

IN THE SUPREME COURT OF THE STATE OF DELAWARE

TALBOT INC., TIMOTHY GUNNISON,	:	
FRANCOIS PAYARD, NAOMI ROTHMAN,	:	
ROASRIA GABRIELLI, MARSHALL	:	
CANNON, AJEET GUPTA, DANIEL	:	
LEMON, CLARE LEONARD, and	:	
PATRICK RHANEY,	:	No. 162, 2015
	:	
Defendant Below,	:	
Appellants,	:	
	:	
v.	:	
	:	
ALPHA FUND MANAGEMENT L.P.,	:	
	:	
Plaintiff Below,	:	Court Below:
Appellee.	:	Court of Chancery of
	:	the State of Delaware
	:	
	:	C.A. No. 10428-CJ

---

Appellee's Reply Brief

---

Team C  
Attorneys for Appellee  
February 6, 2014

Table of Contents

TABLE OF CITATIONS.....iii

NATURE OF PROCEEDINGS.....1

SUMMARY OF THE ARGUMENT.....2

COUNTERSTATEMENT OF FACTS.....3

ARGUMENT.....7

I. THE COURT OF CHANCERY PROPERLY ISSUED A PRELIMINARY INJUNCTION PREVENTING ENFORCEMENT OF TALBOT’S FACIALLY INVALID PROXY FEE-SHIFTING BYLAW BECAUSE THE BYLAW IS INVALID UNDER DELAWARE LAW..7

    A. Question Presented.....7

    B. Scope of Review.....7

    C. Merits of the Argument.....7

        1. Talbot’s Proxy Fee-Shifting Bylaw is Facially Invalid Because it is Inconsistent with Delaware Law and Impermissibly Places Corporate Financial Liability on Stockholders.....7

        2. Talbot’s Unilaterally Adopted Bylaw Regulates The Stockholder’s Right To Vote And Therefore Is Facially Invalid.....11

II. THE COURT OF CHANCERY PROPERLY ISSUED A PRELIMINARY INJUNCTION PREVENTING ENFORCEMENT OF TALBOT’S PROXY FEE-SHIFTING BYLAW BECAUSE THE BYLAW SERVED AN INEQUITABLE PURPOSE AND LACKED A COMPELLING JUSTIFICATION.....15

    A. Question Presented.....15

    B. Scope of Review.....15

    C. Merits of the Argument.....16

        1. Talbot’s Adoption of the Proxy Fee-Shifting Bylaw Served an Inequitable Purpose Because the Bylaw Acted to Obstruct Alpha’s Initiation of a Proxy Contest as a Means to Entrench the Incumbent Directors.....16

        2. Talbot Does Not Have the Compelling Justification Necessary to Adopt a Defensive Measure that Affects the Rights of Stockholders.....19

CONCLUSION.....23

Table Of Citations

**DELAWARE SUPREME COURT CASES**

ATP Tour, Inc. v. Deutscher Tennis Bund,

91 A.3d 554 (Del. 2014).....8, 9, 11, 16

CA, Inc. v. AFSCME Emples. Pension Plan,

953 A.2d 227 (Del. 2008).....7, 11, 12, 13

Data Point Corp. v. Plaza Sec. Co.,

496 A.2d 1031 (Del. 1985).....12, 13

Kaiser Aluminum Corp. v. Matheson,

681 A.2d 392 (Del. 1996).....15, 16

MM Companies, Inc. v. Liquid Audio, Inc.,

813 A.2d 1118, 1126 (Del. 2003).....19, 20, 21

Schnell v. Chris-Craft Industries, Inc.,

285 A.2d 437 (Del. 1971).....16, 17, 18, 19

SI MGMT. L.P. v. Winingger,

707 A.2d 37 (Del. 1998).....7

**DELAWARE CHANCERY COURT CASES**

Blasius Indus. v. Atlas Corp.,

564 A.2d 651 (Del. Ch. 1988).....19, 20, 21, 22

Boilermakers Local 154 Retirement Fund v. Chevron Corp.,

73 A.3d 934 (Del. Ch. 2013).....7, 8, 10, 11, 12, 14, 15

Bird v. Lida, Inc.,

681 A.2d 399 (Del. Ch. 1996).....	10, 11
<u>Feeley v. NHAOCG, LLC,</u>	
62 A.3d 649 (Del. Ch. 2012).....	7, 10
<b>DELAWARE STATUTES</b>	
8 Del. C. § 102(b) (6).....	10
8 Del. C. § 109.....	8
8 Del. C. § 212.....	9
8 Del. C. § 215.....	9
<b>PUBLICATIONS</b>	
Lawrence Hamermesh, <i>Consent in Corporate Law</i> , 70 Bus. Law. 161, (Winter 2014/2015).....	10
18A Am. Jur. 2d <i>Corporations</i> § 771 (2014).....	9
<b>LEGISLATIVE MATERIALS</b>	
Senate Bill 236 (June 3, 2014).....	9
Senate Joint Resolution No. 12 (June 18, 2014).....	9
Synopsis, Senate Bill 236 (June 3, 2014).....	9
<b>ELECTRONIC SOURCES</b>	
The Honorable, Henry DuPont Ridgely, Justice, Supreme Court of Delaware, <i>The Emerging Role of Bylaws in Corporate Governance</i> , available at: <a href="http://www.delawarelitigation.com/files/2014/11/The_Emerging_Role_of_Bylaws_in_Corporate_Governance_copy.pdf">http://www.delawarelitigation.com/files/2014/11/The_Emerging_Role_of_Bylaws_in_Corporate_Governance_copy.pdf</a> .....	9

