IN THE SUPREME COURT FOR THE STATE OF DELAWARE

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

APPELLEES' OPENING BRIEF

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Filed February 6, 2015

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NATURE OF PROCEEDINGS

This is an interlocutory appeal from a Court of Chancery order granting a preliminary injunction dated January 15, 2015. The order was granted in response to an action filed by Alpha Fund Management, L.P. ("Alpha") on December 20, 2014 against Talbot, Inc. ("Talbot") and the individuals that comprise Talbot's board of directors. Alpha filed suit attacking a Proxy-Fee Shifting Bylaw that the board unilaterally adopted. Alpha claims the bylaw is facially invalid under Delaware law and alternatively that the board adopted the bylaw as a product of inequitable conduct, in violation of their fiduciary duty.

Alpha also filed a motion seeking a preliminary injunction to enjoin the Defendants from taking any action to effectuate or enforce the terms and provisions of the Proxy Fee-Shifting Bylaw they unilaterally adopted on December 18, 2014. Chancellor Junge issued his opinion on January 14, 2015 and the aforementioned preliminary injunction order came the next day, on January 15, 2015.

One week later, on January 22, 2015, defendants below, Talbot, Inc. filed a notice of appeal from the interlocutory order. This is Alpha's opening brief.

SUMMARY OF ARGUMENT

1. Since the Proxy-Fee Shifting Bylaw unreasonably infringes on the right of shareholders to vote, it contravenes Delaware common law and should be declared facially invalid. The right to vote goes beyond casting a ballot to the right to nominate an opposing slate of directors for election to the board. Even though these rights can be restricted, the restrictions cannot be unreasonable. Since the bylaw creates an extreme level of uncertainty as to whether or not the opposition will have to pay, the bylaw is an unreasonable infringement. The Proxy-Fee Shifting Bylaw should also be invalidated because it deals with an external, substantive issue, areas beyond the scope of what bylaws are meant to regulate. By getting into these areas, the Talbot bylaw does not deal with the rights of its stockholders as stockholders and is therefore improper and should be invalidated.

2. This Court should uphold the Chancery Court's finding that the Proxy Fee-Shifting Bylaw was adopted by the Talbot board for an inequitable purpose. The board's decision cannot be protected by the business judgment rule because the bylaw interferes with shareholder franchise. The bylaw cannot withstand equitable analysis because it was adopted by the Talbot board for the subjective purpose of deterring a shareholder from waging a proxy contest. The bylaw, which imposes a large financial risk upon a shareholder waging a proxy contest, had the effect of thwarting corporate democracy and disenfranchising Talbot shareholders and thus must be enjoined.

STATEMENT OF FACTS

This appeal and the underlying action arise from Defendant Talbot Inc.'s ("Talbot") adoption of a proxy contest fee-shifting bylaw (the "Proxy Fee-Shifting Bylaw" or the "Proxy Bylaw"). The Proxy Bylaw requires a dissident shareholder group who launches an unsuccessful proxy contest to reimburse the corporation for reasonable fees and expenses incurred by the corporation in resisting the dissident group's campaign. Op. at 1. The terms of the Proxy Fee-Shifting Bylaw also afford the Board the discretion to waive any fee shifting obligations otherwise imposed by the Proxy Fee-Shifting Bylaw. Op. at 6.

Plaintiff Alpha Fund Management L.P. ("Alpha" or the "Alpha Fund") is a relatively small investment manager formed as a limited partnership under the laws of Delaware and headquartered in New York City. Op. at 2. Defendant Talbot is a publicly traded Delaware corporation with approximately 75 million shares of common stock outstanding. Op. at 2. Talbot has a market capitalization of approximately $2.25 billion and for its most recent fiscal year, Talbot posted net earnings of $1.1 billion. The nine individual defendants comprise the members of the Board of Talbot. Op. at 3.

By June of 2014, Alpha had acquired approximately 4% of the outstanding shares of Talbot. Alpha CEO Womack then reached out to and met with Defendant and CEO Gunnison on July 10, 2014, suggesting a detailed restructuring proposal for Talbot that Womack argued would substantially improve value for Talbot's stockholders. Op. at 3.

Gunnison expressed immediate skepticism to Womack about the merits of the restructuring proposal. Op. at 4.

