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,

Defendants Below,
Appellants,

v.

ALPHA FUND MANAGEMENT L.P.,

Plaintiff Below,
Appellee.

No. 162, 2015

Court Below:
Court of Chancery of
the State of Delaware

C.A. No. 10428-CJ

APPELLANTS' OPENING BRIEF

Team J
Attorneys for Appellants
February 6, 2015

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NATURE OF THE PROCEEDINGS

Appellee, Plaintiff below, brought suit seeking injunctive relief against Appellants, Defendants below, in the Court of Chancery of the State of Delaware on claims that Talbot's December 2014 Proxy Fee-Shifting Bylaw is facially invalid and was adopted for an inequitable purpose. On January 14, 2105, Chancellor Junge granted a preliminary injunction, preventing Talbot, Inc. and the Board from taking action to enforce the Proxy Fee-Shifting Bylaw in connection with any proxy contest for the election of Talbot's Board of Directors at the May 2015 annual stockholders' meeting.

Appellants filed a notice of appeal on January 15, 2015, and this Court accepted expedited appeal on January 29, 2015.

Appellants request that this Court reverse the Court of Chancery's interlocutory order. Specifically, Appellants ask that this Court to hold that the Proxy Fee-Shifting Bylaw is facially valid and that the Bylaw is legally enforceable.

SUMMARY OF THE ARGUMENT

The Court of Chancery improperly issued a preliminary injunction because Talbot's Bylaw is facially valid. Under Delaware law, fee-shifting bylaws are permissible because they dictate a process, not a substantive result. Neither the DGCL nor any other statute forbids these bylaws. Although the Bylaw deals with proxy expenses, it is still a valid fee-shifting bylaw. The Board may unilaterally pass bylaws that relate to "the corporation's business, the conduct of its affairs, and the rights of its stockholders." Talbot's Bylaw regulates how stockholders exercise their right to bring proxy contests. It only

regulates part of the proxy procedure by providing a reimbursement mechanism. It does not eliminate stockholders' right to wage a proxy contest. Thus, this Court should reverse the injunction.

Facially valid bylaws must be equitable. Talbot's Bylaw is enforceable because it has an equitable effect and it was passed under equitable circumstances. Inequitable bylaws thwart shareholders' legitimate actions. The Bylaw does not prevent shareholders' proxy contests; when enforced, the Bylaw only shifts expenses to the losing party. At most, the Bylaw deters frivolous contests. The Bylaw was not enacted to entrench current management. The Board spent considerable time understanding the Bylaw, considering whether to pass it, and unanimously voting in its favor. The Board hoped the Bylaw would deter Alpha from "playing games for short-term wins" and cited the financial benefits of reimbursement. Ultimately, the Board had legitimate business reasons for its adoption. Thus, this Court should reverse the preliminary injunction below.

COUNTERSTATEMENT OF FACTS

Appellant Talbot, Inc. ("Talbot" or the "Company") is a publically traded Delaware corporation. Mem. Op. at 2. Appellee Alpha Fund Management L.P. ("Alpha") is an investment management fund and activist shareholder in the companies it invests in. Mem. Op. at 2. In 2013, Alpha began purchasing shares of Talbot. Mem. Op. at 3.

Shortly after acquiring 4% of outstanding Talbot stock, Alpha CEO Jeremy Womack ("Womack") met with Talbot CEO and Chairman of the Board of Directors ("Board"), Timothy Gunnison ("Gunnison"), to suggest a

Restructuring Proposal. Mem. Op. at 3. Womack believed that the Restructuring Proposal would create immediate shareholder value by shedding two of Talbots's three divisions. Mem. Op. at 3. Gunnison expressed skepticism of the Restructuring Proposal; Gunnison believed it vastly underestimated the synergy between Talbot's three divisions and failed to account for Talbot's significant cost cutting strategies already underway. Mem. Op. at 4.

During the next six months, Alpha began acquiring Talbot shares until it owned 7% of Talbot's outstanding stock. Mem. Op. at 4. Talbot had a poison pill rights plan in place (triggers at 15% ownership) that precluded Alpha, or any other investor, from taking control of the Company without Board consent; however, Alpha could still exert considerable power over the Company through proxy solicitation. Mem. Op. at 4 n. 2. On December 10, 2014, Alpha filed a Schedule 13D with the Securities and Exchange Commission disclosing its ownership interest in Talbot, its disinterest in acquiring the Company outright, and its intent to nominate four candidates to the Board for the sole purpose of advancing the adoption of Womack's Restructuring Proposal. Mem. Op. at 4.

