Client Alert

January 2024

Vice Chancellor Will Provides Stark Warning in *Kellner v. AIM ImmunoTech, Inc.*: Advance Notice Nomination Provisions That "Inequitably Imperil the Stockholder Franchise to No Legitimate End" Will Be Struck Down

On December 28, 2023, Vice Chancellor Will of the Delaware Court of Chancery rendered an important decision in *Kellner v. AIM ImmunoTech, Inc.*, which provides key guidance on advance notice bylaw provisions ("ANBs"). The Court found that four out of six of the amended ANBs at issue in the case were "overbroad, unworkable, and ripe for subjective interpretation by the Board," and struck them down for running afoul of Delaware law. In so doing, Vice Chancellor Will noted the following about these four offensive ANBs:

> Rather than further the identified purpose of obtaining transparency [through] disclosure, these provisions seem designed to thwart an approaching proxy contest, entrench the incumbents, and remove any possibility of a contested election.

Shareholder activists should be well-apprised of this decision as it provides useful guidance on the permissible scope of ANBs that their target companies have or may adopt. Nominating stockholders should review ANBs carefully for overly broad "stockholder associated persons" definitions in ANBs and seek advice on how to navigate them. For companies and boards, the decision serves as a warning that ANBs that are overbroad and ripe for subjective interpretation are not likely to withstand judicial scrutiny. See our Key Takeaways at the end of this Client Alert on the practical impact this decision may have on shareholder nominations.

Andrew Freedman, Chair of Olshan's Shareholder Activism Group, prepared an expert report on behalf of the plaintiff and provided rebuttal expert testimony at trial regarding whether certain ANBs within AIM's amended bylaws are commonplace or consistent with market practice. The Court cited Mr. Freedman's testimony and expert report in rejecting the improper ANB provisions.

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ANBs at Issue in *Kellner v. AIM*

1. AAU Provision

AIM's amended bylaws require disclosure of all arrangements, agreements or understandings ("AAUs"), "whether written or oral, and including promises," relating to a Board nomination (the "AAU Provision"). The Court focused on two issues: the definition of Stockholder Associated Person (or "SAPs") and a 24-month look back for furnishing information regarding AAUs. The Court found that in general the AAU Provision had a proper corporate purpose – to allow the Board to determine who is "behind a nomination" and to allow stockholders to evaluate the nominating stockholder's and its nominees' motives in determining how to vote their shares.

However, the Court took serious issue with the defined term Stockholder Associated Person, finding that the AAU Provision's requirement to disclose AAUs among persons "acting in concert" with the nominating stockholder and any beneficial owners, nominees, SAPs, affiliates, associates and immediate family members swept too broadly. The Court highlighted that "the interplay of the various terms – 'acting in concert,' 'Associate,' 'Affiliate,' and 'immediate family member' within the SAP definition, and SAPs within the AAU Provision – causes them to multiply, forming an ill-defined web of disclosure requirements."

As the Court noted, this type of "acting in concert" verbiage that read literally could extend to a daisy chain of stockholders unknown to each other has already been addressed by the Court of Chancery and Delaware Supreme Court in *Williams Cos. S'holder Litig.*, in the context of a stockholder challenge to a poison pill, and therefore does not break new ground. Sounding a further warning bell, the Court cited the complaint in *Politan Capital Mgmt., L.P. v. Kiani*, as another example of a board going to "extremes" with an acting in concert ANB.

The Court concluded, "Knowing that a proxy contest was coming, augmenting the AAU Provision with vague requirements about far-flung, multi-level relationships suggests an intention to block the dissident's effort." The Court, citing Mr. Freedman's testimony and report, also indicated that such provision would likely fail even without enhanced scrutiny, given that it was "overbroad, unworkable, and ripe for subjective interpretation by the Board."

This overly broad SAP definition has been a major concern of ours going back several years and has certainly been a contributing factor in making the shareholder nomination process much more cumbersome, costly, confusing and uncertain for nominating shareholders. We are gratified that Vice Chancellor Will agreed with us when she wrote in her decision that broadly defined SAPs are "more akin to a tripwire than an information gathering tool."

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The Court did not take issue with a bespoke 24-month lookback for supplying information regarding AAUs under the particular facts and circumstances of the case.

2. Consulting/Nomination Provision

AIM's amended bylaws also require disclosure of AAUs between the nominating stockholder or an SAP, 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 ten years (the "Consulting/Nomination Provision"). The Court found that this ANB provision contained the same fatal flaw as the AAU Provision insofar that its extension to SAPs rendered it overly broad. It was also concerning because it "imposes ambiguous requirements across a lengthy term" of a full decade. This extended time period was further troubling because the verbiage swept in exchanging informal investment tips and "advice" on unrelated companies and "potential investments."

The Court concluded that the Consulting/Nomination Provision must fall, again citing to Mr. Freedman's testimony, since such a provision "would give the Board license to reject a notice based on a subjective interpretation of the provision's imprecise terms."