On December 10, 2014 Alpha filed the Schedule 13D with the SEC disclosing that they hold 7% of the total Talbot shares outstanding. Op. at 4. Alpha also disclosed that its purchase was for investment purposes only and that they would not seek to acquire a controlling stockholder position or otherwise try to acquire the Company outright. Op. at 4. However, Alpha further disclosed that it had presented the Restructuring Proposal to Gunnison and had been rebuffed, and thus would seek to advance the Restructuring Proposal by nominating four directors for election to the Talbot board at the upcoming annual stockholders meeting. Op. at 4.

In response to the 13D, Gunnison immediately called a special meeting of the Board for December 18, 2014. Since the board had already convened its regular December meeting, the December 18 meeting was devoted exclusively to the events surrounding Alpha's 13D filing. Op. at 5. The meeting included a detailed presentation about the Restructuring Proposal, as originally presented by Womack to Gunnison in July 2014 and as similarly set forth in the Schedule 13D. Op. at 5. The whole board agreed that the current business plan promised greater long term value for the Company and its stockholders than the Restructuring Proposal. Op. at 6.

The parties sharply disagreed about the amount of fees and expenses that Talbot might reasonably incur and then impose on Alpha if it is not successful in their proxy campaign. Op. at 8. Talbot's

Vice President for Finance and Operations estimated that such costs might approximate $8 million, while Alpha's proxy solicitor estimated the cost to be in excess of $12 million. Op. at 8.

After all presentations were concluded, the Talbot board continued their discussions about adopting the proxy bylaw. Gunnison urged approval, disparaging the Restructuring Proposal as an ill-conceived short term plan that would harm the Company in the long run. Op. at 8.

At least three other Talbot directors shared a similar sentiment. One expressed strong support for the Proxy Fee-Shifting Bylaw as a means of holding Alpha at bay, stating that we need to raise the stakes for this guy [Womack]. Op. at 8. Another agreed and suggested that the risk of added costs imposed by the Proxy Fee-Shifting Bylaw might get Alpha to think twice about all this. Op. at 8. Another director disparaged Womack and Alpha as playing financial games for purely short term wins and stated that if the Bylaw helps to stop Alpha, then I'm for it. Op. at 8. Not all directors expressed similar views but no one expressed disagreement with them either. Only one director supported the bylaw for its reimbursement effects. Op. at 8.

Following their discussion, the board unanimously approved a resolution adopting the Proxy Fee-Shifting Bylaw. The board then resolved not to waive the fee-shifting obligation for the Alpha proxy contest. Op. at 9.

Argument

I. THE PROXY FEE-SHIFTING BYLAW IS FACIALLY INVALID BECAUSE IT CONFLICTS WITH DELAWARE COMMON LAW BY UNREASONABLY RESTRICTING A SHAREHOLDER'S RIGHT TO VOTE AND BECAUSE IT REGULATES SUBJECT MATTER BEYOND THE ALLOWABLE SCOPE FOR A BYLAW.

A. Question Presented

Whether the Proxy-Fee Shifting Bylaw is facially invalid since it creates unreasonable uncertainty regarding a shareholder's right to vote or because it improperly regulates substantive and external issues.

B. Scope of Review

The validity of a corporate bylaw is a question of law that is reviewed de novo. *Centaur Partners, IV v. Nat'l Intergroup, Inc.*, 582 A.2d 923, 926 (Del. 1990); *CA, Inc. v. AFSCME Employees Pension Plan*, 953 A.2d 227, 231 (Del. 2008).

C. Merits of Argument

1. The Proxy-Fee Shifting Bylaw contravenes established Delaware common law because the restriction it places on the shareholder's right to vote is unreasonable.

Even though the Court of Chancery declined to rule on the facial validity of the Proxy-Fee Shifting Bylaw, they did find that a colorable claim for facial invalidity existed. Op. at 12. This court should take the Chancery finding to the next step, and find the bylaw facially invalid because it is in conflict with shareholder rights previously recognized by Delaware law.