Alpha's Schedule 13D immediately attracted media attention due to Alpha's reputation as a determined activist investor and Womack's past success in forcing companies to undergo restructuring. Mem. Op. at 5. One week after the Schedule 13D filing, Gunnison called a Board meeting to discuss Alpha's actions. Mem. Op. at 5. All nine Board members were present, including Gunnison and 8 disinterested directors. Mem. Op. at 5. The meeting lasted over two hours and

included a detailed presentation from the Talbot's Vice President for Finance and Operations about Alpha's Restructuring Proposal and Talbot's cost cutting measures. Mem. Op. at 5. The Board unanimously agreed the current business plan would provide a better long-term, and possibly greater short-term, value. Mem. Op. at 5–6. Gunnison and at least three other directors believed the Restructuring Proposal to be "an ill-conceived short-term plan at best" with the potential to harm Talbot in the long run. Mem. Op. at 8.

The meeting also featured presentations from inside and outside counsel on a fee-shifting bylaw (the "Bylaw"). Mem. Op. at 6. The Bylaw requires a dissident shareholder group that launches an unsuccessful proxy contest to reimburse Talbot for the reasonable expenses that it may incur while resisting the group's campaign. Mem. Op. at 1. The Bylaw is only applicable to unsuccessful proxy contests in which less than half of the dissident group's nominees are elected. Mem. Op. at 1. The Board fully understood the Bylaw before unanimously adopting it and agreed it would benefit Talbot in several ways. Mem. Op. at 7. Notably, the Bylaw would help the Company recoup significant expenses. Mem. Op. at 15. Additionally, because the Bylaw would increase the financial risk associated with engaging in a proxy contest, it could provide the added benefit of dissuading Alpha from doing so. Mem. Op. at 14. Some directors disparaged Alpha as "playing financial games for purely short-term wins" and expressed hope that the Bylaw might make Alpha think twice about its agenda. Mem. Op. at 8.

Four days after the Board's meeting and adoption of the Bylaw, Alpha nominated four candidates and filed suit, attacking the facial validity and enforceability of the Bylaw. Mem. Op. at 10.

ARGUMENT

I. THE COURT OF CHANCERY IMPROPERLY ISSUED A PRELIMINARY INJUNCTION BECAUSE PLAINTIFF FAILED TO DEMONSTRATE A REASONABLE PROBABILITY OF SUCCESS ON THE MERITS CONCERNING THE FACIAL VALIDITY OF A FEE-SHIFTING BYLAW.

A. Question Presented

Whether the Court of Chancery's grant of a preliminary injunction should be reversed because Talbot's fee-shifting is permissible under Delaware law and because the Bylaw only dictates part of the proxy contest process, not a substantive result.

B. Scope of Review

Courts may grant a preliminary injunction when a plaintiff can prove the following three elements: (1) a reasonable probability of success on the merits; (2) an imminent threat of irreparable injury; and (3) a balancing of the equities that tips in its favor. *Ivanhoe Partners v. Newmont Mining Corp.*, 535 A.2d 1334, 1341 (Del. 1987); *SI Mgmt. L.P. v Wininger*, 707 A.2d 37, 40 (Del. 1998). The grant of a preliminary injunction is reviewed for abuse of discretion. *Id.* This Court reviews the Court of Chancery's legal conclusions *de novo*. *Unitrin, Inc. v. Am. Gen. Corp.*, 651 A.2d 1361, 1385 (Del. 1995). Talbot contests only the first element, contending that Alpha failed to demonstrate a reasonable probability of success on the merits. Mem. Op. at 10.

C. Merits of the Argument

1. Talbot's Fee-Shifting Bylaw Is Facially Valid Because It Is Authorized by the Delaware General Corporation Law, Is Consistent with the Corporation's Certificate of Incorporation, and Is Not Otherwise Prohibited.

The Court should reverse the Court of Chancery's grant of Alpha's motion for preliminary injunction because Talbot's Bylaw is facially valid. Under Delaware corporate law, "the bylaws of a Delaware corporation constitute part of a binding broader contract among the directors, officers, and stockholders formed within the statutory framework of the [Delaware General Corporation Law ("DGCL")]." *Boilermakers Local 154 Ret. Fund v. Chevron Corp.*, 73 A.3d 934, 939 (Del. Ch. 2013). Corporate bylaws 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). The Delaware Supreme Court held that, to be facially valid, a bylaw must (1) be authorized by the DGCL; (2) be consistent with the corporation's certificate of incorporation; and (3) not be otherwise prohibited. *ATP Tour, Inc. v. Deutscher Tennis Bund*, 91 A.3d 554, 557–58 (Del. 2014); 8 Del. C. § 109(b). "That, under some circumstances, a bylaw might conflict with a statute, or operate unlawfully, is not a ground for finding it facially invalid." *ATP Tour, Inc.* 91 A.3d at 558.

a. The Bylaw is permissible under Sections 109(a) and (b) of the DGCL.

