IN THE SUPREME COURT OF
THE STATE OF DELAWARE

TALBOT INC., TIMOTHY GUNNISON, FRANCOIS PAYARD, NAOMI ROTHMAN, ROSARIA GABRIELLI, MARSHALL CANNON, AJEET GUPTA, DANIEL LEMON, CLARE LEONARD, and PATRICK RHANEY,	)	No. 162, 2015
Defendants Below, Appellants	)	Court Below: Court of the Chancery of the State of Delaware in and for New Castle County
v.	)	
ALPHA FUND MANAGEMENT L.P.	)	Civil Action No. 10428-CJ
Plaintiff Below, Appellee.	)	

APPELLANT'S OPENING BRIEF

Filed by Team F
Attorneys for Appellants

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NATURE OF PROCEEDINGS

This is an appeal from the Court of Chancery's Memorandum Opinion ("Op.") submitted on January 12, 2015. The present action was commenced in the Court of Chancery on December 22, 2014 by Plaintiff, Alpha Fund Management, L.P ("Alpha"), against Defendants: (1) Talbot, Inc. ("Talbot" or "Company"); (2) Talbot board members Timothy Gunnison, Francois Payard, Naomi Rothman, Rosaria Gabrielli, Marshall Cannon, Ajeet Gupta, Daniel Lemon, Clare Leonard, and Patrick Rhaney (collectively "Talbot Board").

On December 22, 2014, activist shareholder Alpha moved for a preliminary injunction to prevent Talbot and the Talbot Board from enforcing a proxy contest fee-shifting bylaw ("Proxy Fee-Shifting Bylaw") in connection with election of Talbot's board of directors ("Board"). (Op. 10). The election is slated to take place at Talbot's annual stockholders meeting in May 2015. *Id.* Alpha alleges the Proxy Fee-Shifting Bylaw is facially invalid under Delaware law and a product of inequitable conduct, rendering it a breach of the Talbot Board's fiduciary duty. *Id.*

The Proxy Fee-Shifting Bylaw, which requires unsuccessful proxy contestants to reimburse Talbot for reasonable professional fees and expenses incurred in resisting proxy contests, would have gone into effect had Alpha won fewer than two of four proposed seats on the Talbot Board. (Op. 6-7). Talbot estimates the costs associated with resisting proxy contests at approximately $8 million. (Op. 8). By contrast, Alpha estimates those same costs as exceeding $12 million.

Id. According to Alpha, the Talbot Board adopted the Proxy Fee-Shifting Bylaw in order to obstruct Alpha's efforts to undertake a proxy contest. (Op. 1). Alpha emphasizes that the Proxy Fee-Shifting Bylaw prevents it from conducting a proxy contest for seats on the Board and is therefore improperly chilling. (Op. 11-12). Alternatively, Alpha claims that the existence of the Proxy Fee-Shifting Bylaw would discourage Talbot shareholders from voting for Alpha's nominees for the Board. (Op. 15).

On January 15, 2015, Chancellor Junge granted Alpha's motion for preliminary injunction. As a result, Talbot and the Talbot Board are enjoined from any action to enforce the terms and provisions of the Proxy Fee-Shifting Bylaw in relation to proxy contests for the upcoming stockholders meeting. (Op. 1).

Pursuant to Supreme Court Rule 42, Talbot and the Talbot Board appealed the order on January 16, 2015, which was granted on January 21, 2015.

SUMMARY OF THE ARGUMENT

I. The Court of Chancery incorrectly granted Alpha's motion for a preliminary injunction. Alpha does not have a reasonable probability of success on the merits. First, Talbot's Proxy-Fee Shifting Bylaw is valid on its face because its adoption is authorized by Delaware law, is consistent with Talbot's charter, and is not otherwise prohibited. The Delaware General Corporate Law related to adoption of bylaws is expansive, and the Proxy-Fee Shifting Bylaw is more narrowly tailored than the fee-shifting bylaw this Court upheld in *ATP*. Furthermore, the Court of Chancery has established both that corporate bylaws are stockholder contracts and that contracting parties may agree to fee-shifting provisions via contract.

II. Alpha also fails to show that the Talbot Board breached a Fiduciary Duty in adopting the Proxy Fee-Shifting Bylaw. As the bylaw is facially valid and touches on issues of control and the voter franchise, it is appropriate to use a *Unocal* assessment to determine whether the Board's fiduciary obligations were satisfied. The Talbot Board's bylaw adoption meets the *Unocal* standard because the Talbot Board acted in good faith by rejecting the Restructuring Proposal, a business strategy it felt was unwise, short-term, and in conflict with economic measures already in effect in the Company. Even in the event this Court deems a *Schnell* analysis necessary, the Proxy Fee-Shifting Bylaw will pass muster because the bylaw is neither preclusive nor coercive and was adopted in reasonable response to the perceived threat.