Section 109(a) of the Delaware General Corporation Law ("DGCL") permits the board of directors to adopt, amend, or repeal bylaws when, like here, a company's certificate of incorporation expressly confers this power to the board. 8 *Del.C.* § 109(a). Even though corporate bylaws are presumed valid, to go beyond the presumption to validity, a bylaw must meet three separate requirements. *Frantz Mfg. Co. v. EAC Indus.,* 502 A.2d 401, 407 (Del. 1985).

For a bylaw to be facially valid it must be authorized by the DGCL, be consistent with the corporation's certificate of incorporation, and not be otherwise prohibited. *ATP Tour, Inc. v. Deutscher Tennis Bund,* 91 A.3d 554, 557-558 (Del. 2014). Here, neither side argues, nor did the Chancery Court find that this bylaw is inconsistent with the certificate of incorporation of Talbot. However, Appellee asserts that the bylaw conflicts with Delaware common law and is therefore otherwise prohibited.

The right of the shareholder to exercise their franchise is fundamental and goes beyond just voting. Delaware courts have long recognized that the right of shareholders to participate in the voting process includes the right to nominate an opposing slate. *Linton v. Everett,* C.A. No., 1997 WL 441189, (Del.Ch. 1997); *see also Hubbard v. Hollywood Park Realty Enters., Inc.,* C.A., 1991 WL 3151, 258 (Del.Ch. 1991). Appellee acknowledges that even though these rights are fundamental, it does not mean that they cannot be restricted. However, the law says that any restrictions must not infringe upon the exercise of those rights in an unreasonable way. *Hubbard* at 258.

This bylaw is an unreasonable infringement on the right to vote, because it always threatens and sometimes imposes an unreasonable burden on those seeking to nominate candidates. The burden is the costs the challenger might be asked to pay, while the unreasonableness is the uncertainty the costs create that hang over the heads of the shareholder contemplating a challenge. The Chancery Court was "troubled" by this and said the bylaw worked to prevent an otherwise "robust" proxy contest, instead leaving the shareholders with an uncontested election. Op. at 12.

It is even more troubling and unreasonable that a second degree of uncertainty is created by the fact that whether or not the bylaw is invoked in a specific proxy fight is left up to board's discretion. Op. at 7. Not only is the decision left solely to the board, but also the board can make a decision and then change their minds when the proxy contest is over. Op. at 9. The problem with this is that it creates too much uncertainty as to whether or not the proxy fees will be shifted and can cause the opposition to reconsider their campaign altogether. We see this happening with the Alpha slate in this case, as they have stated they will be forced to end their challenge if the bylaw is invoked. Op. at 12. Since the board can consider the bylaw after the fact, it stays in play and therefore always threatens the franchise.

This is analogous to the situation in *Hubbard,* where the board created unreasonable uncertainty for its shareholders by changing its position after their shareholders could nominate an opposing slate of

directors to challenge the board. *Hubbard* at 259. These post deadline decisions, according to the court in *Hubbard* constitute a material change in circumstances and does not afford a fair opportunity to the shareholders to nominate a dissident slate of directors with opposing views. *Hubbard* at 260.

In both instances, having to deal with this uncertainty places an unreasonable burden on the opposing group because it practically requires clairvoyance on their part. *Hubbard* at 258. The only thing the opposing group knows for certain is that there is a speculative possibility of a shift in the board's position. This is unreasonable and conflicts with the principles established in *Hubbard* and because of this, the bylaw should be found facially invalid.

While it is true that in its most recent case considering a fee-shifting bylaw this court upheld the validity of fee shifting, the circumstances of that case and that bylaw are distinguishable from those here and therefore do not control the outcome.

In this court's recent decision in *ATP Tour,* the court affirmed the validity of unilaterally adopted fee shifting bylaws. However, the court stated explicitly in the opinion that it was upholding a fee-shifting bylaw *like the one described* (emphasis added). *ATP Tour* at 558. The bylaw that Talbot adopted is not like the one described in *ATP Tour* because the type of action that creates the fees in each bylaw are different and because the type of cost the *ATP Tour* bylaw sought to shift is a different kind of cost than in the Talbot bylaw.

Because of these key differences, this court's ruling in *ATP Tour* does not control the outcome of this case.