NATURE OF THE PROCEEDING

Appellee, Plaintiff below, challenged the validity of Talbot Inc.'s Proxy Fee-Shifting Bylaw seeking a preliminary injunction against Appellants, Defendant's below, in the Court of Chancery. The Appellee based the challenge on claims that the Proxy Fee-Shifting Bylaw was facially invalid and was enacted for an inequitable purpose. Chancellor Junge granted a preliminary injunction against the enforcement of the Proxy Fee-Shifting By-law in connection with any proxy contest for the Talbot Inc.'s Board of Directors election at the May 2015 annual stockholders meeting on January 15, 2015.

Appellants filed a notice of appeal on January 22, 2015, and this Court accepted an expedited appeal on January 29, 2015.

Appellee requests that this Court affirm the Court of Chancery's order and find Talbot Inc.'s Proxy Fee-Shifting Bylaw is facially invalid and unenforceable as an action based on an inequitable purpose.

## Summary of The Argument

1. This Court should find Talbot Inc.'s Proxy Fee-Shifting Bylaws facially invalid. Delaware law prohibits Proxy Fee-Shifting Bylaws because they impermissibly expose stockholders to personal financial liability. Additionally, Proxy Fee-Shifting Bylaws interfere with a substantive stockholder right. That is, the bylaws obstruct stockholders' participation in the election of the board of directors. Accordingly, Proxy Fee-Shifting Bylaws are facially invalid.

2. This Court should uphold the Court of Chancery's preliminary injunction because Talbot Inc. adopted the Proxy Fee-Shifting bylaw for an inequitable purpose. In direct response to Alpha Fund Management L.P.'s disclosure that it would initiate a proxy contest, Talbot Inc. attempted to entrench the incumbent board of directors by unilaterally adopting a Proxy Fee-Shifting Bylaw. Moreover, Alpha Fund Management L.P.'s actions were neither preclusive nor coercive and therefore Talbot Inc.'s Board of Directors lacked a compelling justification to adopt the bylaw. Accordingly, this Court must find that the Proxy Fee-Shifting Bylaw is invalid.

COUNTERSTATEMENT OF FACTS

This interlocutory appeal of a preliminary injunction order arises out of the Defendant Talbot Inc.'s ("Talbot") board of directors' adoption of a Proxy Fee-Shifting Bylaw in direct response to the Plaintiff Alpha Fund Management L.P.'s ("Alpha") plan to contest the director's incumbency. Mem. Op. at 14.

Talbot is a publicly traded Delaware corporation that manufactures critical fasteners for aerospace and other industrial markets (the "Fastener's Division"). Mem. Op. at 2. The company also produces micro-electronic circuitry components for consumers (the "Components Division") and has a growing stake in software development for industrial manufacturing markets (the "Software Division"). Mem. Op. at 2. Talbot has approximately 75 million shares of common stock outstanding and a market capitalization of approximately \$2.25 billion. Mem. Op. at 2. For the most recent fiscal year, Talbot reported net earnings after taxes of \$120 million on revenues of \$1.1 billion. Mem. Op. at 2. The Talbot Board of Directors consists of nine directors who stand for election annually. Mem. Op. at 3.

Alpha is a small limited partnership under the laws of Delaware and manages funds including sophisticated investors such as insurance companies, pension funds, and university endowments. Mem. Op. at 2. At the end of last year, Alpha owned an equity portfolio worth \$1.1 billion. Mem. Op. at 2. Alpha's Chief Executive Officer, Jeremy Womack, has directed Alpha to be an activist stockholder in the companies it invests in. Mem. Op. at 2.

Alpha began acquiring stock in Talbot in late 2013 and once Alpha acquired 4% of the outstanding shares, Womack reached out, on behalf of Alpha, to Talbot's CEO and member of the Board of Directors, Timothy Gunnison



to propose a restructuring plan (the "Restructuring Proposal") that would shed the Component and Software Divisions, cutting operating expenses and focusing on the more profitable Fasteners Division. Mem. Op. at 3. Gunnison was skeptical stating that Womack did not account for the synergy of the divisions and failed to take into account cost cutting measures already in place. Mem. Op. at 4.

Alpha continued to acquire shares and after acquiring 7% of Talbot's outstanding shares, filed a 13D with the Securities and Exchange Commission ("SEC") disclosing the shares and investment only intentions with Talbot including the Restructuring Proposal and plan to advance this proposal by nominating four directors to the Talbot Board at the May 2015 stockholders meeting. Mem. Op. at 4.