Talbot's Bylaw is facially valid because Section 109(a) of the DGCL permits the corporation to adopt, amend, or repeal bylaws. 8 Del. C. § 109(a). DGCL Section 109(b) provides that bylaws "may contain any

provision not inconsistent with law or the certificate of incorporation, relating to the business of the corporation, the conduct of its affairs . . . or the rights or powers of its stockholders . . . .” 8 Del. C. § 109(b); *contra Crown EMAK Partners, LLC v. Kurz*, 992 A.2d 377, 398 (Del. 2010)(“[A] bylaw provision that conflicts with the DGCL is void.”).

This Court should begin with the presumption that Talbot’s Bylaw is valid and, if possible, construe it in a manner consistent with the law. *Frantz Mfg. Co.*, 501 A.2d at 407; *CA, Inc. v. AFSCME Emps. Pension Plan*, 953 A.2d 227, 238 (Del. 2008); ATP Tour, Inc., 91 A.3d at 557. Indeed, this Court, in recent cases, has consistently upheld board-adopted bylaws that arguably impinged on the rights of stockholders. *See ATP Tour, Inc.*, 91 A.3d at 555 (upholding facial validity of a board-adopted bylaw for non-stock corporation that shifted the company’s litigation fees to an unsuccessful stockholder plaintiff); *City of Providence v. First Class Citizens BancShares*, Inc., 99 A.3d 229, 231 (Del. Ch. 2014)(upholding the facial validity of a board-adopted forum selection bylaw for a Delaware corporation that required any shareholder litigation to be brought in North Carolina where the company was headquartered); *Boilermakers Local 154 Ret. Fund*, 73 A.3d at 939 (upholding facial validity of a board-adopted exclusive forum bylaw for Delaware corporation that required any shareholder litigation to be brought in Delaware).

Pursuant to Section 109(a) of the DGCL, both the board of directors and the shareholders of corporations, independently and concurrently, possess the power to adopt, amend, and repeal bylaws.

Del. C. § 109(a). The Court, however, has reasoned that such power is subject to certain limitations. *See CA., Inc.*, 953 A.2d at 232. In *CA., Inc.* ("*CA*"), AFSCME Employee Pension Plan ("AFSCME"), a CA stockholder, proposed a bylaw, which addressed reimbursement of election expenses of shareholders whose candidates were successfully elected to board of directors. *Id.* 229–30. The question before the Court was whether or not such a bylaw may be proposed and enacted by shareholders without concurrence of the company's board of directors. *Id.* at 231. Section 109(a) relevantly provides that:

> [T]he power to adopt, amend or repeal bylaws shall be in the stockholders entitled to vote . . . Notwithstanding the foregoing, any corporation may, in its certificate of incorporation, confer the power to adopt, amend or repeal bylaws upon the directors . . . The fact that such power has been so conferred upon the directors . . . shall not divest the stockholders . . . of the power, nor limit their power to adopt, amend or repeal bylaws.

Boilermakers Local 154 Ret. Fund, 73 A.3d at 941 (quoting Del. C. § 109(a)).

But Section 109(a) does not exist in a vacuum; it must be read together with Section 141(a), which provides that "the business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors, except as may be otherwise provided in this chapter or in its certificate of incorporation." Del. C. § 141(a). The DGCL does not statutorily allocate such broad management power to the shareholders. *CA, Inc.*, 953 A.2d at 232; *cf. Quickturn Design Sys. v. Sharpiro*, 721 A.2d 1281, 1291 (Del. 1998)(holding that a board's delayed redemption provision impermissibly deprived a newly elected board of its managerial authority under Section 141(a)). Indeed, it is well-established that

stockholders of a corporation, subject to the DGCL, may not directly manage the business and affairs of the corporation, without specific authorization in either the statute or the certificate of incorporation. *CA, Inc.*, 953 A.2d at 232; *see also, McMullin v. Beran*, 765 A.2d 910, 916 (Del. 2000)("[o]ne of the fundamental principles of the [DGCL] statute is that the business affairs of a corporation are managed by or under the direction of its board of directors."). Therefore, the shareholders' statutory power to adopt, amend, or repeal bylaws is limited by the board's management prerogatives under Section 141(a). *CA, Inc.*, 953 A.2d at 232.

The Bylaw at issue here and the bylaw in *CA* both address the reimbursement of proxy expenses and both bylaws have the intent and effect of regulating the process for electing the corporations' directors. *See id.* at 236; Mem. Op. at 1. Although such purely procedural bylaws do not facially encroach upon the board's managerial authority under Section 141(a), the bylaw in *CA* improperly encroached on the board's authority because it mandated reimbursement of a stockholder's proxy expenses. *Id.* at 235–36; Del. C. § 141(a). Ultimately, the Court struck down the bylaw in *CA* because it divested the board's discretionary power. Here, however, it is Talbot's Board, not its stockholders, that is trying to adopt the Bylaw. Mem. Op. at 1. Section 141(a) grants the Board power to manage the corporations business and affairs. 8 Del. C. § 141(a). Moreover, Talbot's Bylaw is distinct from *CA* because it contains waiver language that reserves the directors' fiduciary duty to waive any fee-shifting obligations

otherwise imposed by the Bylaw. Mem. Op. at 6. Thus, under the DGCL, the Board has the proper authority to enact the Bylaw.