STATEMENT OF FACTS

Talbot is a Delaware corporation headquartered in Chestertown, Maryland. (Op. 2). Talbot currently has three divisions: the first and primary division manufactures high tech fasteners for the aerospace and industrial markets ("Fasteners Division"); a second division manufactures circuitry components for digital tablets and gaming systems ("Components Division"); and the third division develops software for industrial manufacturing ("Software Division"). *Id.* Talbot, which is publicly traded on the New York Stock Exchange, occupies a crucial niche in the world of highly engineered industrial components. *Id.* The Company's three divisions have proven successful: Talbot currently has a market capitalization of approximately $2.25 billion as well as net revenues of $1.1 billion. *Id.*

In 2013, investment manager Alpha, a limited partnership under the laws of Delaware, began acquiring shares in Talbot. (Op. 2-3). By June 2014, Alpha had acquired 4% of Talbot's outstanding shares. (Op. 3). On July 10, 2014, Alpha CEO Jeremy Womack ("Womack") met with Talbot CEO Timothy Gunnison ("Gunnison") and proposed a detailed restructuring proposal ("Restructuring Proposal") under which Talbot would shed both its Components Division and Software Division. *Id.* Overall, Gunnison found the Restructuring Proposal lacking. CEO Gunnison acknowledged the Restructuring Proposal was sophisticated and detailed, but stated it underestimated the relatedness of Talbot's three divisions and failed to account for the Company's recent cost cutting measures. (Op. 4.)

Alpha continued to acquire Talbot shares through December 2014. *Id*. On December 10, 2014, Alpha filed its Schedule 13D with the Securities and Exchange Commission. *Id*. In its Schedule 13D, Alpha disclosed that it now held 7% of outstanding Talbot shares and planned to nominate four directors for Talbot's Board at the annual stockholders meeting slated for May 2015. *Id*. Talbot's Board is not classified so all nine members will face re-election in May. (Op. 3). The current Board—save CEO Gunnison—are independent. *Id*.

On December 18, 2014, CEO Gunnison called a special meeting of the Talbot Board to discuss Alpha's Schedule 13D filing. (Op. 5). During the meeting, which was attended by the entire Board, Vice President for Finance and Operations Mark Rosewood gave a detailed presentation of Alpha's Restructuring Proposal and its Schedule 13D filing, as well as the significant cost cutting measures already underway at the Company. *Id*. The Board also received legal advice from Talbot's Vice President and General Counsel, Renee Stone, as well as outside attorney Sandra Ellsworth of Jackson and Wyeth LLP. *Id*. Ms. Stone and Ms. Ellsworth advised the Board on the feasibility of the Proxy Fee-Shifting Bylaw, which would require unsuccessful proxy contestants to reimburse Talbot for reasonable costs and expenses incurred during its resistance of those proxy contests. (Op. 6-7). Over the course of the two-hour meeting, Ms. Ellsworth advised the Board to consider the potentially adverse financial impact of proxy contests, while Ms. Stone explained the terms of the proposed Proxy Fee-Shifting Bylaw would allow the Board to waive fee requirements for

failed proxy contestants at their discretion. (Op. 5-6). Following their presentations, Vice President Rosewood, Ms. Stone, and Ms. Ellsworth left the meeting. (Op. 8).

The Talbot Board discussed the Proxy Fee-Shifting Bylaw at some length, then unanimously approved a resolution adopting it. (Op. 9). Lead independent director Payard supported the Proxy Fee-Shifting Bylaw because it would allow Talbot to recoup its losses (estimated to run to millions of dollars) in the event of a failed proxy contest. *Id.* Four of the other Talbot Board members, including CEO Gunnison, voiced concerns about Alpha and the short-term nature of its plans. (Op. 8). In this vein, the Talbot Board resolved not to waive the fee requirements for Alpha, but agreed it might revisit the idea of waiver at a later time. (Op. 9).

Four days after the meeting of the Talbot Board, as well as publication of a press release asserting the Talbot Board's decisions, Alpha sent a certified letter providing notice of its intended nominees for the Board. (Op. 9). That same day, December 22, 2014, Alpha filed this lawsuit.

ARGUMENT

I. This Court Should Deny Alpha's Request for a Preliminary Injunction Because the Proxy Fee-Shifting Bylaw Adopted by the Talbot Board is Facially Valid.

A. Question Presented

May the Board of a Delaware corporation lawfully adopt a bylaw that permits (but does not require) the corporation to obtain reasonable professional fees, costs, and expenses from a stockholder who fails to achieve the election of at least half of his or her proxy contest nominees?

