IN THE SUPREME COURT OF THE STATE OF DELAWARE

TALBOT, INC., TIMOTHY GUNNISON, FRANCOIS PAYARD, NAOMI ROTHMAN, ROSARIA GABRIELLI, MARSHALL CANNON, AJEET GUTPA, DANIEL LEMON, CLARE LEONARD and PATRICK RHANEY,	:	No. 162, 2015
Defendants Below, Appellants,	:	
v.	:	
ALPHA FUND MANAGEMENT L.P.,	:	
Plaintiff Below, Appellee.	:	

APPELLANTS' OPENING BRIEF

Filed by Team L,
Counsel for Defendants Below,
Appellant

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TABLE OF CONTENTS

Page

TABLE OF CITATIONS

Page(s)

DELAWARE SUPREME COURT CASES:

DELAWARE CHANCERY COURT CASES:

UNITED STATES COURT OF APPEALS CASES:

DELAWARE STATE STATUTES AND RULES:

OTHER SOURCES:

NATURE OF PROCEEDINGS

On December 18, 2014, after extensive deliberation at a special meeting of the Board of Directors, the board of Talbot, Inc. ("Talbot") unanimously adopted a Proxy Fee-Shifting Bylaw ("Bylaw"). On December 22, 2014, Alpha Fund Management L.P. ("Alpha") filed suit against Talbot alleging the Bylaw was facially invalid and a breach of the directors' fiduciary duties. Alpha also filed for a preliminary injunction to prevent the Bylaw from going into effect. After expedited discovery, the court below granted the preliminary injunction on January 12, 2015.

Talbot submitted notice of appeal to this Honorable Court on January 22, 2015, in accordance with Del. Const. art. IV, § 11 and Supr. Ct. R. 7. This Court accepted Talbot's appeal on January 29, 2015.

SUMMARY OF ARGUMENT

I. This Court should reverse the Court of Chancery's grant of a motion for a preliminary injunction. Because Talbot's Bylaw is facially valid, Alpha cannot demonstrate that its claim has a reasonable probability of success on the merits. This Court should apply the test set forth in *ATP Tour, Inc. v. Deutscher Tennis Bund*, 91 A.3d 554 (Del. 2014), for determining the validity of fee-shifting bylaws. Because the test for fee-shifting bylaws set forth in *ATP Tour* applies to Talbot's Bylaw, and because the Bylaw meets the three requirements for facial validity under *ATP Tour*, the Bylaw is facially valid.

II. The Court of Chancery erred in finding that the Talbot board adopted the Bylaw for an improper purpose under *Blasius Indus., Inc. v. Atlas Corp.*, 564 A.2d 651 (Del. Ch. 1988). Because the Bylaw was not adopted for the primary purpose of impeding the stockholder franchise, *Blasius* does not apply. Instead, the Bylaw should be analyzed under *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985). Because the Bylaw satisfies both prongs of Unocal—reasonableness and proportionality—this Court should defer to the Talbot board's business judgment.

STATEMENT OF FACTS

Appellant-Defendant Talbot, is a multidivisional, publically traded Delaware corporation headquartered in Maryland with a market capitalization of $2.25 billion. Op. at 2. Talbot operates three manufacturing divisions: critical fasteners for aerospace and other markets, micro-electronic circuitry components, and software for industrial manufacturing applications. Op. at 2. Talbot's board is composed of nine directors, eight of which are outside directors, and all nine are elected annually. Op. at 3. Appellee-Plaintiff is Alpha—a Delaware limited partnership formed under the laws of Delaware and headquartered in New York City. Op. at 2. Alpha manages a range of funds and has "regularly been an activist stockholder in the companies in which [it] has invested". Op. at 2.