The Court has defined not only who may properly adopt corporate bylaws, but also what types of bylaws are valid. As mentioned *supra*, last year, the Delaware Supreme Court held that the DGCL does not forbid the enactment of fee-shifting bylaws. *ATP Tour, Inc.*, 91 A.3d at 557. In *ATP Tour, Inc.* ("*ATP*"), a provision of the corporation's bylaws shifted attorneys' fees and costs to unsuccessful plaintiffs in intra-corporate litigation. *Id.* at 555. The majority reasoned that "[a] bylaw that allocates risk among parties in intra-corporate litigation appears to satisfy the DGCL's requirement that bylaws 'relat[e] 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.'" *Id.* at 558 (quoting 8 Del. C § 109(b)).

Talbot, like ATP, is a Delaware corporation, governed by a Board that has the authority to unilaterally amend its bylaws. Mem. Op. at 2–3; 91 A.3d at 555. *ATP* involved a non-stock corporation, but the Court still found that, under 8 Del. C. § 141(a), the provisions of the DGCL, including Section 109(b), apply and all references to the stockholders of a corporation are deemed to apply to the members of a non-stock corporation. *Id.* at 557. Similarly, Sections 109(a) and (b) apply to Talbot, a publicly traded corporation. Del. C. § 109(a)–(b). Although the Talbot Bylaw deals with proxy expenses, as opposed to intra-corporate litigation expenses, it is also a fee-shifting bylaw. Mem. Op. at 1. Therefore, the Delaware Supreme Court's interpretation

of the DGCL provisions decision in *ATP* can be fairly read to apply to both stock and non-stock corporations. Because the DGCL does not prohibit fee-shifting, they are permitted under Delaware law in both cases. *See ATP Tour, Inc.*, 91 A.3d at 560 n. 10.

b. Talbot's Certificate of Incorporation expressly grants to the Board the power to adopt, amend, or repeal bylaws.

After reviewing the DGCL, the Court will analyze the corporate charter to determine whether or not a bylaw is facially valid. *See* 8 Del. C. § 109(b). Under Delaware law, bylaws may contain any provision not inconsistent with the corporation's certificate of incorporation. *Id*.

Corporate charters may explicitly vest the board with certain powers. For example, Article SEVENTH, Section (1) of CA's certificate of incorporation explicitly vests CA's board of directors with the power to manage the business and conduct the corporation's affairs. *CA., Inc.*, 953 A.2d at 230. This provision parallels the language of Section 141(a). 8 Del. C. § 141(a). Additionally, Article SEVENTH Section (2) provides that ". . . the power to make, alter, or repeal the By Laws, and to adopt any new By Law, except a By Law classifying directors for election for staggered terms, shall be vested in the board of directors." *CA., Inc.*, 953 A.2d at 231 n. 4. Thus, although CA's bylaws and certificate of incorporation do not specifically address the reimbursement of proxy expenses, it is "undisputed that the decision whether to reimburse election expenses is presently vested in the discretion of CA's board, subject to their fiduciary duties and applicable Delaware law." *Id*. at 230.

Corporate charters may permit fee-shifting provisions, either explicitly or implicitly by silence. *ATP Tour, Inc.*, 91 A.3d at 558. Section 102(a) of the DGCL does not require that fee-shifting provisions be included in a charter. *See* 8 Del. C. § 102(a). Pursuant to other charter-delegated powers, however, directors may unilaterally adopt fee-shifting bylaws. *See ATP Tour, Inc.*, 91 A.3d at 555. In *ATP*, the board adopted a provision, shifting litigation expenses to unsuccessful plaintiffs in intra-corporate litigation. *Id.* Traditionally, Delaware follows the American Rule, under which, parties to litigation generally must pay their own litigation costs, including attorneys' fees and costs. *Mahani v. Edix Media Grp.*, Inc., 935 A.2d 242, 245 (Del. 2007). However, contracting parties may agree to obligate the losing party to pay the prevailing party's fees. *ATP Tour, Inc.*, 91 A.3d at 558. Because corporate bylaws are "contracts among a corporation's shareholders, a fee-shifting provision contained in a corporation's validly enacted bylaw would also fall within the contractual exception to the American Rule. *Id.; see also Sternberg v. Nanticoke Mem'l Hosp., Inc.*, 62 A.3d 1212, 1218 (Del. 2013)(holding that 'An exception to [the American R]ule is found in contract litigation that involves a fee shifting provision.'")(citation omitted).