In response to Alpha's plan to nominate four directors, Talbot's Board held a meeting outside of its separate regularly monthly meeting on December 18, 2014 in which all Board members were present, along with the Vice President for Finance Operations, the Company's Vice President and General Counsel, and a partner with the Company's outside law firm, Jackson and Wyeth LLP ("Jackson and Wyeth"). Mem. Op. at 5. Talbot's Vice President for Finance Operations presented on Alpha's Restructuring Proposal and the ongoing cost cutting plan. Mem. Op. at 5. The Board members believed the current cost cutting plan promised greater long-term value for the Company and its stockholders than Alpha's Restructuring Proposal. Mem. Op. at 5-6.

After the Board determined that, in their opinion, Alpha's Restructuring Proposal was not in the best interest of Talbot and the stockholders, they heard presentations from in-house and outside counsel on terms and mechanics of Proxy Fee-Shifting Bylaw. Mem. Op. at 6. Outside

counsel presented proxy contest costs for corporations ranging "from \$800,000 to \$3 million in fees for small firms, and \$4 million o \$14 million for large firms." Mem. Op. at 6. A Proxy Fee-Shifting Bylaw would require an unsuccessful proxy contestant to take on liability for the Talbot's reasonable professional fees and expenses that Talbot incurs in resisting a proxy contest if not successful. Mem. Op. at 6-7. Within the terms of the Proxy Fee-Shifting Bylaw proposed, a proxy contest is not successful if less than half of the contestant's nominees win election. Mem. Op. at 7.

Outside counsel also advised the Board they could consider the potentially adverse financial impact of proxy contest costs on the corporation and the stockholders in the exercise of good faith and business judgment, however, no conclusive determination regarding the legal validity of a the Proxy Fee-Shifting Bylaw was made. Mem. Op. at 6 n.4. In-house counsel also stated that the terms of the Proxy Fee-Shifting Bylaw in discussion would allow the Board, in the proper exercise of fiduciary duties, to waive the fee-shifting obligation imposed by the bylaw. Mem. Op. at 6.

As applied to Alpha, the Proxy Fee-Shifting Bylaw would impose financial liability to reimburse Talbot for a proxy contest if one or none of Alpha's nominees win election. Mem. Op. at 7. The parties disagree about the amount of expenses that Talbot may incur and impose on Alpha under the Fee-Shifting Bylaw. Mem. Op. at 7.<sup>1</sup>

During Board discussion of the Proxy Fee-Shifting Bylaw, many of the members reiterated their belief that Alpha's Restructuring Plan is an "ill-conceived short term plan at best" and believed that adopting the Proxy Fee-

---

<sup>1</sup>Alpha's proxy solicitor estimated costs to likely exceed \$12 million, while Talbot's Vice President for Finance Operations estimated costs to the company of \$8 million. Mem. Op. at 8.

Shifting Bylaw would "raise the stakes for this guy [Womack]," and the Bylaw "might get Alpha to think twice about all this." Mem. Op. at 8. Only one Director expressed support for the Proxy Fee-Shifting Bylaw due to the overall ability it would give the Company to recoup loss after an insurgent's proxy contest failed. Mem. Op. at 9.

At the conclusion of this meeting, the Talbot Board adopted the Proxy Fee-Shifting Bylaw and decided to not waive the fee-shifting obligation for Alpha at this time. Mem. Op. at 9. The Board disclosed all of this information in a press release the same day. Mem. Op. at 9.

Four days after Talbot's press release regarding Talbot Board's adoption of the Proxy Fee-Shifting Bylaw and decision to not waive the obligation for Alpha, Alpha sent a certified letter to Talbot providing formal notice of intention to nominate four people for election to the Talbot Board at the May 2015 annual stockholders meeting. Mem. Op. at 9. This same day, Alpha filed suit in the Delaware Court of Chancery attacking the Proxy Fee-Shifting Bylaw and requesting a preliminary injunction to prevent Talbot from enforcing the Proxy Fee-Shifting Bylaw against Alpha in the May 2015 proxy contest. Mem. Op. at 10.

## ARGUMENT

I. THE COURT OF CHANCERY PROPERLY ISSUED A PRELIMINARY INJUNCTION PREVENTING ENFORCEMENT OF TALBOT'S FACIALLY INVALID PROXY FEE-SHIFTING BYLAW BECAUSE THE BYLAW IS INVALID UNDER DELAWARE LAW.

A. Question Presented

Whether Talbot's Proxy Fee-Shifting Bylaw is prohibited by Delaware law, and therefore facially invalid, because it imposes personal financial liability on Talbot stockholders and precludes stockholder participation in the election of board of directors.