In 2013, Alpha acquired 4% of Talbot's outstanding shares and shortly thereafter, Jeremy Womack, CEO of Alpha, met with Timothy Gunnison, Talbot's CEO and sole inside director, to suggest a detailed Restructuring Proposal that would eliminate two of Talbot's three divisions. Op. at 2, 3. Gunnison was skeptical about this proposal, suggesting that Womack underestimated the synergy of Talbot's three divisions and failed to account for "significant cost cutting measures" that Talbot had already implemented. Op. at 4.

Alpha quickly increased its holdings in Talbot to 7% shares outstanding and filed a Schedule 13D with the SEC stating that it would attempt to implement the Restructuring Proposal by electing four directors to Talbot's board. Op. at 4. Since Alpha had a reputation for forcing restructuring plans on other companies in which it had a

stake, Talbot's board called a special meeting exclusively to discuss Alpha's filing. Op. at 5. All of Talbot's board members, as well as several company officers and legal representatives, were present for the meeting. Op. at 5. The meeting lasted more than two hours and included a detailed presentation of the Restructuring Proposal in addition to the cost cutting measures already in place. Op. at 5. After considering the proposal, the board unanimously agreed that the company's current plan promised greater long-term value and possibly greater short-term value as well, and thus it was the best choice for Talbot and its stockholders. Op. at 5-6. The board also heard presentations from in-house and outside legal counsel regarding a proposed proxy fee-shifting bylaw, which ensured that the board understood the mechanics of the Bylaw before voting on it. Op. at 6. Counsel explained the devastating news that a proxy contest could cost Talbot as much as $12 million, but that the Bylaw would give Talbot the ability to avoid that negative financial impact altogether. Op. at 6, 8. The Bylaw would require a dissident stockholder to reimburse Talbot for all reasonable professional fees and expenses incurred in defending against dissidents in a proxy contest if less than half of the dissident stockholder's nominees won election to the board. Op. at 6. However, the Board would retain the authority to waive the fee assignment. Op. at 6.

After the presentations concluded, Gunnison expressed his opinion that the Restructuring Proposal was ill-conceived and led the company toward a flawed short-term business model, a point on which multiple directors agreed. Op. at 8. Gunnison supported the Bylaw because it

would allow Talbot to recoup costs incurred in defending against the proxy contest. Op. at 8. Some directors acknowledged that the Bylaw might affect the proxy contest; however, in unanimously approving the bylaw the board reserved the right to waive Alpha's duty to reimburse following the proxy contest. Op. at 8-9. On December 22, 2014, Alpha nominated four individuals to Talbot's board and filed suit against Talbot for adopting the Bylaw. Op. at 9. Alpha also moved the Court of Chancery for a preliminary injunction, which was hastily granted, to prevent Talbot from enforcing the Bylaw. Op. at 1, 10. The lower court declined to rule on the facial validity of the Bylaw. Op. at 12. This Honorable Court accepted Talbot's appeal on January 29, 2015.

ARGUMENT

I. THE COURT OF CHANCERY ERRED IN GRANTING THE PRELIMINARY INJUNCTION BECAUSE TALBOT'S FEE-SHIFTING BYLAW IS FACIALLY VALID.

A. QUESTION PRESENTED

Should Talbot be enjoined from adopting a fee-shifting bylaw that allows the corporation to recover from a dissident stockholder the expenses Talbot reasonably incurs in defending against an unsuccessful proxy contest?

B. SCOPE OF REVIEW

This Court reviews the grant of a preliminary injunction for abuse of discretion. *SI Mgmt. L.P. v. Wininger*, 707 A.2d 37, 40 (Del. 1998). However, this Court gives no deference to the trial court's legal conclusions. *Id.* Because the facial validity of a proxy fee-shifting bylaw is a novel question of law in Delaware, Op. at 12, it warrants *de novo* review.