B. Scope of Review

A motion for preliminary injunction must be evaluated on the moving party's ability to demonstrate "(1) a reasonable probability of success on the merits; (2) irreparable harm; and (3) a balance of equities in its favor." *SI Management L.P. v. Wininger*, 707 A.2d 37, 40 (Del. 1998). The Court of Chancery's legal conclusions underlying its ruling on a preliminary injunction are subject to *de novo* review by this Court. *Id.*

C. Merits of the Argument

1. Talbot's Proxy Fee-Shifting Bylaw is Facially Valid Because it is Authorized by Delaware Law, Consistent with Talbot's Charter, and Not Otherwise Prohibited.

Talbot's Proxy Fee-Shifting Bylaw is facially valid. Delaware corporate law expressly empowers corporations to include in their bylaws 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 and powers of its stockholders, directors, officers or employees." DEL. CODE ANN. tit. 8 § 109(b) (West 2010). This portion of the Delaware General Corporation Law ("DGCL") has been characterized as "broad authorizing language." *Boilermakers Local 154 Retirement Fund v. Chevron Corp.*, 73 A.3d 934, 953 (Del. Ch. 2013)[Hereinafter *Boilermakers*]. A permissive interpretation of this particular provision is supported by the DGCL's overarching purpose of providing "directors and stockholders with flexible authority, permitting great discretion for private ordering and adaptation." *Hollinger Int'l v. Black*, 844 A.2d 1022, 1078 (Del. Ch. 2004), *aff'd*, 872 A.2d 559 (Del. 2005). In light of this expansive authority, "the bylaws of a corporation are presumed to be valid, and the courts will construe the bylaws in a manner consistent with the law rather than strike down the bylaws." *Frantz Mfg. Co. v. EAC Indus.*, 501 A.2d 401, 407 (Del. 1985).

This Court found a fee-shifting bylaw similar to the Proxy Fee-Shifting Bylaw at issue here to be facially valid in *ATP Tour, Inc. v. Deutscher Tennis Bund*, 91 A.3d 554, 558 (Del.2014). In declaring the *ATP* bylaw facially valid, this Court looked to DGCL § 109(b) and identified three requirements a facially valid bylaw must meet. The bylaw must (1) be authorized by the DGCL; (2) be consistent with the corporation's certificate of incorporation; and (3) "not be otherwise prohibited [by common law]." *Id.* at 557-58. While the nature of the bylaw in *ATP*—litigation fee-shifting for members of a non-stock corporation—differs slightly from Talbot's Proxy Fee-Shifting Bylaw,

the facial validity analysis used in *ATP* is appropriate in the case at bar. The objectives of the *ATP* bylaw and the Proxy Fee-Shifting Bylaw are one and the same. In *ATP,* this Court held that "neither the DGCL nor any other Delaware statute forbids the enactment of fee-shifting bylaws." *Id.* at 558. Additionally, it was determined that "no principle of common law prohibits directors from enacting fee-shifting bylaws." *Id.* In determining that a fee-shifting bylaw is compatible with the common law, this Court relied on contract theory. This Court has previously held that corporate bylaws are "contracts among a corporation's shareholders." *Airgas, Inc. v. Air Prods. & Chems., Inc.*, 8 A.3d 1182, 1188 (Del. 2010). It is established that contracting parties may agree to a fee-shifting provision by way of a contract. *Sternberg v. Nanticoke Mem'l Hosp., Inc.*, 62 A.3d 1212, 1218 (Del. 2013).

Talbot's Proxy Fee-Shifting Bylaw is narrower than the bylaw this Court upheld in *ATP*; therefore, the Proxy Fee-Shifting Bylaw should be declared facially valid. Talbot's Proxy Fee-Shifting Bylaw applies only to proxy contests, whereas the bylaw in *ATP* applies to all member-initiated litigation (analogous to stockholder litigation in a traditional stock-based corporation). Additionally, Talbot's Proxy Fee-Shifting Bylaw addresses this Court's concerns about ambiguities in fee-shifting bylaws. The fee-shifting bylaw at issue in *ATP* allows for disputes about what exactly a constitutes a judgment "that substantially achieves in substance and amount, the full remedy sought." *ATP Tour, Inc.*, 91 A.3d at 559-60. Talbot's Proxy Fee-

Shifting Bylaw is not ambiguous because it establishes a clear threshold: if a stockholder achieves the election of at least half of his or her nominated board members, the bylaw does not apply. Finally, Talbot's Proxy Fee-Shifting Bylaw contains an equitable safeguard absent from ATP's fee-shifting bylaw, as Talbot's Board has discretion not to enforce the bylaw. Including an option to waive the bylaw when equity dictates such action has been viewed favorably in other instances. *See Boilermakers,* 73 A.3d at 954. For these reasons, this Court should find Talbot's Proxy Fee-Shifting Bylaw facially valid.