B. Scope of Review

A court may grant a preliminary injunction upon a plaintiff's showing of the following three factors: (1) a reasonable probability of success on the merits; (2) irreparable harm; and (3) a balance of equities in its favor. SI MGMT. L.P. v. Winger, 707 A.2d 37, 40 (Del. 1998). The Appellants have conceded the second and third factors. Mem. Op. at 10. This Court must review the Court of Chancery's grant of a preliminary injunction for abuse of discretion without deference to the Court of Chancery's legal conclusions. SI MGMT., 707 A.2d at 40. Because the Court of Chancery below declined to rule on facial validity, this Court reviews the issue of facial validity de novo. Mem. Op. at 12.

C. Merits of the Argument

1. Talbot's Proxy Fee-Shifting Bylaw is Facially Invalid Because it is Inconsistent with Delaware Law and Impermissibly Places Corporate Financial Liability on Stockholders.

A Proxy Fee-Shifting Bylaw is prohibited by Delaware law. See CA, Inc. v. AFSCME Emples. Pension Plan, 953 A.2d 227, 237 (Del. 2008) See

Feeley v. NHAOCG, LLC, 62 A.3d 649 (Del. Ch. 2012); See Boilermakers Local 154 Retirement Fund v. Chevron Corp., 73 A.3d 934 (Del. Ch. 2013). According to the Delaware Code, “bylaws may contain any provision,” not inconsistent with law or with the certificate of incorporation, relating to the business of the corporation, the conduct of its affairs, and its rights or powers or the rights or powers of its stockholders, directors, officers or employees.” 8 Del. C. § 109(b).

This Court has stated that for a bylaw to be facially valid, it “must [1] be authorized by the Delaware General Corporation Law (DGCL), [2] [be] consistent with the corporation’s certificate of incorporation, and [3] its enactment must not be otherwise prohibited.” ATP Tour, Inc. v. Deutscher Tennis Bund, 91 A.3d 554, 557-58 (Del. 2014). Furthermore, this Court has held that a corporation’s bylaws are presumed to be valid and the fact that a bylaw may conflict with a statute, or operate unlawfully, does not automatically result in facial invalidity. Id. In asking a court to find that a board-adopted bylaw is facially invalid, the stockholder must show it “cannot operate validly in any conceivable circumstance.” Boilermakers, 73 A.3d at 940.

This Court applied the three-part test to a non-stock corporation’s fee-shifting bylaw in ATP. ATP, 91 A.3d at 557. In ATP, the non-stock corporation unilaterally adopted a broad fee-shifting bylaw that shifted financial liability onto members if they were not “substantially” successful in bringing a claim against the non-stock

corporation. Id. at 556. Two members of the corporation challenged the fee-shifting bylaw as facially invalid, however this Court ultimately held that “fee-shifting provisions in a *non-stock* corporation’s bylaws can be valid and enforceable under Delaware law.” Id. at 555 (emphasis added).

The ATP decision does not extend to stock corporations. See ATP, 91 A.3d at 555. This Court repeatedly stated throughout the ATP decision that the holding applied to *non-stock* corporations. Id. at 557–58 (emphasis added). Recently, the Honorable Henry duPont Ridgely, a Supreme Court of Delaware Justice who took part in the ATP decision, stated that whether ATP applied to for-profit stock corporations was still an “open question.”<sup>2</sup> Furthermore, stock and non-stock corporations possess distinct characteristics. 18A Am. Jur. 2d Corporations § 771 (2014). The Delaware General Corporation Law accounts for these differences between stock and non-stock corporations. For example 8 Del. C. §§ 212 (Voting rights of stockholders; proxies; limitations), 215 (Voting rights of members of nonstock corporations; quorum; proxies); Senate Bill 236 (June 3, 2014).<sup>3</sup> Since this Court’s ATP decision applies to only non-stock

---

<sup>2</sup>The Honorable Ridgely stated he did not speak on behalf of all the Justices, however, it is his understanding that application to stock corporations is an open question. The Honorable Henry DuPont Ridgely, Justice for the Supreme Court of Delaware, The Emerging Role of Bylaws in Corporate Governance (Jan. 29, 2015), [http://www.delawarelitigation.com/files/2014/11/The\\_Emerging\\_Role\\_of\\_Bylaws\\_in\\_Corporate\\_Governance\\_copy.pdf](http://www.delawarelitigation.com/files/2014/11/The_Emerging_Role_of_Bylaws_in_Corporate_Governance_copy.pdf).

<sup>3</sup>In response to the ATP decision, a Delaware Senator proposed an amendment to the Code limiting ATP’s holding to non-stock corporations. Synopsis, Senate Bill 236 (June 3, 2014). Discussions on Senate Bill 236 are forestalled for further examination. Senate Joint Resolution No. 12 (June 18, 2014).

corporations, the question of the facial validity of a stock corporation's Proxy Fee-Shifting Bylaw is a matter of first impression. Mem. Op. at 12.

In this case, Talbot's certificate of incorporation expressly confers power to the board to adopt this bylaw. Mem. Op. at 11. Since the Court of Chancery's opinion is silent as to any inconsistencies between the Proxy Fee-Shifting Bylaw and Talbot's certificate of incorporation, the assumption is that the bylaw is not invalid on this basis. Mem. Op. at 11-12. While Talbot's bylaw is presumed permissible under Talbot's certificate of incorporation, it "cannot operate validly in any conceivable circumstance" because it impermissibly imposes corporate financial liability on stockholders. Boilermakers, 73 A.3d at 940, 948-49.