C. MERITS OF THE ARGUMENT

To obtain a preliminary injunction, the burden is on the moving party to show three factors: (1) a reasonable probability of success on the merits of the claim; (2) irreparable harm; and (3) a balancing of the equities in favor of the moving party. *Wininger*, 707 A.2d at 40. This appeal turns on Alpha's ability to show a reasonable probability of success on the merits of its claim. Because this Court should apply *ATP Tour*'s test for facial validity to Talbot's Bylaw, and because the Bylaw is facially valid, Alpha cannot demonstrate a reasonable probability of success on the merits of its claim. Thus, this Court should reverse the lower court's grant of a preliminary injunction.

1. *ATP Tour*'s test for facially valid bylaws should apply to fee-shifting bylaws in proxy contests.

Although the facial validity of fee-shifting bylaws pertaining to proxy contests is an issue of first impression in Delaware, this Court has held that "fee-shifting provisions in a non-stock corporation's bylaws can be valid and enforceable under Delaware law." *ATP Tour*, 91 A.3d at 555. In *ATP Tour*, the board of a non-stock corporation adopted a fee-shifting bylaw requiring an unsuccessful party litigating against the corporation or any of its members or owners to reimburse the corporation for costs and expenses incurred by the corporation in defending the suit. *Id.* at 556. Two of the members of ATP Tour sued the corporation for other board actions, but the members did not prevail on their claims. *Id.* ATP Tour then attempted to collect legal fees and expenses under the fee-shifting provision. *Id.* Because the case raised novel questions of law, the trial court certified the question of the bylaw's validity to this Court. *Id.* at 557.

The *ATP Tour* analysis for facial validity of fee-shifting bylaws should apply to all corporations, regardless of their classification as stock or non-stock corporations. Although *ATP Tour* involved a non-stock corporation's bylaw, while Talbot is a stock corporation, the majority of the *ATP Tour* opinion refers to fee-shifting bylaws in general without differentiating between the two types of corporation. *E.g.*, *id.* at 558 (noting that the DGCL does not forbid fee-shifting bylaws). Additionally, the Court in *ATP Tour* based its analysis on statutes and case law that apply to stock corporations. Herbert F. Kozlov & Lawrence J. Reina, *Delaware Supreme Court Approves Fee-Shifting Bylaw for Non-Stock Corporations*, BUS. L. TODAY (American Bar

Association), June 2014, at 1. Furthermore, since *ATP Tour*, "commentators have assumed that [the ruling] applies equally to for-profit, stock corporations." SMU Corporate Counsel Symposium, *The Emerging Role of Bylaws in Corporate Governance*, at 19 (Oct. 2014) (unpublished manuscript) (on file with SMU Law Review). In fact, at least three Delaware stock corporations have adopted fee-shifting bylaws in the wake of *ATP Tour.* Nathan A. Cook, *What Fiduciary Duties? Delaware Supreme Court Okays One-Way Fee-Shifting Bylaws*, Class Action Litigation Newsletter (Am. Assoc. for Justice), Summer 2014, at 3, *available at* http://www.gelaw.com/articles/What- Fiduciary-Duties.pdf

The facial validity test in *ATP Tour* should also extend to fee-shifting bylaws pertaining to proxy contests. Even though the bylaw in *ATP Tour* dealt with litigation expenses, while Talbot's Bylaw deals with proxy contests, the same policy underlies both bylaws: the board's goal of reducing unnecessary corporate costs. The board has a duty to strive to maximize the value of the corporation, *Quadrant Structured Prods. Co. v. Vertin,* 102 A.3d 155, 172 (Del. Ch. 2014), and Talbot's Bylaw advances this goal by reducing expenses. Proxy contests generate between $800,000 and $3 million in costs and fees for small corporations and between $4 million and $14 million for larger corporations. *See Bus. Roundtable v. SEC*, 647 F.3d 1144, 1150 (D.C. Cir. 2011); Op. at 6. Talbot's estimated costs for defending against Alpha's proxy campaign fall between $8 million and $12 million. Op. at 8. Moreover, Talbot's legal counsel advised the board that it could consider the "potentially adverse financial impact of

such proxy contests on the corporation and its stockholders" in deciding whether to adopt the Bylaw. Op. at 6.