The Bylaw is valid because Talbot's certificate of incorporation expressly confers power to the Board to adopt, amend, or repeal bylaws and because fee-shifting bylaws are enforceable under Delaware law. Mem. Op. at 11. Similar to *CA*, Talbot's certificate of incorporation and Section 141(a) expressly grant control over corporate bylaws to

the Board. Although the respective bylaws mandated reimbursement of expenses to different recipients, both bylaws pertained to electoral procedures following an unsuccessful proxy contest. Mem. Op. at 1. The fundamental difference between the cases is that Talbot's Bylaw is within the Board's proper authority because the Board would retain discretion to waive reimbursement. This fundamental difference ensures that current and future Board members may freely exercise their fiduciary duties. *Contra CA, Inc.*, 953 A.2d at 238. Furthermore, like in *ATP*, the DGCL permits Talbot's Board to adopt a fee-shifting bylaw, despite the corporate charter's silence on the topic. *See* 8 Del. C. § 102(a). Because the Board may lawfully pass a fee-shifting bylaw under Sections 109(b) and 141(a) and because such action does not contravene Talbot's corporate charter, the Bylaw is valid.

c. Delaware common law does not prohibit the Bylaw.

Bylaws that are inconsistent with any statute or rule of common law are void. *Frantz Mfg. Co.*, 501 A.2d at 407. No Delaware statute, however, forbids the enactment of bylaws that shift litigation fees. *ATP Tour Inc.*, 91 A.3d at 558. Here, Talbot also adopted a fee-shifting bylaw and, although it relates to a proxy contest rather than intra-corporate litigation, it, nonetheless, would not be in violation of any common law or precept. Mem. Op. at 1. Therefore, because the Bylaw is facially valid, this Court should reverse the Court of Chancery's grant of Alpha's motion for preliminary injunction.

2. The Bylaw Is Valid Under Delaware Law Because It Regulates A Process; It Does Not Mandate A Substantive Decision.

Under Delaware law, bylaws typically do not contain substantive mandates, but, instead, direct how the corporation may take certain

actions. *Boilermakers Local 154 Ret. Fund*, 73 A.3d at 951. "[T]here is a general consensus that bylaws that regulate the process by which the board acts are statutorily authorized." *Id.* at 235 (quoting *Hollinger Int'l., Inc. v. Black*, 844 A.2d 1022, 1079 (Del. Ch. 2004)). Section 109(b) allows corporations to set "self-imposed rules and regulations that are deemed expedient for its convenient functioning." *Boilermakers Local 154 Ret. Fund*, 73 A.3d at 951.

The DGCL and Delaware case law are replete with examples of the process-oriented bylaws. For example, Section 141(b) "authorizes bylaws that fix the number of directors on the board, the number of directors required for a quorum (with certain limitations), and the vote requirements for board action." 8 Del. C. § 141(b). Additionally, the Court has upheld forum selection bylaws that designate an exclusive forum as statutorily and contractually valid because they relate to the corporation's business, conduct of its affairs, and stockholders' rights. *Boilermakers Local 154 Ret. Fund*, 73 A.3d at 939; *City of Providence*, 99 A.3d at 233. Specifically, forum selection bylaws address "rights" because they regulate where stockholders can exercise their right to bring certain internal affairs claims. *Boilermakers Local 154 Ret. Fund*, 73 A.3d at 950–51.

Seemingly restrictive procedural bylaws may be valid if they do not unduly intrude upon the board's authority. *CA., Inc.* 953 A.2d at 236. In *Frantz Mfg. Co.*, the Court upheld a bylaw that required attendance of all directors for a quorum and unanimous approval before board action could be taken. 501 A.2d at 407. In contrast, the Court struck down the bylaw in *CA* as unduly restrictive because it mandated

reimbursement of stockholders' proxy fees. 953 A.2d at 236. Under CA's bylaw, the board's fiduciary duty to deny reimbursement in situations where proxy contests are motivated by personal or petty concerns is wholly restricted. *Id.* at 240.

A bylaw that addresses reimbursement of election expenses is not *per se* invalid. Indeed, the Bylaw at issue here is valid because, like the forum selection bylaws, it simply regulates how stockholders may exercise their right to proxy contests. The Bylaw does not eliminate the stockholders' opportunity to bring such contests. Moreover, unlike the reimbursement bylaw in *CA*, Talbot's Bylaw does not hinder the Board's fiduciary discretion to waive reimbursement. In fact, the Bylaw is even less restrictive than the quorum and forum selection bylaws because, the Bylaw does not contain a mandate. Reimbursement only occurs if the proxy contest is unsuccessful and, even then, the Board has discretion to waive any fee-shifting obligations imposed by the Bylaw. The preliminary injunction should be reversed because, under Delaware law, the Bylaw permissibly defines the process by which stockholders may undertake a proxy contest.