Bylaws that impermissibly impose personal liability on stockholders are inconsistent with Delaware law and therefore, are facially invalid. See Feeley, 62 A.3d at 667. Delaware corporate law respects principles of limited liability so that stockholders are generally able "to limit their risk to the amount of their investment in the entity." Feeley, 62 A.3d at 667; Lawrence Hamermesh, Consent in Corporate Law, 70 Bus. Law. 161, (Winter 2014/2015) (citing Del. C. Ann. tit. 8 § 102(b)(6)). This principle creates the corporate veil, shielding stockholders from becoming personally liable for debts or liabilities of the corporation. Bird v. Lida, Inc., 681 A.2d 399, 402 (Del. Ch. 1996). Only with this limited liability for stockholders can a corporation promote investor diversification made up by relatively passive investors. Id.

In this case, Talbot's Board of Directors have inappropriately planned to impose the corporation's financial liability on stockholders, like Alpha. While Alpha and other stockholders take on their own financial liability for a proxy contest, imposing on them the company's costs associated with such a proxy contest is an action in direct conflict with the principle of stockholder limited liability. Id.

This Court should find Talbot's Proxy Fee-Shifting Bylaw facially invalid because it impermissibly places Talbot's financial liability on stockholder Alpha. This Court should further find that Talbot's bylaw is facially invalid because it is an impermissible, substantive bylaw.

2. Talbot's Unilaterally Adopted Bylaw Regulates The Stockholder's Right To Vote And Therefore Is Facialy Invalid.

The Proxy Fee-Shifting Bylaw, unilaterally adopted by Talbot, is facially invalid because it precludes stockholders from participating in Talbot's board of director electoral process. This Court has held that for a bylaw to be facially valid the bylaw's enactment must not be "prohibited," by Delaware law. ATP, 91 A.3d at 557-58. Additionally, Delaware courts have long accepted the notion that corporate bylaws maintain a "procedural, process-oriented nature." Boilermakers, 73 A.3d at 951 (quoting CA, Inc. v. AFSCME Emps. Pension Plans, 953 A.2d 227 (Del. 2008)). That is, valid bylaws cannot decide "substantive" decisions, but merely define the process employed to make those substantive. CA, Inc., 953 A.2d at 234-35. This Court has held that stockholders possess the substantive right "to participate



in selecting the contestants" for board elections. Id. at 237. Moreover, bylaws that determine the "kind of remedy" that a corporation may achieve are substantive. Boilermakers, 73 A.3d at 952.

Fee-shifting bylaws that encroach upon basic stockholder rights possesses an inherently substantive character. See Data Point Corp. v. Plaza Sec. Co., 496 A.2d 1031 (Del. 1985). In Datapoint Corp. v. Plaza Sec. Co., a corporation adopted a bylaw that delayed the consummation of shareholder-approved actions. Id. at 1033-034. A shareholder, who was interested in buying a majority stake in Datapoint, challenged the facial validity of the bylaw. Id. at 1033. This Court ruled that the enacted provision contravened § 228 by delaying corporate action after valid shareholder consent had already been obtained. Id. at 1035 (Citing 8 Del. C. § 228). While this Court acknowledged that a bylaw could provide minimal review concerning the validity of stockholder consent without violating § 228, the bylaw instituted by Datapoint was "so pervasive as to intrude upon fundamental stockholder rights." Id. at 1036. Accordingly, this Court held that the bylaw was facially invalid. Id.

Furthermore, this Court emphasized stockholder's substantive right to partake in the election of a corporation's board of directors. CA, Inc, 953 A.2d at 237. In CA, Inc., shareholders proposed an amendment to the corporation's bylaws that would reimburse parties that were fifty percent or more successful in electing their candidates as a result of a proxy contest. Id. at 229-30. This Court recognized that stockholders have a "legitimate and protected interest" in the election of directors. Id. at 237. In addition, this

Court highlighted that the “unadorned right to cast a ballot in a contest for [corporate] office . . . is meaningless without the right to participate in selecting contestants.” Id. at 234 (quoting Harrah’s Entm’t v. ICC Holding Co., 802 A.2d 294, 311 (Del. Ch. 2002)).

Although, the bylaw was ultimately found invalid on other grounds, this Court emphasized the importance of stockholder’s ability to nominate candidates for the election to the board of directors. Id. at 237.