The bylaw adopted in *ATP Tour* was not about proxy contests, it was about intra corporate legal actions filed by other members of the corporation. These two types of actions are very different. Proxy contests are forward looking and concern a right that all shareholders have and retain without having to get the permission of the board to use, the right to vote. On the other hand, bringing intra corporate litigation is backward looking and, not a right that shareholders can exercise unilaterally, as they have to navigate the demand requirement first. The difference in the necessity of the permission of the corporation to commence the action shows that these two bylaws are different in kind and should not be controlled by the same rule.

In addition to the difference between the types of actions the two bylaws regulate, the policy reason for allowing litigation costs to shift, deterrence, is not encouraged for shareholder voting.

On the other hand, the idea of shifting proxy costs to shareholders makes little sense when considering deterrence, and when one considers the DGCL. Delaware courts do not encourage deterring shareholder proxy contest and have even endorsed the idea of reimbursing their expenses for conducting them. *CA, Inc. v. AFSCME Emps. Pension Plan,* 953 A.2d 227, 238 (Del. 2008). (endorsing the reimbursement of shareholder proxy costs while invalidating the bylaw since it mandated reimbursement instead of making it discretionary). In addition to this, Section 113 of the DGCL allows shareholders to be

reimbursed for proxy costs by the corporation, but nowhere does it take a similar position about a corporation getting reimbursed for their costs by the stockholders.

These differences between the types of actions each of the bylaws concern and the reasons the courts and the DGCL have for assigning their costs the way they do show that the Talbot bylaw is not like the one described in ATP Tour and should therefore be found facially invalid.

2. It is improper for bylaws to regulate substantive, or external matters, that do not concern the rights of shareholders as shareholders, and the Proxy-Fee Shifting Bylaw does both.

The Talbot bylaw is facially invalid because it is not a procedural bylaw, as it does not have a process oriented function. It is well-established Delaware law that the bylaws of a Delaware corporation must be of a procedural, process-oriented nature. *Boilermakers Local 154 Retirement Fund v. Chevron Corp.*, 73 A.3d 934, 951 (Del.Ch. 2013). The courts of this state have said that bylaws typically do not contain substantive mandates, but direct the process under which the corporation, the board, and its stockholders may take certain actions. *CA, Inc.* at 235. While there is no black letter test for considering the validity of the subject matter of a bylaw, courts focus on whether or not the bylaw has a process oriented function. *Id.*

The Talbot bylaw does not have a process oriented function, and it is therefore not a procedural bylaw, but a facially invalid

substantive one. In *Chevron*, while considering the validity of a forum selection bylaw, the Court of Chancery gave some examples of substantive matters bylaws could not properly regulate. The court said bylaws that regulate whether stockholders may file suit or the kind of remedy that they may obtain on behalf of themselves or the corporation would be improper. *Chevron* at 952. The Talbot bylaw is very similar, since it also regulates the kind of remedy the corporation may obtain on behalf of itself.

The Talbot bylaw mandates that if Talbot chooses to seek anything from an unsuccessful contesting party, the remedy due the corporation is the reimbursement of all fees reasonably incurred in the proxy fight. Op. at 6-7. This is not a process; there is no formula to decide when to shift the fees. The only difference between the bylaw and the example is that the example concerns the remedy stockholders can obtain on behalf of themselves in addition to what they can claim in the name of the corporation, the exact same thing the example would have been invalidated for. In both instances the remedy the corporation would receive is mandated by the bylaw. Since the Talbot bylaw so closely follows the example of the invalid bylaw given in *Chevron*, the Talbot bylaw should be found facially invalid.

Alternatively, the bylaw improperly seeks to go beyond the broad subjects that 8 *Del.C.* § 109(b) permits bylaws to address and is also facially invalid because of this. Section 109(b) provides that bylaws must relate to the "business of the corporation, the conduct of its affairs, its rights or powers or the rights or powers of its

stockholders", as stockholders. When the subject matter that the bylaw seeks to regulate is an internal affairs claim, the bylaw quintessentially relates to these proper subjects. *Chevron* at 951.

By contrast, when the bylaw seeks to regulate an external matter it goes beyond the statutory language of 8 *Del.C.* § 109(b). *Chevron* at 952. Another example the Court of Chancery provided in *Chevron*, shows that the Talbot bylaw improperly regulates an external matter. The court gave two examples of external matters and said they were improper because they do not deal with the rights and powers of stockholders as stockholders. One of the examples is particularly applicable here. The court said it would be improper for a bylaw to attempt to bind a stockholder bringing a personal injury claim for an injury suffered on the corporation's premises. *Id.* The Talbot proxy fee-shifting bylaw, also attempts to do this and therefore regulates an improper, external matter.