II. THE COURT OF CHANCERY IMPROPERLY ISSUED A PRELIMINARY INJUNCTION BECAUSE PLAINTIFF FAILED TO DEMONSTRATE A REASONABLY PROBABILITY OF SUCCESS ON THE MERITS CONCERNING THE ENFORCEABILITY OF THE FEE-SHIFTING BYLAW.

A. Question Presented

Whether Talbot's Proxy Fee-Shifting Bylaw is equitable under Delaware law when it does not preclude shareholders from exercising their right to vote or nominate Board candidates, when it was unanimously passed by Talbot's Board who fully discussed and

understood the Bylaw, and when the Board believed its passage was in the best interest of Talbot's shareholders.

B. Scope of Review

Courts 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). As noted *supra*, the plaintiff must establish the following: (1) a reasonable likelihood of success on the merits; (2) that he will suffer imminent irreparable harm if the preliminary injunction is not granted; and (3) that the damage to the plaintiff, if the injunction is denied, must exceed the damage to the defendant, if the preliminary injunction is granted. *Id.* Talbot has ceded the second and third elements of this legal framework. Mem. Op. at 10.

C. Merits of the Argument

1. The Bylaw Is Enforceable Under Delaware Law Because It Is Equitable In Its Effect and Was Passed Under Equitable Circumstances.

    a. Talbot's Bylaw is equitable in its effect because its use will not obstruct dissident shareholders' legitimate efforts to exercise their rights to undertake a proxy contest.

Talbot's Bylaw is valid and enforceable because it was adopted by the appropriate corporate procedures and for a proper corporate purpose. *See ATP Tour, Inc.*, 91 A.3d at 559. Facially valid bylaws are unenforceable in equity if adopted or used for inequitable purposes. *Id.* at 558. The Delaware Supreme Court famously stated that "inequitable action does not become permissible simply because it is legally possible." *Id.* (quoting *Schnell v. Chris-Craft Indus., Inc.*, 285 A.2d 437, 439 (Del. 1971)).

In *Schnell*, the Court held that management's attempt to obstruct dissident stockholders' legitimate efforts to exercise their rights to undertake a proxy contest was impermissible. 285 A.2d at 439. Specifically, the board moved the annual stockholder's meeting to a date one month earlier than initially planned. *Id.* at 438. This change left the shareholders with insufficient time to wage a successful proxy contest; thus, precluding them from contesting incumbent management. *Id.; see also Lerman v. Diagnostic Data, Inc.,* 421 A.2d 906 (De. Ch. 1980) (holding that a bylaw, enacted after the board of directors learned of an impending proxy fight, operated inequitably to preclude shareholders from contesting incumbent management); *but cf. Huffington v. Enstar Corp.,* 9 Del. J. Corp. L. 185 (Del. Ch. 1984) (holding that a bylaw did not force shareholders to prepare their proxy contest so hastily that they were denied sufficient time to prepare).

The Court's equitable powers can only be roused under *Schnell* where circumstances suggest that the company manipulated the voting process in such way as to constitute a grave incursion into the fabric of corporate law. *Accipiter Life Scis. Fund, L.P. v. Helfer Eyeglasses*, 905 A.2d 115, 127 (Del. Ch. 2006). In *Accipiter Life Scis. Fund,* a corporation announced its stockholders' meeting in a press release devoted mainly to financial results. *Id.* at 117. Due to the company's advance notice bylaw, stockholders had 10 days from the date of that announcement to nominate a slate of directors to the board. *Id.* at 118. Ultimately, shareholders were indirectly precluded from the election, the incumbent board ran uncontested, and

the shareholders sued to overturn the results, claiming that the board inequitably manipulated the company's election machinery. *Id.* at 117. The Court reiterated Delaware Supreme Court's caution that proper invocation of the *Schnell* doctrine is highly contextual and should be reserved for those instances which by an improper manipulation of the law would interfere with a fair voting process and deprive a person of a clear right. *Id.* at 124; *see also Alabama By-Prods. Corp. v. Neal,* 588 A.2d 255, 258 (Del. 1991). Delaware courts have been more likely to find an action impermissible if the board acted with the intent of influencing a vote or precluding a proxy contest for control. *Accipiter Life Scis. Fund, L.P.*, 905 A.2d at 124. The Court agreed that the company's announcement made it more difficult than necessary to discover important corporate information and did not approve of processes intended to limit shareholders' rights. *Id.* at 127. However, shareholders could have read the announcement, realized they had 10 days to nominate candidates, and met that deadline. *Id.* Thus, the Court concluded that the announcement did not reach the standard required for equitable relief under *Schnell* because it did not make the dissident's challenge extremely difficult or impossible. *Id.*

Board-adopted forum selection and fee-shifting bylaws have been deemed enforceable by Delaware courts. In *ATP*, the Court held that fee-shifting bylaws are not *per se* invalid simply because they deter litigation. 91 A.3d at 560. The intent to deter litigation is not invariably an inequitable purpose. Therefore, a bylaw would not

automatically be rendered unenforceable due to its litigation deterring effect.