The Proxy Fee-Shifting Bylaw unilaterally adopted by the Talbot board of directors is innately substantive because it excludes Alpha from participating in the board electoral process. See Data, 496 A.2d at 1036; CA, Inc., 953 A.2d at 237. This Court in CA, Inc. stressed that the nominating process is a “fundamental and outcome-determinative step” in elections and allowing for “voting while maintaining a closed selection process [] renders the former an empty exercise.” CA, Inc., 953 A.2d at 237 (quoting Harrah’s Entm’t v. ICC Holding Co., 802 A.2d 294 (Del. Ch. 2002)). The Talbot bylaw precludes stockholders from participating in the nomination procedure, because it unfairly imposes one-way financial liability on stockholders that are not substantially successful in electing their proxy candidates. Mem. Op. at 7 n.7. Thus, Talbot’s bylaw is directly opposite of the policy that this Court characterized as “facilitating” shareholder participation in the election process in CA, Inc.. 953 A.2d at 237.

The bylaw will always prevent Talbot stockholders from initiating a proxy contest because of the lingering possibility of incurring the corporation’s enormous expenses. Mem. Op. at 8. Talbot’s Board of

Directors' ability to waive the bylaw is meaningless in the face of a proxy contest. Mem. Op. at 7 n.7. In this case, Alpha has stated it will not proceed with a proxy contest if the bylaw is not invalidated due to the risk of incurring enormous personal financial liability.<sup>4</sup> Mem. Op. at 12. Therefore, Talbot's bylaw substantially interferes with Alpha's substantive rights.

Bylaws that outline the nature of the remedy that corporate actors may obtain are substantive. See Boilermakers, 73 A.3d at 952-53. In Boilermakers, the validity of a unilaterally adopted forum selection clause was challenged. Id. at 938. The court held that forum selection clauses are "process-oriented because they regulate *where* stockholders may file suit, not *whether* the stockholder may file suit." Id. at 951-52. Furthermore, the court held that forum selection clauses are not substantive because they do not dictate the "remedy that the stockholder may obtain." Id. at 952. Since bylaws equally apply to both the stockholders and board of directors, it follows that no facially valid bylaw can regulate the remedy a corporation can seek. See Id. at 952-53.

The Proxy Fee-Shifting Bylaw substantively altered the remedy available to both Talbot and Alpha. Mem. Op. at 7 n.7. By allowing Talbot to shift the burden of paying proxy contest costs to an unsuccessful stockholder, like Alpha, this bylaw has substantially transformed their available remedy. Mem. Op. at 7 n.7. Therefore, the bylaw at issue in this case is substantive because it dictates what

---

<sup>4</sup>Alpha's proxy solicitor has anticipated proxy costs in excess of twelve million dollars, while Talbot has estimated costs of eight million. Mem. Op. at 8.

remedy is available to the parties involved in a proxy-contest.

Boilermakers, 73 A.3d at 952.

Moreover, the court deciding Boilermakers further justified the validity of forum selection clauses because stockholders retain the power to amend or repeal bylaws by voting in different directors.

Boilermakers, 73 A.3d at 956-57. However, this rationale is moot if the stockholder's ability to nominate new directors is abolished, as it is in this case. Mem. Op. at 12.

This Court should uphold the preliminary injunction because Talbot's Proxy Fee-Shifting Bylaw is facially invalid. Furthermore, Talbot enacted the bylaw for an inequitable purpose, because it was created in direct response to Alpha's disclosure that it was planning to initiate a proxy contest.

II. THE COURT OF CHANCERY PROPERLY ISSUED A PRELIMINARY INJUNCTION PREVENTING ENFORCEMENT OF TALBOT'S PROXY FEE-SHIFTING BYLAW BECAUSE THE BYLAW SERVED AN INEQUITABLE PURPOSE AND LACKED A COMPELLING JUSTIFICATION.

A. Question Presented

Whether the Talbot Board of Director's purpose in adopting the Proxy Fee-Shifting Bylaw was inequitable when the bylaw is meant to defeat a potential proxy contest and to entrench the existing board of directors.

B. Scope of Review

Courts review the grant of a preliminary injunction for abuse of discretion without deference to the legal conclusions of the lower court. Kaiser Aluminum Corp. v. Matheson, 681 A.2d 392, 394 (Del. 1996). A court may grant a preliminary injunction if a plaintiff has

established a reasonable probability of success on the merits, irreparable harm, and a balance of equities in its favor. Id. The Appellants have conceded the second and third factors. Therefore, this Court reviews the Court of Chancery's determination of a reasonable probability of success on the merits for abuse of discretion, without deference to the legal conclusions. Id.

C. Merits of Argument

1. Talbot's Adoption of the Proxy Fee-Shifting Bylaw Served an Inequitable Purpose Because the Bylaw Acted to Obstruct Alpha's Initiation of a Proxy Contest as a Means to Entrench the Incumbent Directors.

The Court of Chancery properly enjoined Talbot's Board from enforcing its Proxy Fee-Shifting Bylaw because the purpose of the bylaw was to inequitably obstruct Alpha's ability to partake in a proxy contest, thereby entrenching the incumbent directors. Mem. Op. at 7 n. 7. While this Court should find the Proxy Fee-Shifting Bylaw facially invalid, it must also, find this bylaw unenforceable because it serves an equitable purpose. Schnell v. Chris-Craft Indus., Inc., 285 A.2d 437, 439 (Del. 1971).