Although Alpha contends that the Bylaw *could* have a "chilling effect" on corporate democracy, this Court "exercise[s] caution [before] invalidating corporate acts based upon hypothetical injuries . . . ." *CA, Inc. v. AFSCME Emps. Pension Plan*, 953 A.2d 227, 238 (Del. 2008) (quoting *Stroud v. Grace*, 606 A.2d 75, 79 (Del. 1992)). Unlike the hypothetical injuries for which Alpha seeks to invalidate the Bylaw, proxy expenses impose a very real and substantial hardship upon Talbot. Like the fee-shifting bylaw in *ATP Tour* that was designed to reduce intra-corporate litigation expenses, Talbot's Bylaw would save the corporation a substantial amount of money by mitigating the immense costs of defending against proxy contests. Because the same corporate objective underlies both subtypes of fee-shifting bylaw, the *ATP Tour* test for facial validity should apply to Talbot's Bylaw.

2. This Court should reverse the Court of Chancery's decision to grant a preliminary injunction because Talbot's Bylaw satisfies the requirements for facial validity under *ATP Tour.*

To be facially valid, a corporate bylaw must satisfy three requirements: (1) the bylaw must be authorized by the Delaware General Corporation Law (hereinafter "DGCL"); (2) the bylaw must be consistent with the company's certificate of incorporation; and (3) adoption of the bylaw must not be otherwise prohibited. *ATP Tour*, 91 A.3d at 557-58.

a. Talbot's Bylaw is authorized under the DGCL.

Boards of directors have broad governing power under Delaware law. The board is responsible for managing the business and affairs of

the corporation. 8 Del. C. § 141(a). "Traditionally, the bylaws have been the corporate instrument used to set forth the rules by which the corporate board conducts its business." *Hollinger Int'l, Inc. v. Black*, 8144 A.2d 1022, 1078 (Del. Ch. 2004). A corporation may, in its certificate of incorporation, grant authority to the board to unilaterally adopt, amend, or repeal bylaws. 8 Del. C. § 109(a). The DGCL provides that "[t]he bylaws may contain any provision, not inconsistent with the law or with the certificate of incorporation, relating to the business of the corporation, the conduct of its affairs, and its rights or powers or the rights or powers of its stockholders, directors, officers or employees." 8 Del. C. § 109(b). Furthermore, corporate bylaws are presumed to be valid, and "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).

Fee-shifting bylaws are permissible under Delaware law as "[n]either the DGCL nor any other Delaware statute forbids the enactment of fee-shifting bylaws." *ATP Tour*, 91 A.3d at 558. Section 113 of the DGCL permits bylaws that require the corporation to reimburse stockholders for proxy expenses, but the statute does not address rules for dissident stockholders reimbursing the corporation for proxy expenses. However, a corporate bylaw that relates to the business of the corporation, the conduct of its affairs, and its rights and powers is consistent with the DGCL. *See City of Providence v. First Citizens BancShares, Inc.*, 99 A.3d 229, 234 (Del. Ch. 2014); *Boilermakers Local 154 Ret. Fund v. Chevron Corp.*, 73 A.3d 934, 939

(Del. Ch. 2013), *judgment entered sub nom. Boilermakers Local 154 Ret. Fund & Key W. Police & Fire Pension Fund v. Chevron Corp.* (Del. Ch. June 22, 2013).

Delaware courts have recently upheld board-adopted bylaws that affect stockholder rights. In *City of Providence*, the plaintiff city challenged a bank holding company's adoption of a forum selection bylaw in the wake of a merger agreement. 99 A.3d at 230-31. The company's bylaw mandated that parties adjudicate internal corporate disputes in North Carolina courts. *Id.* at 234. The court reasoned that the forum selection bylaw met the requirements of § 109(b) because it concerned the rights of stockholders to bring claims against the company and related to the company's business and the conduct of its affairs. *Id.* Thus, the court held the forum selection bylaw to be facially valid. *Id.* at 236.

