



Delaware Courts Provide Guidance on Incumbent Board Enforcement of Advance Notice Bylaws

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Editor’s note: Edward Micheletti is a Partner and Ryan Lindsay is Counsel at Skadden, Arps, Slate, Meagher & Flom LLP. This post is based on their Skadden memorandum. This post is part of the [Delaware law series](#); links to other posts in the series are available [here](#). Related research from the Program on Corporate Governance includes [The Long-Term Effects of Hedge Fund Activism](#) (discussed on the Forum [here](#)) by Lucian Bebchuk, Alon Brav, and Wei Jiang; and [Dancing with Activists](#) (discussed on the Forum [here](#)) by Lucian Bebchuk, Alon Brav, Wei Jiang, and Thomas Keusch.

In late 2021 and early 2022, two decisions from the Court of Chancery addressing advance notice bylaws reiterated, consistent with long-standing Delaware law, that clear and unambiguous advance notice bylaws will be enforced. These decisions also noted that application of such bylaws remains subject to equitable review to determine if the incumbent board acted manipulatively or otherwise inequitably in rejecting stockholder board nominees.¹ However, these decisions also articulated slightly different standards of review — with the court in the first decision holding that under the court’s equitable review a stockholder could prove “compelling circumstances” justifying a finding of inequitable conduct, while the court in the second decision expressly applied enhanced scrutiny, placing the burden on the incumbent board to demonstrate it acted reasonably.²

The Court of Chancery’s most recent decision on this topic further reiterates that clear and unambiguous bylaws will be enforced. Furthermore, the decision clarifies that enhanced scrutiny focusing on the reasonableness of incumbent board conduct is the standard of review that applies to the application of even validly enacted advance notice bylaws. Therefore, when assessing a board’s application of an advance notice bylaw, the court will analyze whether the board has identified proper corporate objectives and has justified its actions as reasonable in relation to those objectives.

¹ See [Skadden Discusses Delaware Court Rulings on Advance Notice Bylaws and Incumbent Director Conduct](#), The CLS Blue Sky Blog, June 29, 2022; see also *Rosenbaum v. CytoDyn Inc.*, 2021 WL 4775140 (Del. Ch. Oct. 13, 2021); *Strategic Inv. Opportunities LLC v. Lee Enters., Inc.*, 2022 WL 453607 (Del. Ch. Feb. 14, 2022).

² *Rosenbaum*, 2021 WL 4775140, at *15; *Strategic Inv. Opportunities LLC*, 2022 WL 453607, at *14.

AIM ImmunoTech

In *Jorgl v. AIM ImmunoTech Inc.*,³ the Court of Chancery rejected a request for preliminary, mandatory injunctive relief on behalf of a dissident stockholder and his proposed slate of board nominees by denying the plaintiff's motion for preliminary injunction in favor of the defendants, AIM ImmunoTech Inc. and the incumbent board.

The court's decision laid out the interesting factual circumstances of the plaintiff's director nominations, which occurred within the larger context of an ongoing attempt by a group, comprised of both stockholders and non-stockholders, to take over the company. As one part of this takeover attempt, the plaintiff, who had only acquired stock 10 days before his director nominations were submitted, put forth two non-stockholders for positions on the company's three-member board. The incumbent board was immediately suspicious, as one of the nominees was the same individual recently submitted as a director nominee by another stockholder. The board had rejected those nominations and suspected that a stockholder named Franz Tudor, who had allegedly been harassing the company for years, was secretly behind them. The short period and common nominee between the prior failed nominations and the plaintiff's current nominations prompted the board to investigate further. It discovered information leading it to conclude that Tudor and his allies were also behind the plaintiff's effort. Based on this undisclosed information, the board unanimously rejected the nomination notice, leading to litigation.

The court first analyzed the board's decision to reject the nomination notice by considering whether it complied with the company's advance notice bylaw. The court noted that Section 1.4(c) of the bylaws required disclosure by the nominating stockholder of "a description of 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."⁴ The court reiterated that "[c]lear and unambiguous advance notice bylaw conditions act[] in some respects as conditions precedent to companies being contractually obligated to take certain actions."⁵

The court concluded that the plain meaning of "arrangements or understandings," as demonstrated by reference to dictionary definitions, required the stockholder "to disclose any advance plan, measure taken, or agreement—whether explicit, implicit, or tacit—with any person towards the shared goal of the nomination."⁶ The court rejected the plaintiff's argument that "arrangements or understandings" required a *quid pro quo*.

Next, the court considered whether the nomination notice satisfied the unambiguous requirements of the bylaw. The court analyzed the record evidence that, behind the scenes of the plaintiff's nomination, both stockholders and non-stockholders, led by Tudor, were working together to devise legal strategy and to formulate a plan for a proxy contest in order to ultimately take control of the board. The court rejected the plaintiff's argument that the information in the notice was truthful and to the best of his knowledge at the time. Clearly doubting the veracity of the plaintiff's statements about his own knowledge, the court held that the disclosure about

³ 2022 WL 16543834 (Del. Ch. Oct. 28, 2022).

⁴ *Id.* at *11.