A court may not uphold a bylaw as valid if the adoption of the bylaw serves an inequitable purpose. Id. When deciding if an action serves an inequitable purpose, the courts look to all facts and circumstances surrounding the adoption of the bylaw, including the manner in which the board adopted the bylaw. ATP, 91 A.3d at 558. This Court has held the use of "corporate machinery" to obstruct access to proxy contests in an attempt to entrench an already existing board of directors is inequitable. Schnell, 285 A.2d at 439.

A bylaw is inequitable when it interferes with a stockholders ability to participate in a proxy contest as a means to entrench the incumbent directors. Id. In Schnell, a dissident group of stockholders sought injunctive relief barring the board of directors from enforcing a bylaw amendment that advanced the date of the stockholders' meeting. Id. at 438. The board adopted the bylaw two days after the dissident group filed SEC filings, which informed the board of its intentions to begin a proxy contest in response to the corporation's underwhelming financial performance. Id. at 439 (quoting Schnell v. Chris-Craft Indus., Inc., 285 A.2d 430, 434 (Del. Ch. 1971)). This Court found the board's adoption of the advancement was in direct response to these SEC filings. Id. at 439. The advancement of the stockholders' meeting date greatly precluded the dissident group from partaking in a proxy contest. Id. This Court reasoned that the bylaw was adopted for the inequitable purpose of obstructing the dissident group's potential proxy contest as a means to entrenching the incumbent directors. Id. Accordingly this Court declared the bylaw invalid. Id. at 440.

In the present case, Talbot's Board adopted the Proxy Fee-Shifting Bylaw in direct response to the threat of a proxy contest by Alpha. Mem. Op. at 4-5. Like the board in Schnell which adopted a bylaw soon after becoming aware of a potential proxy contest, Talbot's Board acted a mere eight days after becoming aware of Alpha's intention to initiate a proxy contest. Mem. Op. at 4-5. Furthermore, the December 18th board meeting arose after Talbot's Board had already met for its monthly board meeting. Mem. Op. at 5. The Board's agenda

at the December 18th meeting focused on Alpha's Restructuring Proposal and how to prevent its adoption. Mem. Op. at 5-9.

In direct response to Alpha's threat of a proxy contest, Talbot's Board adopted the Proxy Fee-Shifting Bylaw, which inequitably obstructed Alpha's ability to initiate a proxy contest. Mem. Op. at 9. Similar to the board's adoption of a bylaw advancing the stockholders meeting in Schnell, 285 A.2d at 438, the Talbot Board's adoption of the Proxy Fee-Shifting Bylaw obstructed Alpha's ability to wage a proxy contest, Mem. Op. at 9. By potentially shifting all costs of a proxy contest onto stockholders, Talbot's Board effectively forced Alpha to abandon its proxy contest. Mem. Op. at 12.

The deposition testimony of Talbot directors is further evidence that the Board adopted the bylaw in an effort to obstruct Alpha's threatened proxy contest. Mem. Op. at 12. For example, one director stated the bylaw "might get Alpha to think twice about all this." Mem. Op. at 8. Furthermore, another director stated "if the [Proxy Fee-Shifting] bylaw helps to stop Alpha, then I'm for it." Mem. Op. at 8. While one director reasoned the bylaw would allow the company to "recoup costs," no directors disagreed with obstructing Alpha from instituting a proxy contest. Mem. Op. at 9. Based on these facts, the Talbot Board adopted the Proxy Fee-Shifting Bylaw for an inequitable purpose.

Talbot's Board obstructed Alpha's ability to initiate a proxy contest in an attempt to entrench their position on the board. Mem. Op. at 5-9. Similar to the stockholder in Schnell, 285 A.2d at 439, Alpha unhappy with the financial performance of Talbot, initiated a

proxy contest in order to nominate directors with shared views of changing the corporation's business structure, Mem. Op. at 3-4. The Talbot Board Members, like the board members in Schnell, 285 A.2d at 439, unanimously disagreed with the proposed business plan, and therefore adopted the bylaw to effectively prohibit the stockholders from partaking in proxy contests, Mem. Op. at 9-12. This Court must find that the Talbot Board adopted the Proxy Fee-Shifting Bylaw, as a means to entrench itself.

Examining all the facts and circumstances, the Talbot Board adopted the Proxy Fee-Shifting Bylaw for the inequitable purpose of obstructing Alpha's initiation of a proxy contest in an attempt to entrench the incumbent directors. Because the bylaw was adopted for an inequitable purpose, this Court must uphold the Court of Chancery's finding that the bylaw is invalid.

2. Talbot Does Not Have the Compelling Justification Necessary to Adopt a Defensive Measure that Affects the Rights of Stockholders.