Likewise, in *Boilermakers*, the boards of Chevron and FedEx adopted forum selection bylaws establishing Delaware courts as the exclusive forums for their corporations' internal affairs litigation. 73 A.3d at 937. The Court of Chancery considered challenges to the validity of those board-adopted bylaws and found them facially valid and in accordance with Delaware statutory law. *Id.* at 938-39. Because the bylaws implemented "procedural rules for the operation of the corporation[s], [that] plainly relate to the 'business of the corporation[s],' the 'conduct of [their] affairs,' and regulate the 'rights or powers of [their] stockholders,'" the bylaws at issue were deemed consistent with the DGCL. *Id.*

Finally, this Court held that a Board-adopted, fee-shifting bylaw is facially valid in *ATP Tour*. 91 A.3d at 558. This Court found that the bylaw in *ATP Tour* did not conflict with the DCGL because the bylaw "allocates risk among parties in intra-corporate litigation." *Id.* Rather, adoption of the bylaw constituted regulation of the company's business and affairs and the rights or powers of the company, its stockholders, directors, officers, or employees. *Id.* (citing 8 Del. C. § 109(b)).

Talbot's Bylaw is consistent with § 109(b) because it seeks to regulate the corporation's internal affairs, the business of the corporation, and the rights of the corporation and its stockholders. The Bylaw is simply a mechanism for mitigating the adverse financial impact of proxy contests. Op. at 1. Similar to the forum selection bylaws in *City of Providence* and *Boilermakers,* Talbot's Bylaw establishes a procedure by which stockholders may vindicate their rights by requiring unsuccessful dissident stockholders to reimburse the corporation for its expenses. Op. at 6-7. Because proxy contests are intra-corporate affairs that relate to the corporation's business and the rights and powers of the corporation and its stockholders, Talbot's Bylaw comports with the DGCL.

Moreover, Talbot's Bylaw is very similar to the facially valid fee-shifting bylaw in *ATP Tour*. Like the bylaw in *ATP Tour* that allocated risk among parties in intra-corporate litigation, Talbot's Bylaw allocates financial risk among the parties in intra-corporate director elections. Op. at 6-7. Because Talbot's Bylaw represents a legitimate exercise of the board's authority to conduct the

corporation's business and provide for the rights and powers of the corporation and its stockholders by regulating the intra-corporate affairs of proxy contests, this Court should find that the Bylaw complies with Delaware law.

b. The Bylaw is consistent with Talbot's certificate of incorporation.

Talbot's Bylaw is consistent with Talbot's certificate of incorporation because Talbot's certificate of incorporation reserves power to the board to amend and adopt bylaws, Op. at 11, and because Talbot's Bylaw contains a valid subject matter. Moreover, courts should make "every reasonable effort" to reconcile the certificate of incorporation with a bylaw. *Essential Enters. Corp. v. Automatic Steel Prods., Inc.*, 159 A.2d 288, 289 (Del. Ch. 1960).

Alpha has not disputed the authority of Talbot's board to adopt bylaws under Talbot's certificate of incorporation. *See* Op. at 11-12. The board may unilaterally adopt bylaws if the charter reserves power to the board to do so. 8. Del. C. § 109(a). Talbot's certificate of incorporation grants Talbot's board authority to adopt bylaws that are consistent with § 109(b). Op. at 11. Because Alpha failed to contest the board's authority to adopt bylaws, and Talbot's certificate of incorporation allows the board to do so, Op. at 11, this Court should find that Talbot's Bylaw is consistent with its charter.