The state of Delaware does not limit the definition of personal injury to physical injuries. In Delaware, an injury is sustained when a wrongful act or omission occurs. *Brown v. E.I. DuPont de Nemours and Company, Inc.* 820 A.2d 362, 366 (Del.2003). Often, in corporate proxy fights, the challenger wages a battle because they feel that they have been injured. The Talbot bylaw offers the directors the option to bind these stockholders to reimbursement if they are not successful in their claims. This is the type of behavior the court in *Chevron* warned was external and therefore improper. Because of its overreach into an external matter, the Talbot bylaw is facially invalid.

II. THE CHANCERY COURT'S IMPOSITION OF INJUNCTIVE RELIEF WAS PROPER BECAUSE THE TALBOT BOARD ADOPTED THE PROXY FEE-SHIFTING BYLAW FOR THE SOLE INEQUITABLE PURPOSE OF THWARTING SHAREHOLDER FRANCHISE.

A. Question Presented

Whether a board adopted bylaw that imposes a large financial risk upon a shareholder waging a proxy contest, which was adopted for the subjective purpose of deterring a shareholder from waging a proxy contest, was adopted for an inequitable purpose.

B. Scope of Review

Courts will review the grant or denial of a preliminary injunction for abuse of discretion, but without deference to the legal conclusions of the trial court. *Kaiser Aluminum Corp. v. Matheson*, 681 A.2d 392, 394 (Del. 1996).

C. Merits of the Argument

1. The Talbot board's decision to adopt the Proxy Fee-Shifting bylaw is not protected by the business judgment rule.

The Talbot board's decision to adopt the Proxy Fee-Shifting Bylaw cannot be protected by the business judgment rule because the bylaw interferes with corporate democracy and shareholder franchise. When a board acts for the primary purpose of impeding the exercise of stockholder voting power, the board bears the heavy burden of demonstrating a compelling justification for such action. *Blasius Indus., Inc. v. Atlas Corp.*, 564 A.2d 651 at 661 (Del. Ch. 1988). When directors prevent the effectiveness of a shareholder vote, it conflicts with their duty of loyalty, and the court imposes a

heightened standard of review. *Stroud v. Grace*, 606 A.2d 75 at 91 (Del. 1992). Directors attempting to utilize corporate machinery and Delaware Law for the purpose of perpetuating itself in office; and, to that end, for the purpose of obstructing the legitimate efforts of dissident stockholders in the exercise of their rights to undertake a proxy contest against management… are inequitable purposes, contrary to established principles of corporate democracy… and may not be permitted to stand. *Schnell v Chris-Craft Industries*, 285 A.2d 437 at 439 (Del. 1971).

In *Blasius*, evidence established that the incumbent board added two new members to the seven-member board in order to prevent a shareholder from placing a majority of new directors on the board. *Blasius*, 564 A.2d at 652. The Court found that the action by the board involved allocation, between shareholders as a class and the board, of effective power with respect to governance of the corporation and held that the deferential business judgment rule did not shield directors' actions from scrutiny. *Id.* Here, similarly to *Blasius*, the proxy fee-shifting bylaw had the deterrent effect of dissuading a majority shareholder from waging a proxy contest and thus, denied Talbot shareholders of their right to elect new directors in the upcoming election. This is cause for enhanced judicial scrutiny.

Furthermore, any finding that the Talbot board acted in good faith is no defense to the illegality of their conduct. When board action thwarts shareholder franchise, even when the action was taken in good faith, it may constitute an unintended violation of the duty

of loyalty that the board owed to the shareholders and may be set aside by the court. *Id.* at 663. Thus, whether or not the Talbot board adopted the bylaw in good faith, their decision cannot be protected by the business judgment rule.