The allocation of powers between the board of directors and the stockholders, in particular the stockholder's right to vote, is the most "fundamental principle[] of corporate democracy." MM Cos., Inc. v. Liquid Audio, Inc., 813 A.2d 1118, 1126 (Del. 2003). When a board of directors restricts the stockholders' right to vote such action must be scrutinized for a compelling justification, regardless of whether the board acts in good faith. Id. at 1128 (quoting Blasius Indus. v. Atlas Corp., 564 A.2d 651 (Del. Ch. 1988)). Accordingly, the corporation carries a "heavy burden" in establishing a compelling justification. Blasius, 564 A.2d at 661. Only once the corporation



demonstrates a compelling justification, the analysis shifts to whether the board acted reasonably and proportionally. MM, 813 A.2d at 1132.

In Blasius, the court found that the board of director's action increasing the number of board seats, while done in good faith, was not valid because it was not based on a compelling justification. Blasius, 564 A.2d at 663. In Blasius, a stockholder filed a SEC 13D form, which disclosed the stockholder's intention to expand the board and gain a majority to effectuate a corporate restructuring plan. Id. at 653. At the time of the filing, the corporation was already implementing its own restructuring plan. Id. In response to the shareholder's actions, the corporation's board held an emergency meeting. Id. at 654. At the meeting, the board increased the number of directors from seven to nine and unilaterally filled the new seats effectively preventing the stockholder from obtaining a majority on the board. Id. at 655. The board's intention was to ensure continuation of the existing restructuring plan because it viewed the stockholder's proposal as unviable. Id. at 653. The court held that the board's nomination of two additional directors was invalid because it was not based upon a compelling justification. Id. at 663.

The court rejected the board's justification that it acted in the best interest of the company because when a stockholder's right to vote is implicated the best interest of the company becomes irrelevant. Id. The court pointed out that the board could instead act to educate the other stockholders as to the potential risks and dangers surrounding the stockholder's proposed restructuring plan. Id.

This Court affirmed the Blasius analysis in MM, a case with similar facts to Blasius. Blasius, 813 A.2d 1118. While this Court found that coercive action by a stockholder may be compelling justification, it reinforced that the board carries the difficult burden of showing the coercive or preclusive action. Id. at 1131. Furthermore, this Court affirmed the requirement of heightened judicial scrutiny when a board's action implicates a stockholder's right to vote. Id. at 1129.

In the present case, the analysis the court employed in Blasius applies because the action by Talbot's Board involved the stockholder's voting rights. Mem. Op. at 7. n.7. Like the board in Blasius, which acted to limit stockholder's ability to nominate directors, 564 A.2d at 655, the Talbot Board effectively limited Alpha's access to the board by imposing the threat of proxy fees, Mem. Op. at 6-7. The Talbot Board's implementation of the Proxy Fee-Shifting Bylaw dissuades stockholders from initiating a proxy contest, thereby limiting voting rights. Mem. Op. at 12.

Since the present case implicates stockholder-voting rights, Talbot has the heavy burden of showing a compelling justification for its actions; a burden Talbot does not meet. Blasius, 564 A.2d at 660-62. Although the Talbot Board may have acted on the belief that its current restructuring plan was in the best interest of the corporation, Mem. Op. at 16, this belief does not meet the compelling justification required by Blasius, 564 A.2d at 663. As the court opined in Blasius, the board should not rely upon its own belief of the best interest of the corporation, and should instead defer to the

stockholders. Blasius, 564 A.2d at 663. The Talbot Board should have deferred to the stockholders and educated them on the negative impacts of the restructuring plan instead of applying its own opinion. As the court reasoned in Blasius, the best interest of the corporation is not a compelling justification to overcome the scrutiny applied to actions impacting stockholder-voting rights. Id.

Finally, the Talbot Board cannot show coercive or preclusive action by Alpha. Like the stockholder in Blasius, which held a mere 9.1% of the stocks, Alpha held a small minority of shares amounting to only 7% of the stock. Id. Because the Blasius court did not consider the action of a stockholder controlling 9.1% as coercive, 564 A.2d at 662, this Court should also not consider the actions of Alpha, holding a 7% controlling interest, as coercive, Mem. Op. at 1. Furthermore, Alpha's Restructuring Proposal was not preclusive because it did nothing to limit the actions of Talbot. Mem. Op. at 3. Because Talbot cannot show Alpha's actions to be coercive or preclusive, Talbot has not satisfied the required compelling justification for its adoption of the Proxy Fee-Shifting Bylaw.

In the present case, Talbot cannot satisfy the burden of providing a compelling justification for interfering with its Stockholder's rights. The record is silent as to any evidence that Alpha's action in initiating the proxy contest was coercive or preclusive. Furthermore, Talbot cannot rely on its justification that it passed the bylaw for the best interest of the corporation. Mem. Op. 14-15. As such, under Blasius, the Talbot Board's action lacks compelling justification, and is thus, invalid. Based on the lack of

compelling justification and the inequitable nature of the bylaw, this Court should uphold the Court of Chancery's preliminary injunction.

#### CONCLUSION

For the foregoing reasons, this Court should affirm the preliminary injunction preventing enforcement of Talbot's Proxy Fee-Shifting Bylaw against stockholder Alpha for the upcoming elections at the annual stockholders' meeting.