Even if Alpha contends that the Bylaw is inconsistent with Talbot's certificate of incorporation, the Bylaw contains a valid subject matter and thus constitutes a legitimate exercise of authority. A decision regarding reimbursement of election expenses is within the scope of the authority of directors as managers of the

corporation's business and affairs. *CA*, 953 A.2d at 230. The purpose of a bylaw is to establish decision-making procedures rather than to dictate how a board should make substantive decisions. *Id.* at 234-35. Although the record is silent on the content of Talbot's certificate of incorporation, the charter "could permit fee-shifting provisions, either explicitly or implicitly." *ATP Tour*, 91 A.3d at 558.

Regulation of proxy contests is a proper subject matter for bylaws because it is within the scope of the board's authority. In *CA*, this Court considered whether stockholders could adopt a fee-shifting bylaw that required the corporation to reimburse the reasonable expenses incurred by stockholders in nominating at least one candidate to the board in a contested election. 953 A.2d at 229-30. Although neither the corporation's charter nor its bylaws discussed proxy expenses, the proposed bylaw was consistent with the charter because the charter contained a provision closely related to Section 141(a) of the DGCL that confers business management power on the board of directors. *Id.* at 230. The Court found the board's authority to establish rules for reimbursing election expenses was part of its management power and merely questioned *stockholders'* authority to adopt such rules. *Id.* at 230-31. This Court concluded that reimbursement of proxy expenses is a proper subject matter for a board-adopted bylaw because it "has both the intent and the effect of regulating the process for electing directors." *Id.* at 235-36.

The subject matter of Talbot's Bylaw is valid because it is consistent with the board's management authority. Because Talbot's Bylaw designates which party will pay expenses in proxy contests, Op.

at 7, the Bylaw sets forth procedures for corporate governance. Like the fee-shifting bylaw in *CA* that was consistent with CA's charter because it regulated procedures for electing directors, Talbot's Bylaw also concerns valid subject matter because it regulates director elections. The validity of Talbot's Bylaw is even more apparent than the validity of the CA's bylaw because the Bylaw includes a provision that allows the board to waive the reimbursement obligation when doing so would be necessary to uphold its fiduciary duties. Op. at 6. Because Talbot's certificate of incorporation allows the board to adopt bylaws, and the Bylaw contains a proper subject matter, Talbot's Bylaw is consistent with its certificate of incorporation.

c. The adoption of the Bylaw is not otherwise prohibited.

"[N]o principle of common law prohibits directors from enacting fee-shifting bylaws." *ATP Tour*, 91 A.3d at 558. Parties may contract for the allocation of costs and expenses in intra-corporate disputes. *Id.* As the Court of Chancery has held and this Court has affirmed, "bylaws, together with the certificate of incorporation and the broader DGCL, form part of a flexible contract between corporations and stockholders" because the charter may allow the board to adopt bylaws which are binding upon stockholders. *Id.*; *Boilermakers*, 73 A.3d at 940. Under this contract, stockholders that invest in a corporation in which the board has authority to amend and adopt bylaws "assent to be bound" by bylaws amended or adopted by the board. *Boilermakers*, 73 A.3d at 940.

By investing in Talbot, Alpha assented to be bound by bylaws adopted by Talbot's board. Between late 2013 and mid-2014, Alpha

acquired 3 million shares of Talbot's stock and continued to purchase additional shares through December 2014, by which time it had accumulated 5.25 million shares. Op. at 3, 4. Furthermore, Alpha admitted that it acquired shares of Talbot's stock "for investment purposes only." Op. at 4. Because Talbot's certificate of incorporation grants to the board the power to adopt bylaws, Op. at 11, Alpha had constructive notice at the time it invested in Talbot that, as a stockholder of the corporation, it would be subject to board-adopted bylaws. By choosing to purchase shares of Talbot while on constructive notice, Alpha therefore assented to be bound by Talbot's board-adopted bylaws, including the fee-shifting Bylaw.