2. The Validity of Talbot's Proxy Fee-Shifting Bylaw is Supported by its Procedural, Process-Oriented Nature.

In adopting the Proxy Fee-Shifting Bylaw, the Talbot Board sought to mitigate uncertainty and establish procedure for stockholder-initiated proxy contests. A corporation's right to adopt "self-imposed rules and regulations deemed expedient for [the corporation's] convenient functioning" is a central tenet of DGCL. *Gow v. Consol. Coppermines Corp.*, 165 A. 136, 140 (Del. Ch. 1933). Properly functioning bylaws do not "mandate how the board should decide specific substantive business decisions, but rather, to define the process and procedures by which those decisions are made." *CA, Inc. v. AFSCME Emps. Pension Plan*, 953 A.2d 227, 240 (Del.2008). Talbot's Proxy Fee-Shifting Bylaw certainly satisfies these basic criteria. The Proxy Fee-Shifting Bylaw does not force the Board to take any actions and attempts to bring increased order to the proxy contest process.

3. The Host of Procedural Safeguards to Limit or Prevent the Proxy Fee-Shifting Bylaw's Application Reinforces the Bylaw's Validity.

Numerous procedural safeguards exist to reduce the risk of Talbot's Proxy Fee-Shifting Bylaw being unfairly applied to stockholders. These safeguards substantially bolster the Bylaw's validity. As noted *supra*, the Proxy Fee-Shifting Bylaw only grants the Talbot Board the right to recover fees; it does not mandate recovery in any instance. Additionally, the Bylaw is subject to the most direct form of attack: repeal by disapproving stockholders. *Boilermakers,* 73 A.3d at 956. The power to repeal bylaws is imparted to Talbot's stockholders through 8 *Del C.* § 109(a) and has been characterized by this Court as "legally sacrosanct, *i.e.*, the power cannot be non-consensually eliminated or limited by anyone other than the legislature itself." *CA, Inc.*, 953 A.2d at 232. In addition to the power to repeal, a Talbot stockholder (like any stockholder) has the power to voice his or her disapproval of a director's action by voting against that director during elections. *Boilermakers,* 73 A.3d at 956. Further, directors who support "anti-stockholder" bylaws are likely to face criticism from shareholder proxy advisory services. While the impact of such criticism may be indirect and difficult to measure, the perception of proxy advisory services can function as a powerful deterrent.

The courts and legislature also police the application of corporate bylaws like Talbot's Proxy Fee-Shifting Bylaw. If it so desires, the legislature can adopt legislation to limit or prohibit

proxy fee-shifting bylaws. Additionally, since fees generated by the Proxy Fee-Shifting Bylaw must be awarded by a judge, Talbot will face "the scrutiny of the courts" any time it seeks to recover from dissident stockholders that fail to reimburse Talbot in accordance with the Bylaw. *Boilermakers,* 73 A.3d at 954. Cumulatively, these safeguards reinforce the validity of Talbot's Proxy Fee-Shifting Bylaw.

II. This Court Should Deny Alpha's Request for Preliminary Injunction Because the Proxy Fee-Shifting Bylaw Adopted by the Talbot Board Does Not Constitute a Breach of Any Fiduciary Duty.

A. Question Presented

Whether the Talbot Board breached a fiduciary duty in adopting a bylaw that may deter proxy contests, and that was adopted in the context of Alpha's attempt to gain influence over the Board and implement its own own Restructuring Proposal.

B. Scope of Review

As noted *supra,* a motion for preliminary injunction must be evaluated on the moving party's ability to demonstrate "(1) a reasonable probability of success on the merits; (2) irreparable harm; and (3) a balance of equities in its favor." *SI Management L.P.*, 707 A.2d at 40. The Court of Chancery's legal conclusions underlying its ruling on a preliminary injunction are subject to *de novo* review by this Court. *Id.*

C. Merits of the Argument

1. The Talbot Board Did Not Breach a Fiduciary Duty in Enacting the Proxy Fee-Shifting Bylaw Because the Bylaw Satisfies the Requirements of *Unocal*.

The Talbot Board did not breach its fiduciary duty (inequitably or otherwise) by enacting the Proxy Fee-Shifting Bylaw. Just as a Board may adopt a shareholder rights plan to address a threat to the "corporation's best interest, so too" does a board have the authority to "adopt a bylaw to protect against what they claim is a threat to their corporation and stockholders." *Boilermakers*, 73 A.3d at 953. Additionally, this Court has held that a fee-shifting bylaw may be used to deter litigation. *ATP Tour, Inc.*, 91 A.3d at 560. The Proxy Fee-Shifting Bylaw works similarly to the fee-shifting bylaw upheld in *ATP*, except that it deters proxy contests.