In *Aprahamian*, the incumbent board had moved the date of the annual meeting on the eve of that meeting when it learned that a dissident stockholder group had or appeared to have in hand proxies representing a majority of the outstanding shares. The Court restrained that action and compelled the meeting to occur as noticed. *Aprahamian v. HBO & Company*, 531 A.2d 1204 (Del. Ch. 1987). The Court concluded as follows: the corporate election process, if it is to have any validity, must be conducted with scrupulous fairness and without any advantage being conferred or denied to any candidate or slate of candidates. In the interests of corporate democracy, those in charge of the election machinery of a corporation must be held to the highest standards of providing for and conducting corporate elections. The business judgment rule therefore does not confer any presumption of propriety on the acts of directors in postponing the annual meeting. *Id.* at 1206-07.

In *Schnell*, when the defendant board of directors learned that an insurgent group planned to wage a proxy contest at the corporation’s annual stockholder meeting on January 11, 1972, as previously set by the by-laws, the board changed the date of the meeting to December 8, 1971. The purpose of this change was to prevent the insurgent group from conducting an election contest at all, because the insurgent’s

proxy materials would likely not clear SEC review in time to allow for a meaningful electoral challenge. The court famously held that inequitable action did not become permissible simply because it was legally possible, and nullified the December 8 stockholder meeting. *Schnell,* 285 A.2d 437 at 439. *Schnell* made it very clear that a board acting with the purpose of disenfranchising shareholders and perpetuating itself in office would not be protected by the business judgment rule, but instead would be subjected to equitable analysis.

Here, as in *Schnell*, the board's actions may have been facially valid, but nevertheless must undergo enhanced judicial scrutiny to determine whether the board acted with an inequitable purpose. Therefore, the business judgment rule cannot insulate the Talbot board's decision to enact the Proxy Fee-Shifting Bylaw.

2. The Proxy Fee-Shifting Bylaw was adopted for the sole inequitable purpose of deterring Alpha from waging a proxy contest.

The Court of Chancery properly determined that the Talbot board adopted the Proxy Fee-Shifting Bylaw for the inequitable purpose of thwarting corporate democracy and perpetuating itself in office. Op. at 17. One of the most venerable precepts of Delaware's common law corporate jurisprudence is the principle that inequitable action does not become permissible simply because it is legally possible. *MM Companies, Inc. v. Liquid Audio, Inc.,* 813 A.2d 1118 (Del. 2003). Whether a specific fee-shifting bylaw is enforceable, however, depends on the manner in which it was adopted and the circumstances under

which it was invoked. Bylaws that may otherwise be facially valid will not be enforced if adopted or used for an inequitable purpose. *ATP Tour, Inc. v Deutscher Tennis Bund*, 921 A.3d 554, 557-558 (Del. 2014). In the landmark *Schnell* decision, for example, this Court set aside a board-adopted bylaw amendment that moved up the date of an annual stockholder meeting to a month earlier than the date originally scheduled. The Court found that the board's purpose in adopting the bylaw and moving the meeting was to "perpetuate itself in office" and to "obstruct the legitimate efforts of dissident stockholders in the exercise of their rights to undertake a proxy contest against management." *Id.* In sum, the enforceability of a facially valid bylaw turns on the circumstances surrounding its adoption and use. *Id.*

Schnell's broad holding spawned an entirely new line of Court of Chancery decisions in which certain principles emerged from those cases which are inextricably related to their specific facts. Almost all of the post-*Schnell* decisions involved situations where boards of directors deliberately employed various legal strategies either to frustrate or completely disenfranchise a shareholder vote. As *Blasius* recognized, in those circumstances, board action was intended to thwart free exercise of the franchise and there can be no dispute that such conduct violates Delaware law. *Stroud*, 606 A.2d at 75. Thus, while the legal standard is clear, the determination of whether a bylaw was adopted for an inequitable purpose is a very fact-specific inquiry in which the court must take all circumstances surrounding the bylaw's adoption into account.

In *ATP Tour*, a decision that the Court of Chancery relied heavily upon when determining that the Talbot board acted with an inequitable purpose, the challenged bylaw shifted attorneys' fees and costs to unsuccessful plaintiffs in intra-corporate litigation. *ATP Tour*, 921 A.3d at 555. The Court found the bylaw to be facially valid, but nevertheless declined to hold that the ATP fee-shifting provision was adopted for a proper purpose or was enforceable in the circumstances presented. *Id.* at 558. Similarly to the fee-shifting bylaw in *ATP Tour*, the proxy fee-shifting bylaw adopted by the Talbot board cannot be enforced because it was adopted for an inequitable purpose.

