

February 5, 2024

# Delaware Courts Provide Guidance on Advance Notice Bylaws

Recent decisions by Vice Chancellor Will of the Delaware Court of Chancery in [Paragon Technologies, Inc. v. Cryan](#) and [Kellner v. AIM Immunotech Inc.](#) provide guidance for boards concerning the validity of advance notice bylaws. In both cases, the court upheld the boards' enforcement of advance notice bylaws to prevent activist nominees from standing for election. In *Kellner*, however, the court invalidated some bylaw provisions because of their overbreadth or ambiguity. The court found those bylaws to be unreasonable under an enhanced scrutiny standard the Delaware Supreme Court articulated last year. *Paragon* and *Kellner* reflect the Delaware courts' general approach to uphold reasonable and clear advance notice bylaws and to carefully scrutinize overly broad or vague bylaws. Below, we discuss key themes from these two decisions.

## Takeaways from the Court's Decisions

*Delaware courts will evaluate board decisions on advance notice bylaws under enhanced scrutiny review.* Since 1988, boards acting with the "primary purpose" of interfering with the right to elect directors had to show a compelling justification for that action under the *Blasius* standard. Last year, in *Coster v. UIP Companies, Inc.*, the Delaware Supreme Court held that actions allegedly taken to interfere with the corporate franchise should be evaluated under the standard used to examine the adoption of defensive measures generally "with sensitivity to the stockholder franchise." Fundamentally, the standard is reasonableness and requires a two-part analysis: (i) whether the board faced a threat "to an important corporate interest or to the achievement of a significant corporate benefit" and (ii) "whether the board's response to the threat was reasonable in relation to the threat posed and was not preclusive or coercive to the stockholder franchise."

*Reasonable, unambiguous advance notice bylaws will continue to be enforced by Delaware courts.* Although courts have stated in the poison pill context that protecting against "activism" in and of itself is not a legitimate corporate interest, both *Kellner* and *Paragon* reiterate that there is a legitimate corporate interest for advance notice bylaws – namely, ensuring transparency from a nominating stockholder and its nominees so that boards have time to evaluate proposed candidates, stockholders are fully informed and elections are orderly. With these purposes in mind, courts must determine whether a board's decisions concerning an advance notice bylaw were reasonable in relation to the threat posed, including the reasonableness of the terms of the bylaw itself and of the board's enforcement of the bylaw against activists.

In *Kellner*, for example, the court deemed reasonable a 24-month lookback on a requirement to disclose all agreements, arrangements and understandings "whether written or oral, and including promises" relating to a director nomination because it clarified the period covered by the requirement and "reduced the risk of gamesmanship through overly narrow readings of the bylaw." The court also found that a provision requiring disclosure of the dates of first contact among those involved in the nomination, while unusual, was tailored and called for a "more defined set of information that could be known or knowable with reasonable diligence" and that a requirement that nominees complete a questionnaire in the form provided by the company was reasonable in scope. Similarly, in *Paragon*, the court found certain other advance notice bylaws to be reasonable, including one requiring plans or proposals that would be required to be disclosed pursuant to Item 4 of Schedule 13D, as well as one requiring the disclosure of potential conflicts and "substantial interests" pursuant to Regulation 14D.

*Advance notice bylaws that are overly broad or difficult to decipher may fail enhanced scrutiny review.* Boards adopting or amending advance notice bylaws should review the terms for clarity and overbreadth, ensuring that the provisions do not unduly burden a stockholder's ability to submit a compliant nomination. In *Paragon*, the court questioned the reasonableness of a requirement to disclose "events, occurrences, and/or circumstances involving or relating to the Proposed Nominee that could impact, impede, and/or delay" a candidate's ability to obtain security clearance. The court agreed with the plaintiff's position that the bylaw was ambiguous and that "stockholders are left to guess" about the impediments required to be disclosed. Similarly, in *Kellner*, the court found a number of advance notice bylaws to be overly broad or ambiguous, including:

- A definition of "Stockholder Associated Person"<sup>1</sup> that created "an ill-defined web of disclosure requirements" with "unending permutations";
- A requirement to disclose 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. While a similar requirement had been previously upheld by a Delaware court, the 10-year lookback in this provision was deemed too long;
- A requirement to disclose all known supporters of the nominating stockholder and nominees which was too broad and went beyond a similar provision previously validated by a Delaware court that was limited to "financial" supporters; and
- A requirement to disclose ownership of company stock (including beneficial, synthetic, derivative and short positions), which extended to Stockholder Associated Persons, immediate family members and persons acting in concert, which the court deemed "indecipherable" such that "[a] stockholder could not fairly be expected to comply."

*A Delaware court will look at whether the board's enforcement of an otherwise valid advance notice bylaw is equitable.* If a board's enforcement of a valid advance notice bylaw has a preclusive effect on a stockholder's ability to make nominations, then the court may require the board to permit the activist's nominees to stand for election. For example, in *Paragon*, aspects of the preliminary record caused the court to "look skeptically" at the board's response to the activist's nomination notice, including the fact that the board declined to provide a complete list of deficiencies and continually found new deficiencies. The court found some of these shortcomings identified by the board to be "nitpicky" or "suspect," including rejection of the notice for failure to comply with the bylaw requiring a nominee to disclose known barriers to obtaining a security clearance where none of the sitting directors had a security clearance and the board did not oversee matters involving classified information.

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<sup>1</sup> "Stockholder Associated Person" was defined in *Kellner* to be "any person acting in concert with [a] Holder [(i.e., the nominating stockholder and each beneficial owner on whose behalf the nomination is made)] with respect to the Stockholder Proposal or the Corporation, (ii) any person controlling, controlled by, or under common control with such Holder or any of their respective Affiliates or Associates, or a person acting in concert therewith with respect to the Stockholder Proposal or the Corporation, and (iii) any member of the immediate family of such Holder or an Affiliate or Associate of such Holder."

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