3. Known Supporter Provision

This provision requires the nominating stockholder to disclose, as to each of the nominees, all known supporters of the nomination (the "Known Supporter Provision"). Defendants claimed that a similar provision had been upheld in *Rosenbaum v. CytoDyn, Inc.* The Court noted that the ANB in *CytoDyn* was limited to disclosure of financial supporters. In contrast, AIM's provision required disclosure of supporters known to SAPs, and it was not clear to the Court what "support" in this context meant.

Vice Chancellor Will stated that the Board "overreached" in adopting such a provision that "impedes the stockholder franchise while exceeding any reasonable approach to ensuring thorough disclosure." In striking down the Known Supporter Provision, the Court stated that the "limits of this provision are ambiguous" and could allow the Board to "take a broad reading of [this provision] and reject the nomination as noncompliant for reasons a stockholder could not realistically anticipate." By contrast, a Known Supporter Provision tied to "financial support or meaningful assistance" would likely survive scrutiny.

4. Ownership Provision

This provision requires a nominating stockholder to disclose ownership of AIM securities, including derivative and synthetic positions, held by SAPs, persons acting in concert and immediate family members (the "Ownership Provision"). Defendants claimed to have crafted this provision to tie to

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updated Schedule 13(d) beneficial ownership requirements and to address concerns that have arisen with investments in synthetic securities. While Vice Chancellor Will could not say whether AIM's 1,099-word Ownership Provision "would choke a horse," she found that it was "indecipherable" and "seem[ed] designed to preclude a proxy contest for no good reason." The Court's concerns included not only the sheer length of the Ownership Provision, but also vague requirements such as disclosing investments in any "principal competitor," which was undefined. So, while the underlying purpose was sound, the Court concluded that this provision "as drafted sprawls wildly beyond [its] purpose."

5. First Contact Provision

This provision requires disclosure of the dates of first contact among those involved in the nomination effort. The Court found that while unusual, this ANB made sense in view of the Board's 2022 experience and should not be difficult to comply with.

6. Questionnaire Provision

This fairly common provision requires the nominating stockholder's director nominees to complete a form of D&O questionnaire furnished by the Company. The Court found "nothing unreasonable" about the provision on its face. Kellner's main attack on the questionnaire requirement was that AIM had five business days to furnish it upon a nominating stockholder's written request, which could create an opportunity for gamesmanship. The Court found that manipulative abuse of this timing mechanism could still be achieved in a shorter period of time, and therefore such concern would be better addressed by considering whether the Board's enforcement of the provision was reasonable.

Key Takeaways

- The Court's disdain for overly broad "stockholder associated persons" definitions in ANBs, which are designed to frustrate the nomination process and introduce tripwires, was clear throughout the decision. In fact, according to Vice Chancellor Will, this broadly defined SAP concept is what caused otherwise reasonable bylaws to go "off the rails."

- AIM did not amend its ANBs on a "clear day"; it did so in the wake of a shareholder activist campaign. When an ANB is adopted on a cloudy day, the burden of proof to demonstrate that its adoption was reasonable under the circumstances lies with the defendants, which may include the board and company. On a clear day, the burden lies with the plaintiff stockholder. *Regardless of who has the burden of proof, Vice Chancellor Will's emphasis on the need to strike a balance between appropriate corporate purposes and the stockholder franchise is therefore significant, and appears intended to send a*

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message that certain of the extreme ANBs adopted by AIM with which she took issue would fail under all circumstances.

- The Court expressed concerns that a vaguely drafted ANB "would give the Board license to reject a notice based on a subjective interpretation of the provision's imprecise terms." The more an ANB permits discretion and subjectivity, the less reasonable and proportionate to purpose it becomes in the Court's view.

- We may see companies subject to perennial activist campaigns, particularly those waged by repeat activists, amend their existing AAU Provisions to add a 12- to 24-month lookback in reliance on the Court's fact-specific blessing of AIM's AAU lookback.

- Companies will likely be advised to tighten up the language in their existing AAU Provisions, Consulting/Nomination Provisions and other ANBs that incorporate the definition of SAP to ensure that they are more workable from a practical disclosure standpoint and to avoid the appearance of being "more akin to a tripwire than an information gathering tool." Specifically, it would not surprise us to see companies pare back double references to "affiliates," "associates" and "family members" that we commonly see in both the ANBs and the definition of SAP.

- In the wake of the Court's decision, companies may also be advised to amend their Questionnaire Provisions to allow five business days to furnish their forms of questionnaires and to use them to extract more comprehensive information from the nominating stockholder and candidates. Such customized questionnaires and "waiting periods" may effectively foreclose stockholder nominations unless the stockholder requests the questionnaire well in advance of the nomination window closing.

Please contact the Olshan attorney with whom you regularly work or one of the attorneys below if you would like to discuss further or have questions.

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