Furthermore, Talbot's Bylaw does not prevent Alpha from initiating a proxy contest. Alpha and other stockholders can still launch proxy contests. However, because dissidents face the risk of having to repay the corporation for its expenses, contenders with a low chance of success may decide to reconsider soliciting proxies. Thus, the Bylaw balances the cost-saving interests of the corporation and the interests of individual stockholders seeking to elect directors to the board by allowing them to conduct proxy contests and possibly obtain a fee waiver from the board. By seeking to reduce the expenses of proxy contests, Talbot made a good faith effort to retain funds to benefit the corporation as a whole. Because the *ATP Tour* test for facial validity should apply to Talbot's Bylaw, and because the Bylaw satisfies that test, Alpha cannot demonstrate a reasonable probability of success on the merits of its claim. Therefore, this

Court should reverse the grant of a preliminary injunction against Talbot.

II. THE COURT OF CHANCERY ERRED IN GRANTING THE PRELIMINARY INJUNCTION BECAUSE TALBOT'S BOARD ADOPTED THE BYLAW FOR A PROPER PURPOSE.

A. Question Presented

Should this Court defer to the Talbot board's business judgment because the board adopted the Bylaw for a proper purpose?

B. Scope of Review

This Court reviews the grant or denial of a preliminary injunction for abuse of discretion but "without deference to the embedded legal conclusions of the trial court." *Kaiser Aluminum Corp. v. Matheson*, 681 A.2d 392, 394 (Del. 1996). Rather, "the Court of Chancery's legal conclusions are subject to *de novo* review." *Lawson v. Meconi*, 897 A.2d 740, 743 (Del. 2006). *De novo* is the appropriate standard of review because the Court of Chancery made legal conclusions when it applied *Blasius* scrutiny instead of granting deference under *Unocal*.

C. Merits of Argument

1. The Court of Chancery erred in applying *Blasius* because the board did not act with the primary purpose of disenfranchising stockholders.

The Court of Chancery failed to apply the correct standard of review in scrutinizing Talbot's Bylaw. Although the court below applied *Schnell v. Chris-Craft Industries*, 285 A. 2d 437 (Del. 1971), concluding that bylaws must be adopted for a proper purpose, *Schnell* did not provide a definition for "proper purpose". Rather, the court subjected the Bylaw to heightened scrutiny under *Blasius*, 564 A.2d at 651, and determined that the Talbot board acted with an improper

purpose. However, the Court of Chancery failed to distinguish the facts of this case from the kind of board action required to trigger enhanced scrutiny under *Blasius*. Because the board did not act for the primary purpose of impeding the stockholder franchise, *Blasius* is not the appropriate standard of review.

This Court has noted that the *Blasius* standard of enhanced judicial scrutiny is "quite onerous, and is therefore applied rarely." *Williams v. Geier*, 671 A.2d 1368, 1376 (Del. 1996). Specifically, the *Blasius* compelling justification standard is appropriate only where a board acts with the primary purpose of interfering with the stockholder franchise. *Stroud v. Grace*, 606 A.2d 75, 92 (Del. 1992). Importantly, courts have refrained from imposing heightened scrutiny in cases where stockholders retain "the powers of corporate democracy." *Unocal*, 493 A.2d at 959. Delaware courts have repeatedly declined to apply *Blasius* when a legitimate board action does not directly affect the electoral process, even when such a decision has the incidental effect of interfering with the stockholder franchise. *See Williams*, 671 A.2d at 1376 (citing *Stroud*, 606 A.2d at 91 (suggesting that *Blasius* applies when a board of directors deliberately frustrates a stockholder vote, but that more incidental electoral effects should be examined under *Unocal*)). Adopting the Bylaw for the purpose of maximizing stockholder value is a proper purpose under *Blasius*, irrespective of any secondary purposes the board may have had in adopting the Bylaw. *See Skoglund v. Ormand Indus., Inc.*, 372 A.2d 204, 207 (Del. Ch. 1976).