The costs of a proxy contest, like those of litigation, are burdensome to target corporations. Fee-shifting works meritoriously to deter the frivolous contests often used to manipulate corporate Boards. *See Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 741 (1975); Stephen Bainbridge, *The case for allowing fee shifting as a privately ordered solution to the s'holder litig. epidemic*, ProfessorBainbridge Blog (Nov. 14, 2014), http://www.professorbainbridge.com/professorbainbridgecom/2014/11/the-case-for-allowing-fee-shifting-bylaws-as-a-privately-ordered-solution-to-the-shareholder-litigat.html. The Talbot Board's application of its bylaw, as with all realizations of its fiduciary authority, "can be challenged as an inequitable breach of fiduciary duty." *ATP Tour*,

Inc., 91 A.3d at 954 (citing *Schnell v. Chris-Craft Indus., Inc.*, 285 A.2d 437, 439 (Del. 1971)).

The Talbot Board was well within its rights under *Unocal* to adopt the Proxy Fee-Shifting Bylaw. *Moran v. Household Intern., Inc.*, 500 A.2d 1346, 1357 (Del. 1985). When a fee-shifting bylaw deters but does not prevent a proxy contest, this Court should find no inequitable purpose is established. *Id.* at 1355. Furthermore, Alpha has failed to establish a reasonable probability of success on the merits. *Third Point LLC v. Ruprecht*, 2014 WL 1922029 at *1 (Del. Ch.).

a. **The Talbot Board's Decision to Enact a Defensive Measure is Subject to *Unocal* Review.**

As argued above, Talbot's fee-shifting bylaw is facially valid. *See Supra* Part I. When an opposing party argues a Board decision is unenforceable due to inequitable motivations, the Court must decide whether the Board was justified in its actions. *Mercier v. Inter-Tel (Del.), Inc.*, 929 A.2d 786, 804 (Del. Ch. 2007). Directors are under a fiduciary duty to "act in the best interests of the corporation's stockholders." *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 955 (Del. 1985). This includes defending the corporation and its stockholders against possible harm. *Id.* However, "[i]f a defensive measure is to come within the ambit of the business judgment rule, it must be reasonable in relation to the threat posed." *Id.* In enforcing a facially valid bylaw, the Board's "compliance with their fiduciary duties" must undergo a *Unocal* assessment. *Third Point LLC v. Ruprecht*, No. CIV.A 9469-VCP, 2014 WL 1922029 at *15 (Del. Ch. May 2, 2014).

In *Stroud v. Grace*, this Court held that *Unocal* applies to "any defensive measure touching on issues of control, even if that measure implicates voting rights. Jack B. Jacobs and Leo Strine, Jr., *Function over Form: A Reassessment of Standards of Review in Delaware Corporation Law*, 56 Bus. Law. 1287, 1316 (2001); *see also Stroud v. Grace*, 606 A.2d 75, 82 (Del. 1992). Accordingly, the *Blasius* standard is unnecessary when the *Unocal* standard is sufficient to "adequately" deal with a board action that "adversely affects the franchise." *Third Point LLC*, 2014 WL 1922029 at *16.

The *Blasius* standard is only appropriate in instances when the "primary purpose of the board's action was to interfere with or impede the exercise of the shareholder franchise," and is not appropriate when the shareholders have a "full and fair opportunity to vote." *Unitrin, Inc. v. American General Corp.*, 651 A.2d 1361, 1379 (Del. 1995) (quoting *Stroud*, 606 A.2d at 92); *see generally Blasius Indus., Inc. v. Atlas Corp.*, 564 A.2d 651 (Del. Ch. 1988). Even in those instances, courts should only apply the *Blasius* standard in "circumstances in which self-interested or faithless fiduciaries act to deprive stockholders of a full and fair opportunity to participate in the matter and to thwart what appears to be the will of a majority of the stockholders." *In re MONY Group, Inc. S'holder Litig.*, 853 A.2d 661, 674 (Del. Ch. 2004).