⁵ *Id.* (citation omitted).

⁶ *Id.* at *12.

“arrangements or understandings” was at least misleading. The court also highlighted that, even if the plaintiff’s knowledge of the extent of the roles of others in the nominations was limited, one of the proposed board nominees clearly knew the full information and was involved in preparation of the nomination notice, yet stayed silent. For all these reasons, the court held that the plaintiff failed to show that the nomination notice undisputedly met the bylaw’s requirements.

The court then moved on to an equitable review of the incumbent directors’ decision to reject the nomination notice, because “the Board’s technical entitlement to reject the Notice does not necessarily mean that equity will allow it to stand.”⁷ The court noted that the parties agreed that some form of enhanced scrutiny was appropriate, but disagreed on the standard’s label and requirements. The plaintiff argued that the defendants were required to show a “compelling justification” for their actions as set forth in *Blasius Industries, Inc. v. Atlas Corp.*⁸ The defendants, on the other hand, argued that — “whether labeled as *Unocal*⁹ or *Blasius*” — enhanced scrutiny review that looks to the reasonableness of the board’s actions should be applied. Concluding that the “exacting review” of *Blasius* was not appropriate, the court noted that “[s]till, this court must ‘reserve space for equity to address the inequitable application of even validly-enacted advance notice bylaws.’”¹⁰ The court stated that “enhanced scrutiny requires a context-specific application of the directors’ duties of loyalty, good faith, and care” and that to satisfy the standard “[t]he board must ‘identify the proper corporate objectives served by their actions and justify their actions as reasonable in relation to those objectives.’”¹¹

In applying enhanced scrutiny review, the court first addressed whether the corporate objectives served by the advance notice bylaw were reasonable. The court began by noting that “[a]dvance notice bylaws are ‘commonplace’ tools for public companies to ensure ‘orderly meetings and election contests.’”¹² Notably, the plaintiff did not question the board’s intentions in adopting the advance notice bylaw and it had been adopted on a “clear day.” Instead, the plaintiff challenged the provision’s potential breadth, arguing that if “arrangements and understandings” is not limited to circumstances where there is an exchange of promises, the standard is unworkable. The court rejected this position after concluding that the plain language of the company’s bylaw was not so sweeping, that it was not unreasonable, that there were legitimate reasons why the board would want to know whether a nomination was part of a broader scheme to control the company and that the information would be important to stockholders in deciding which director candidates to support.

Finally, the court considered whether the board’s rejection of the nomination notice was a reasonable response in relation to these corporate purposes. The defendants argued that they acted reasonably after the board surmised that the nomination notice was part of a broader scheme involving undisclosed arrangements and understandings. The plaintiff, for his part, contended that the board sought merely to entrench itself at the expense of his rights as a stockholder to nominate directors. The court sided with the defendants after considering issues undermining the plaintiff’s position, such as the context in which the board received and considered the plaintiff’s notice, as well as the legitimate grounds the board had to question the

⁷ *Id.* at *14.

⁸ 564 A.2d 651 (Del. Ch. 1988).

⁹ *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985).

¹⁰ *AIM ImmunoTech Inc.*, 2022 WL 16543834, at *15 (citation omitted).

¹¹ *Id.* (citation omitted).

¹² *Id.* (citation omitted).

plaintiff's motives, including his having bought stock only 10 days before nominating two non-stockholders, one of whom was a nominee on a previously rejected nomination notice. Ultimately the court concluded that these factors, in addition to lingering factual disputes, prevented granting the plaintiff's motion as a matter of law.

Takeaways

- This most recent decision by the Court of Chancery involving advance notice bylaws further reiterates that unambiguous bylaws should be enforced according to their terms.
- Nonetheless, Delaware courts will continue to conduct an equitable review of an incumbent board's decision to reject a nomination notice even if that notice failed to comply with unambiguous terms of the advance notice bylaw.
- Prior Court of Chancery decisions approached the standard of review for this equitable review slightly differently. While the courts generally agreed equitable review was appropriate, not all expressly applied enhanced scrutiny. The decision in *AIM* expressly applied enhanced scrutiny and clarified that, in the context of an advance notice bylaw, the burden is on the incumbent board to demonstrate it acted reasonably by identifying proper corporate objectives and justifying its actions as reasonable in relation to those objections.
- However, this decision, consistent with the court's other recent decisions on advance notice bylaws, further indicates that, as a practical matter, clear and unambiguous bylaws adopted on a "clear day" in order to achieve the legitimate goal of an orderly corporate electoral process are unlikely to fail equitable review in the absence of specific evidence of inequitable conduct.
- Furthermore, this decision demonstrates that advance notice bylaws remain an important and legitimate tool for incumbent boards to protect the corporation and its stockholders from undisclosed arrangements by individuals or groups seeking corporate control.¹³

¹³ Despite their acceptance by the Delaware courts, advance notice bylaws remain a continuing focus of litigation and dissident stockholders can be expected to continue challenging the adoption, amendment and/or scope of such bylaws when seeking to make director nominations. See, e.g., *Politan Capital Management LP v. Kiani*, 2022-0948-NAC (Del. Ch.).