Here, the inequitable purpose of the Talbot board was to perpetuate itself in office by denying shareholders of their right to vote for new directors at the upcoming election. The evidence surrounding the adoption of the bylaw clearly demonstrates that the board intended to carry out this inequitable purpose by deterring Alpha from exercising its legal right to wage a proxy contest.

The record is clear in showing that a majority of the Talbot directors, led by CEO Gunnison, intended the bylaw to deter Alpha from waging a proxy contest. According to the Court of Chancery, many of the Talbot directors explicitly saw the adoption of the Proxy Fee-Shifting Bylaw as a deterrent, if not a show stopper, that could potentially dissuade Alpha from undertaking its proxy contest at all. Op. at 14. Gunnison warned the Board that he saw the proxy contest with Alpha as a potential camel in the tent problem that could eventually steer the Company toward a flawed short-term business

model. Op. at 8. At least three other Talbot directors shared a similar sentiment. Op. at 8. Thus, according to the Court of Chancery, the Board appears to have adopted the Proxy Fee-Shifting Bylaw for the subjective purpose of preventing, or at least discouraging, the Company's largest stockholder from exercising its right to undertake a proxy contest against management. Op. at 14.

In addition to the subjective intent of the Talbot board in adopting the bylaw, the objective effects of the bylaw also demonstrate that it was enacted for the inequitable purpose of disenfranchising shareholders. The first and most obvious effect of the fee-shifting bylaw is the strong financial deterrent effect it has against proxy contests. Disregarding the sharp disagreement between the parties, Talbot's minimum costs of defending a proxy contest are likely to exceed $8 million, which Alpha will have to reimburse if it runs an unsuccessful proxy contest. Op. at 8.

The enormous financial risk imposed by the Proxy Fee-Shifting Bylaw demonstrates the equally enormous deterrent effect it has against Alpha from waging a proxy contest in the first place. In fact, Alpha has already expressed that it will abandon the upcoming proxy context if judicial relief invalidating or otherwise restraining enforcement of the Proxy Fee-Shifting Bylaw is not obtained. Op. at 12. This deterrent against a valid proxy contest constitutes an unlawful invasion into the rightful space of the shareholders. See *Blasius*, 564 A.2d at 659 ("The shareholder franchise is the ideological underpinning upon which the legitimacy of directorial

power rests”). The Board’s attempt to control that space by using the threat of substantial costs as a deterrent to Alpha’s lawful stockholder challenge to the directors’ incumbency cannot withstand a *Schnell* analysis. Op. at 17.

Furthermore, the Talbot board cannot use the fee-shifting waiver provision as a defense to the deterrent against Alpha. The Board has already resolved not to waive the fee-shifting obligation for the Alpha proxy contest. Nor can the board claim that its power to reexamine its non-waiver determination after the conclusion of an Alpha proxy contest will have any curing effect on the deterrent against Alpha. According to the Court of Chancery, the possibility of such a waiver is simply too uncertain to remove the ex-ante deterrent effect of the Proxy Fee-Shifting Bylaw for Alpha or any other potential insurgent group. Op. at 15.

Therefore, based on the subjective intent of the Talbot board in adopting the bylaw, along with the objective effect the bylaw will have in deterring Alpha from waging a proxy contest, it is clear that the Talbot board adopted the bylaw for the sole inequitable purpose of disenfranchising shareholders and thus must be preliminary enjoined.

3. Even if the Talbot Board’s actions are subjected to the standard of review set forth in *Blasius*, the bylaw cannot be enforced because there was no compelling justification for its adoption.

If this Court declines to subject the actions of the Talbot board to the “inequitable purpose” analysis set forth in *Schnell*, but

instead subjects the board action to the "compelling justification" standard of review from *Blasius*, the Proxy Fee-Shifting Bylaw will nevertheless fail to overcome judicial scrutiny and must be preliminary enjoined. *Blasius* set forth this standard in cases where board action interferes with shareholder votes… holding that the board bears the heavy burden of demonstrating a compelling justification for such action. *Blasius*, 564 A.2d at 659. Here, the Talbot board acted with the sole inequitable purpose of disenfranchising shareholders and had no compelling justification for such action.