While adoption of the Proxy Fee-Shifting Bylaw may interfere with the stockholder franchise to some extent, it does not "do so in the

manner that *Blasius* was concerned with so long as a proxy contest remains a viable option." *Id.* Furthermore, there is ample precedent supporting Board actions undertaken to deter, or even restrict, the ability of stockholders to "join[] together as a group to finance and promote a joint slate through a proxy contest." *Yucaipa Amer. Alliance Fund II, L.P. v. Riggio*, 1 A.3d 310, 335 (Del. Ch. 2010) (in the context of shareholder rights plans or "poison pills"). "[T]he *reasonableness* of the board's decision to restrict the ability of stockholders to engage in such joint action" is the starting point for review. *Id.* (citing generally *Moran*, 500 A.2d at 1346)(emphasis added). Accordingly, when a Board enacts a bylaw with the purpose of deterring a proxy contest and not for the sole purpose of impeding the shareholder franchise, the Board's decision must be evaluated under *Unocal*. (*See* Op. 5-9, 16).

b. The Talbot Board's Decision to Enact the Proxy Fee-Shifting Bylaw was Reasonably Responsive to Beliefs That Alpha's Restructuring Proposal Threatened Corporate Policies and Effectiveness and Thus Satisfies *Unocal* Analysis.

In order for the business judgment rule to apply to a Board's decision to adopt a defensive measure, *Unocal* analysis must be satisfied. The burden lies with the Board to prove "(a) reasonable grounds for believing that a danger to corporate policy and effectiveness existed; and (b) that the defensive measure adopted was reasonable in relation to the threat posed." *Paramount Commc'ns, Inc.*

v. Time Inc., 571 A.2d 1140, 1152 (Del. 1989) (citing *Unocal*, 493 A.2d at 955).

i. The Talbot Board's Adoption of the Proxy Fee-Shifting Bylaw Satisfies the First Prong of *Unocal* Because the Board Acted in Good Faith and Determined the Threat Posed Warranted Defensive Response Following Reasonable Investigation.

A Board satisfies the first prong of *Unocal* by demonstrating that "after a reasonable investigation, it has determined in good faith" that there existed a threat to the company that "warranted a defensive response." *Unitrin Inc.*, 651 A.2d at 1375. This Court has held that evidence of good faith is "enhanced" when a majority of the Board is comprised of independent directors. *Id.* (citing *Unocal Corp.*, 493 A.2d at 955; *accord Paramount Commc'ns,* 571 A.2d at 1154. Finally, in *Versata Enterprises, Inc. v. Selectica, Inc.*, this Court determined the Selectica Board satisfied its "reasonable investigation" responsibilities by meeting as a whole for more than two hours, reviewing facts of the situation at hand, and consulting subject-matter specialists. *Versata Enters., Inc.* v. Selectica, Inc., 5 A.3d 586, 600 (Del. 2010).

As the Court of Chancery noted, the Talbot Board demonstrated "good faith in preferring the status quo of the Company's cost cutting business plan to Alpha's and Womack's more aggressive Restructuring Proposal," and in determining the benefit of recouping "significant expenses in the event of an unsuccessful proxy contest." (Op. 16). Eight of the nine directors of the Talbot Board are "independent." (Op. 3). The Talbot Board's meeting on December 18, called solely to

address Alpha's Schedule 13D filing, lasted more than two hours and included a "detailed presentation" of the Restructuring Proposal and a review of the Company's "ongoing cost cutting plans" conducted by Talbot's Vice President for Finance and Operation. (Op. 5-6). The meeting also included presentations from both in-house and outside counsel regarding the "terms and mechanics of the Proxy Fee-Shifting Bylaw"; the great expense proxy contests impose on corporations; and the Board's flexibility to waive any fee-shifting obligations. *Id.* On the basis of the foregoing evidence, this Court should find that Talbot satisfies the first prong of *Unocal*.

ii. The Talbot Board's Decision to Adopt the Proxy Fee-Shifting Bylaw Satisfies the Second Prong of *Unocal* Because the Bylaw is Neither Preclusive nor Coercive, and was Enacted in Reasonable Response to a Perceived Threat to the Company.

A Board satisfies the second prong of *Unocal*, the proportionality test, by demonstrating its decision is neither *preclusive* nor *coercive*, and is *reasonable* in response to the threat posed. *Unitrin Inc.*, 651 A.2d at 1387; *see also Riggio*, 1 A.3d at 336-37. "Directors must show that their actions are reasonable in relation to their legitimate objective" and thus "did not preclude the stockholders from exercising their right to vote or coerce them into voting a particular way." *Mercier*, 929 A.2d at 810-11; *see also Versata Enters.*, 5 A.3d at 601.