The Bylaw is reasonable in its application because its effect is equitable. Many cases provide support for enjoining a bylaw enacted under a scenario in which a board, aware of an imminent proxy contest, imposes a bylaw to which compliance would thwart the challenger entirely; however, this is not the situation here. The facts in this case fall short of the types of inequity Delaware courts have previously found to be dispositive. The Bylaw would not prevent Alpha, or any other shareholder group from effectively waging a proxy contest against incumbent management. Alpha contends that the Talbot Bylaw serves to obstruct Alpha's legitimate efforts. In *Schnell* and *Lerman*, the overturned bylaws would have made it impossible for shareholders to wage a proxy contest unless they were clairvoyant. The Bylaw in the present case simply imposes a financial obligation on unsuccessful nominees. If at least 50% of a dissident group's nominees win election to the board, then the Bylaw imposes no burden. There is no guarantee that the Bylaw will have any effect that precludes Alpha from contesting incumbent management. In fact, if the Bylaw does deter some shareholder groups from running, then Alpha will have fewer competitors and a stronger likelihood of success.

In effect, the potential enhanced financial burden may discourage the nomination of individuals who are unlikely to win, but will certainly not preclude nominations. All the Bylaw does is make an unsuccessful election more expensive. Proxy contests are naturally expensive and shareholders have to weigh the likelihood of winning

against this expense. Like the announcement at issue in *Accipiter Life Scis. Fund*, the Bylaw here will make things slightly harder for some shareholders. A certain percentage of any company's shareholders will always be unwilling or unable to fund such a contest. The possible fee imposed by the Bylaw is just another part of the expense of waging a proxy contest and should not deter those who have a good chance of success. It certainly should not deter a group worth $1.1 billion that is known for being an activist shareholder. The fee-shifting Bylaw at issue here is akin to litigation fee shifting bylaw at issue in *ATP*. The type of bylaw passed in *ATP* may deter litigation; it is likely to prompt individuals to think twice about bringing forth frivolous suits. Similarly, Talbot's Bylaw will make shareholders reconsider engaging in frivolous proxy contests.

b. Talbot's Bylaw was passed under equitable circumstances because its primary purpose is not the entrenchment of incumbent management.

In *Int'l Banknote Co., Inc. v. Muller*, 713 F. Supp. 612, 625 (S.D.N.Y 1989), the board of directors breached its duty of care by passing a bylaw primarily motivated by entrenchment and not predicated by sufficient diligence and deliberation. In *Int'l Banknote*, the board of directors enacted a bylaw requiring the slates of proposed directors be filed with the current board of directors no later than 45 days prior to the annual meeting. *Id.* at 622. This bylaw was passed within 24 hours of a shareholder group's Schedule 13D filing, placing the board on notice of its intent to wage a proxy contest. *Id.* at 623. Although the annual meeting was still 58 days away, leaving the shareholder group 13 days to comply with the bylaw, the

Court held that the primary purpose of the bylaw was to entrench the current management. *Id.* In this case, there was almost no discussion about the bylaw when the directors voted and the directors did not even have a copy of the text before them. *Id.* The director that proposed the bylaw even stated that he never considered a need for the bylaw before the insurgents fined their Schedule 13D and revealed in his testimony a desire to maintain management's control rather than to act in the best interests of the shareholders, claiming the board would "take all steps necessary to protect [their] position." *Id.* at 626. The Court held that the bylaw was clearly adopted to entrench management and was a violation of the duty of care. *Id.*

Talbot's Bylaw is enforceable because it was passed under equitable circumstances. Unlike in *Int'l Banknote*, the Bylaw was not passed under circumstances that suggest that the primary motivation was entrenchment. In fact, all nine members of the Board were present at a meeting devoted exclusively to the events surrounding Alpha's Schedule 13D filing. The meeting lasted over two hours and included detailed presentations on the legality of the Bylaw from both in-house and outside counsel. All of the directors fully understood the Bylaw and unanimously passed it. This sharply contrasts the events in *Int'l Banknote*, where there was no real discussion of the bylaw and the director admitted self-interested motivation. In *Int'l Banknote*, the director said he would do anything to protect his position on the board. Here, testimony expressed the Board's desire to prevent Alpha from "playing financial games for purely short-term wins," but not necessarily a desire to protect their own Board seats.