Similar to the case at hand, in *Blasius*, the board was not faced with a coercive action taken by a powerful shareholder against the interests of a distinct shareholder constituency, but was presented with a consent solicitation by a 9% shareholder. Here, Alpha only held 7% of the outstanding Talbot shares.

The facts in *Blasius* further mirror the case at hand in that both boards were faced with a restructuring proposal from a dissident shareholder. The Court in *Blasius* held that the restructuring proposal may have been unrealistic and may have led to injury to the corporation and its shareholders if pursued… however, there is a vast difference between expending corporate funds to inform the electorate and exercising power for the primary purpose of foreclosing effective shareholder action. A majority of the shareholders could view the matter differently than did the board and are entitled to employ the mechanisms provided by the corporation law and the Atlas certificate of incorporation to advance that view. *Id*. at 661.

Here, as in *Blasius*, there was no compelling justification that warranted the Talbot board to interfere with a shareholder vote. The only justification that can, in such a situation, be offered for the action taken is that the board knows better than do the shareholders what is in the corporation's best interest. While that premise is no doubt true for any number of matters, it is irrelevant when the question is who should comprise the board of directors. Id. at 661.

First, there was no threat of a takeover by Alpha because Talbot has in place a poison pill rights plan with a 15% flip-in trigger for any person acquiring a 15% stake without prior approval by the Talbot board. Op. at 4. Alpha also disclosed that its purchase of Talbot shares was for investment purposes only and that Alpha would not seek to acquire a controlling stockholder position or otherwise try to acquire the Company outright. Op. at 4.

Second, there was no threat of Alpha nominated directors dominating the Talbot board. Alpha only intended to nominate 4 of its own directors, while the Talbot board contains 9 seats. Thus, even if Alpha was successful in getting every one of its nominated directors elected, the majority of the board would still be controlled by incumbent Talbot directors.

Finally, when the bylaw and its effects are closely examined, it becomes clear that its reimbursement effects are not enough to meet the compelling justification standard set forth in *Blasius*. When comparing the possible reimbursement effects of the bylaw to the total value of Talbot, the effects seem minuscule. According to Talbot's own

Vice President for Finance and Operations, Talbot would spend approximately $8 million in defending a proxy contest against Alpha. Op. at 8. For comparison, in the most recent fiscal year, Talbot had a market capitalization of approximately $2.25 billion and posted net earnings of $1.1 billion. Op. at 2. The $8 million Talbot would have to spend defending a proxy contest only amounts to 0.355% of its entire market capitalization and only 0.73% of its net earnings for the 2014 fiscal year. Furthermore, Talbot presently has approximately 75 million shares of common stock outstanding. Op. at 2. This means that if Alpha was forced pay $8 million for the reimbursement of an unsuccessful proxy contest, each Talbot share would only increase in value by approximately $0.11. (Talbot shares are currently worth approximately $30 per share. Op. at 2.) The possibility of a diminutive increase in Talbot share value clearly fails to justify the Talbot board's decision to adopt the proxy bylaw and disenfranchise its shareholders.

In fact, the language of the bylaw itself, specifically the inclusion of the fee-shifting waiver provision, demonstrates that the bylaw was adopted solely in order to deter a proxy contest. If the bylaw was actually adopted for the purpose of reimbursing the corporation, the inclusion of the waiver provision would be counterintuitive and meaningless. Thus, it seems as if the waiver provision was included in the bylaw simply to act as a smokescreen to cover the Talbot board's true purpose.

The Talbot board attempted to deter a shareholder from waging a valid proxy contest simply because the board did not want to face a business restructuring proposal. There was no threat of a takeover and there was no threat to the corporation. Instead of allowing the shareholders to freely exercise their voting rights, the Talbot board took it upon themselves to decide what was best for the company. When it comes to corporate democracy, the power belongs to the shareholders and anything that interferes with that power must withstand strict judicial review. Here, there was no compelling justification for the Talbot board to adopt the Proxy Fee-Shifting bylaw and thus the bylaw must be set aside by this Court.

CONCLUSION

For the foregoing reasons, this Court should affirm the preliminary injunction against the Proxy Fee-Shifting Bylaw.