A Board measure is "preclusive" when it makes a dissident shareholder's "ability to wage a successful proxy contest and gain

control . . . 'realistically unattainable.'" *Versata Enters., Inc.*, 5 A.3d at 601. A Board measure is "coercive" when it is "aimed at 'cramming down on its shareholders a management-sponsored alternative.'" *Id.* (quoting *Unitrin*, 651 A.2d at 1387 (citing *Time, Inc.*, 571 A.2d at 1154–55)). A Board measure is "within the range of reasonableness" when the Court determines the directors "made a reasonable decision, not a perfect decision" in context. *Paramount Commc'ns Inc. v. QVC Network Inc.*, 637 A.2d 34, 45 (Del. 1994). The Court should not "substitute their business judgment for that of the directors." *Id.*

This Court holds that when a Board takes action to deter a proxy contest, but does not impede its stockholders from undertaking and voting on a proxy contest, the Board's action is neither preclusive nor coercive. *Moran*, 500 A.2d at 1355. In *Moran*, this Court upheld the Chancery Court's ruling that the defendant Board's implementation of a "poison pill" triggered at 20% of total stock ownership satisfied the *Unocal* test and was subject to the business judgment rule. *Id.* at 1357. In so holding, this Court opined that though the "poison pill" might "deter the formation of proxy efforts . . . it does not limit the voting power of individual shares." *Id.* at 1355.

The Chancery Court holds that a Board decision that "does not contain any feature that would outright force a stockholder to vote in favor of the Board or allow the Board to induce votes in its favor through more subtle means" is neither preclusive nor coercive. *Third Point LLC*, 2014 WL 1922029 at *19. In *Third Point LLC v. Ruprecht*, an

activist investor sued the Board of the target company for adopting a shareholder rights plan, or "poison pill," triggered at a lower percentage of stock ownership for those filing a Schedule 13D versus those filing a Schedule 13G. *Id.* at *1. In its *Third Point* decision, the Chancery Court emphasized that "Third Point's proxy contest with the Board is eminently winnable by either side." *Id.* Furthermore, the Court held that Third Point was unlikely to prove the shareholder rights plan was unreasonable as the target Board enforced its poison pill on the possibility the activist stockholder could obtain "at least negative control" and thus threaten "corporate policy and effectiveness." *Id.* at *22 ("negative control" is defined as "a controlling influence without paying a premium with respect to certain matters." *See Id.* at *13).

Accordingly, a Board-enacted measure satisfies the second prong of *Unocal* when that measure neither induces nor forces a stockholder to vote in favor of the Board, and is enforced in response to the possibility of a threat against corporate policy and effectiveness. Alpha failed to demonstrate that the Proxy Fee-Shifting Bylaw is preclusive, coercive, or unreasonably enforced. The Talbot Proxy Fee-Shifting Bylaw does not preclude a "full and fair vote." *In re MONY Group, Inc. S'holder Litig.*, 853 A.2d at 678. It does not interfere with the stockholder vote at all. At most, the Proxy Fee-Shifting Bylaw deters *some* dissident groups from seeking a proxy contest, much like the shareholder rights plan enforced in *Third Point*. As the Chancery Court opined, there is no evidence the Talbot bylaw "would

have any effect on Alpha's ability to win a proxy contest against the incumbent Board . . . " (Op. 15).

The Proxy Fee-Shifting Bylaw was enacted and enforced in response to a perceived and thoughtfully investigated threat to the Company's plans and effectiveness. (Op. 5–6). Every time a proxy contest is waged, the result comes at a multi-million dollar cost to the Company. (Op. 8). This in turn affects the Company's ability to return profits to its stockholders or invest in its business. *Id.* As argued above, the Board was well within its rights to enact a bylaw deterring a threat to its corporate policies and plans. *See generally Moran*, 500 A.2d 1346. In this case, the Talbot Board made a good faith decision that the Restructuring Plan would not benefit the company or its stockholders in comparison to Talbot's cost cutting and long term value-enhancing plans. *Id.*

The Board's Proxy Fee-Shifting Bylaw satisfies the second prong of *Unocal* because it does not affect the actual votes of stockholders and was implemented in good faith to protect against threats to Talbot's corporate policies, plans and effectiveness. Therefore, Alpha has failed to prove the Board's Proxy Fee-Shifting Bylaw cannot fulfill the requirements of the second prong of *Unocal*.

2. If This Court Finds That Further Review in Equity is Necessary, the Proxy Fee-Shifting Bylaw Survives Review Under *Schnell Bec*ause it was Adopted for Equitable Purpose.

a. This Court Defines "Inequitable Purpose" in Schnell.

A facially valid fee-shifting bylaw is enforceable when it is not "adopted or used for an inequitable purpose." *ATP Tour, Inc.*, 91 A.3d at 558. This Court holds that an "inequitable purpose" is established when a Board's "purpose in adopting" a bylaw is to (1) "'perpetuat[e] itself in office'" and, (2) "'obstruct [the] legitimate efforts of dissident stockholders in the exercise of their rights to undertake a proxy contest against management.'" *Id.* at 558 (quoting *Schnell v. Chris-Craft Industries, Inc.*, 285 A.2d 437, 439 (Del. 1971)). The Talbot Board did not adopt The Proxy Fee-Shifting Bylaw to "perpetuate itself in office," or obstruct a proxy contest. Rather, the Board acted in defense of Company policies, plans, and effectiveness. (Op. 5-9, 16).