2. The Enforceability of the Talbot Bylaw Should Be Reviewed Under the Business Judgment Rule Standard.

Where a corporate board acts for the primary purpose of impeding the exercise of stockholder voting power, the business judgment rule does not apply and the board bears the heavy burden of demonstrating a compelling justification for such action. *Blasius Indus. v. Atlas Corp.*, 564 A.2d 651, 659 (Del. Ch. 1988). In *Blasius*, the board acted for the primary purpose of preventing control of the company from passing out of its hands, effectively reducing the voting power of shareholders, and thwarting shareholders from exercising their voting rights. *Id.* at 660. The Court contends that the fact that the board may know what is in the best interest of the company better than the shareholders is irrelevant when the question is who should comprise the board. *Id.* at 663. However, the standard articulated in *Blasius* is rarely used and is only appropriate where the board breaches its fiduciary duty of loyalty to the corporation and acts in its own self-interest. *See Stroud v. Grace*, 606 A.2d 75, 79 (Del. 1992).

Unocal v. Mesa Petroleum Co., 493 A.2d 946, 954 (Del. 1985) reaffirmed the application of the business judgment rule in the context of a hostile battle for control of a Delaware corporation where board action is taken to the exclusion of, or in limitation upon, a valid stockholder vote. *Unocal* recognized that directors are often faced with an "inherent conflict of interest" during contests for corporate control "[b]ecause of the omnipresent specter that a board may be acting primarily in its own interests, rather than those of the corporation and its shareholders...." *Id. Unocal* thus requires a reviewing court to apply an enhanced standard of review to determine

whether the directors "had reasonable grounds for believing that a danger to corporate policy and effectiveness existed..." and that the board's response "was reasonable in relation to the threat posed." *Id.* at 955. If the board action meets the *Unocal* standard, it is accorded the protection of the business judgment rule. *Id.* The scrutiny of *Unocal* is not limited to the adoption of a defensive measure during a hostile contest for control. In *Moran v. Household Int'l, Inc.*, 500 A.2d 1346 (Del. 1985), the Court held that *Unocal* also applied to a preemptive defensive measure where the corporation was not under immediate "attack." *Id.* at 1350-53. Subsequent cases have reaffirmed the application of *Unocal* whenever a board takes defensive measures in reaction to a perceived "threat to corporate policy and effectiveness which touches upon issues of control." *Gilbert v. El Paso*, 575 A.2d 1131, 1144 (Del. 1990); see *Paramount Comm'ns, Inc. v. Time, Inc.*, 571 A.2d 1140, 1152 (Del. 1990); *Mills Acquisition Co. v. MacMillan, Inc.*, 559 A.2d 1261, 1287 (Del. 1989).

The *Blasius* compelling justification standard is inappropriate for reviewing the facts of the present case and this Court should employ a business judgment rule analysis. As noted *supra*, the Talbot Bylaw passes the inequitable purpose test articulated in *Schnell*. Unlike the action taken in *Blasius*, the Bylaw at issue in the present case will not thwart shareholder voting rights; it will only serve to shift fees incurred in a proxy contest onto a losing party. As such, the business judgment rule is the appropriate standard here. Talbot's Board had several legitimate business interests in passing the Bylaw. Proxy contests are expensive and time-consuming. To go through an

unnecessary contest would waste key resources. The **B**ylaw serves to mitigate both the financial and time imposition. By shifting reasonable fees associated with defending against a proxy contest onto unsuccessful contestants, the company can recoup millions of dollars that could otherwise be spent in furtherance of more productive business purposes. The Bylaw will also serve as a deterrent for some dissidents. This will result in the company having to spend less of its time-contesting proxy fights.

Even if this Court believes the business judgment rule to be too lenient, the Talbot Bylaw can withstand the test set forth in *Unocal*. To satisfy *Unocal*, the Board must show they had reasonable grounds for believing a danger to corporate policy and effectiveness existed and that the Bylaw was a reasonable response in relation to the threat. Alpha's Schedule 13D filing posed a danger to corporate policy and effectiveness. Alpha is known for being an activist shareholder and was strongly advocating its Restructuring Proposal. When Talbot's CEO expressed skepticism towards Alpha's Restructuring Proposal, Alpha responded by purchasing more shares, bringing its ownership of the company from 4% to 7%, filing its Schedule 13D, and announcing its intent to nominate four directors for election to advance the Restructuring Proposal. Talbot's CEO immediately called a meeting of the Board to discuss the Restructuring Proposal and the Board unanimously agreed that it was not in the company's best interests. The Board believed the Restructuring Proposal to be a type of financial game purely for short-term wins and Alpha's determination to push the plan onto Talbot via his Board nominees posed a serious

threat to the company's effective operations. Alpha could run its nominees, become elected, impose its Restructuring Proposal, make a short-term profit, sell its shares, and leave the company in shambles with no long-term potential. The Bylaw was an appropriate response to this threat because it was partially intended to cause shareholders to think twice about waging a proxy contest. By increasing the financial stakes, Talbot can impress upon Alpha that running for the Board is not a "financial game" Alpha can play for their own short-term monetary gain. Therefore, because the Bylaw is enforceable under Delaware law, this Court should reverse the decision below.

CONCLUSION

For the foregoing reasons, this Court should reverse the Chancery Court's grant of preliminary injunction.