suffered from the same issue and was also “problematic” because it imposed a disclosure obligation extending back 10 years and sought “only marginally useful information,” and that the Known Supporter provision incorporated the expansive Stockholder Associated Person definition in a manner that created “an ill-defined daisy chain of persons” from whom a stockholder might need to request, and be unable to obtain, requested information.

Even Where a Bylaw Is Employed Inequitably, Delaware Courts Will Impose a Remedy Only to the Extent Equity Requires

Although the Supreme Court ruled that the Ownership Provision was facially invalid and that the AAU, Consulting/Nomination and Known Supporter Provisions failed enhanced scrutiny as applied to Kellner, the court concluded that Kellner was not entitled to further relief—i.e., an injunction against the company’s enforcement of those bylaws to reject his nomination notice—because he had submitted “false and misleading responses” to some of the other information requests required by the advance notice bylaws. The court referred to that conduct as “deceptive,” and determined that “no further action [was] warranted” due to Kellner’s own inequitable conduct.

Takeaways

The Supreme Court’s *Kellner* decision confirms that, while directors have flexibility in designing bylaws, including advance notice requirements, those bylaws remain susceptible to judicial review for strict legal compliance. And the directors remain susceptible to claims for breach of the fiduciary duty of loyalty if they employ those bylaws inequitably. To satisfy these requirements, drafters of bylaws and directors adopting them should, among other things, consider the clarity of advance notice bylaws as drafted. Directors should also consider whether an advance notice bylaw embodies a proper and equitable purpose, such as ensuring an orderly and fair election where information is disclosed in a timely manner so as to permit stockholders to consider the competing arguments on both sides.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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