The business judgment rule constitutes the "presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interest of the company." *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984). A defining quality of the business judgment rule is that the Court will not substitute its own judgment for that of the Board's as long as the Board's decision can be "attributed to any rational business purpose." *Sinclair Oil Corp. v. Levien*, 280 A.2d 717, 720 (Del. 1971).

The Talbot Board acted in good faith when it rejected a business strategy that was in its determination unwise, short-term, and in conflict with the Company's own cost cutting plans and long term value-enhancing strategy. (Op. 8). The purpose of the Proxy Fee-Shifting Bylaw adopted by the Talbot Board is not to "perpetuate itself in office," but to deter a proxy contest and the negative financial consequences to the corporation and its shareholders that would inevitably occur.

b. Even if This Court Utilizes a *Schnell* Analysis, the Proxy Fee-Shifting Bylaw is Valid.

The primary question under a *Schnell* analysis is whether the Board obstructed the right of dissidents to undertake a proxy contest. *ATP Tour, Inc.*, 91 A.3d at 558. This Court looked to *Schnell v. Chris-Craft Industries* for a determination of what constitutes obstruction to stockholders in the "exercise of [stockholders'] rights to undertake a proxy contest against management." *Id.* (quoting *Schnell*, 285 A.2d at 439). In *Schnell*, dissident stockholders sought injunctive relief to prevent the managing directors of Chris-Craft Industries, Inc., from advancing the date of the annual stockholders meeting by one month, effectively obstructing their attempt to "wage a successful proxy fight" because "of the exigencies of time." *Schnell*, 285 A.2d at 439 (the managing directors also refused to produce a list of stockholders, hired two established proxy solicitors, and moved the meeting to a remote town in upstate New York).

This Court reasoned "[w]hen the by-laws of a corporation designate the date of the annual meeting of stockholders, it is to be

expected that those who intend to contest the re-election of incumbent management will gear their campaign to the by-law date." *Id.* Time is a fixed measure; the action of the Board in *Schnell* effectively precluded a proxy contest vote. Thus, an "inequitable purpose" is established when a bylaw is adopted to preclude a proxy contest. More recently, the Chancery Court held a bylaw enacted by a controlling shareholder preventing the Board "from acting on any matter of significance except by unanimous vote . . ." was inequitable and therefore unenforceable. *Hollinger Intern., Inc. v. Black*, 844 A.2d 1022, 1077-1081 (Del. Ch. 2004) (the bylaw amendments also "set the board's quorum requirement at 80%"; required that special meetings have seven-days' notice; and decreed that stockholders—not directors—fill board vacancies). In *Hollinger*, the bylaws were enacted so the majority stockholder had complete control over the activities of the Board, precluding the Board from taking action with which the majority stockholder disagreed. *Id.* Ultimately, the *Hollinger* bylaw was deemed unenforceable due to its absolutely preclusive nature. *Id.* at 1080. The Hollinger bylaw did not simply make decisions of the Board more difficult, it obliterated entire decision-making channels.

In contrast, this Court upheld a majority shareholder bylaw that had the same effect as the Hollinger bylaw but was "intended to limit the board's anti-takeover maneuvering after [the majority shareholder] had gained control of the corporation." *Frantz Mfg. Co.*, 501 A.2d at 407. Accordingly, this Court held that the bylaws were a permissible attempt "to avoid [] disenfranchisement as a majority shareholder."

Id. In Frantz, the majority shareholder acted to protect a legitimate majority interest against a Board acting for the sole purpose of perpetuating its own control. *Id.* at 407-408.

The Proxy Fee-Shifting Bylaw adopted by the Talbot Board does not preclude a proxy contest; the bylaw simply shifts some of the cost of a proxy contest to the dissident stockholders, and only in the case they are unable to elect at least half of their nominees. (Op. 6-7). Talbot will still fund Alpha's proxy contest while it is being waged, which means Alpha is in no danger of being unable to stage a successful contest. Since the Proxy Fee-Shifting Bylaw does not preclude a proxy contest vote, an inequitable purpose cannot be established.

CONCLUSION

For the foregoing reasons, this Court should reverse the Court of Chancery's opinion, and deny the request for a preliminary injunction. The Proxy Fee-Shifting Bylaw is facially valid, satisfies the *Unocal* standard, and does not constitute obstruction of a proxy contest under *Schnell*.

Respectfully submitted,

/s/ Team F

Team F, Counsel for Defendants - Below, Appellants

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