The Court of Chancery failed to properly distinguish this case from *Blasius*. The court compared the present case to *Schnell*, Op. at 14, where a board of directors prevented a dissident group from pursuing a proxy contest by changing the date of the annual stockholder meeting so that the dissident group would not have time to file its proxy materials. 285 A.2d at 439. In the present case, the Court of Chancery made no finding that the Bylaw would prevent Alpha from pursuing a proxy contest. The opinion simply makes the assertion, without explanation, that the board attempted to interfere with the stockholder franchise. Op. at 16. Although the Bylaw could deter some dissident stockholders from launching proxy contests, this deterrence is merely an incidental side effect—not the board's primary purpose. The board acted primarily to maximize stockholder value by mitigating costs. The objections to Alpha's Restructuring Proposal were chiefly predicated upon a concern for the wellbeing of Talbot, as Talbot Chairman and CEO Gunnison believed the proposal would cause both short and long-term harm. *See* Op. at 16. Because the board did not act with the primary purpose of interfering with stockholder franchise, the court below inappropriately applied *Blasius* in reviewing the adoption of the Bylaw. Rather, the court should have reviewed the board's action under *Unocal*.

2. This Court should apply *Unocal* analysis and defer to the board's business judgment.

The DGCL vests the authority to manage a corporation in the board of directors. 8 Del. C. § 141(a); *see also Paramount Commc'ns, Inc. v. Time Inc.*, 571 A.2d 1140, 1154 (Del. 1989). As a result, this Court traditionally analyzes board decisions under the business judgment

rule, which presumes the propriety of board decisions. *Zapata Corp. v. Maldonado*, 430 A.2d 779, 782 (Del. 1981). Under this rule, the plaintiff bears the burden of rebutting the presumption that the board acted in good faith and with an honest belief that its action was in the best interests of the corporation. *Unitrin, Inc. v. Am. Gen. Corp.*, 651 A.2d 1361, 1373 (Del. 1995). If a challenger cannot meet that burden, the business judgment rule will protect directors and their decisions. *Smith v. Van Gorkom*, 488 A.2d 858, 873 (Del. 1985), *overruled on other grounds by Gantler v. Stephens*, 965 A.2d 695 (Del. 2009).

Nevertheless, courts will sometimes depart from the presumption in favor of business judgment when a board of directors acts in response to a threat to corporate policy. *Unocal* analysis applies when a board adopts "any defensive measures taken in response to some threat to corporate policy and effectiveness which touched upon issues of control." *Gilbert v. El Paso Co.*, 575 A.2d 1131, 1144 (Del. 1990). Under *Unocal*, courts engage in a two-step analysis to evaluate board decisions. *Moran v. Household Int'l, Inc.*, 500 A.2d 1346, 1356 (Del. 1985). Directors must first show that they reasonably perceived a threat to the corporation, its stockholders, or a significant corporate policy. *Unocal*, 493 A.2d at 955. Next, directors must show that their action was proportional to the threat posed. *Id.* at 955-56. If the board can satisfy this two-prong test, then the court will defer to the board's decision under the business judgment rule. *Mills Acquisition Co. v. Macmillan, Inc.*, 559 A.2d 1261, 1288 (Del. 1989).

a. The board's defensive action satisfies the reasonableness prong of *Unocal*.

A board of directors may satisfy its burden under the first prong of Unocal by showing: (1) good faith and reasonable investigation in identifying (2) a legitimate threat to the corporation. *Unocal*, 493 A.2d at 955. The directors' ability to make this showing is materially enhanced if the board is dominated by outside, independent directors. *Id.* Indeed, this Court has stated that a board composed primarily of outside, independent directors, coupled with a showing that the board relied in good faith on advice rendered by its financial and legal counsel, constitutes a *prima facie* showing of good faith and reasonable investigation. *Polk v. Good*, 507 A.2d 531, 537 (Del. 1986).

When identifying a threat the corporation, directors have a duty to protect the financial interests of the corporation and its stockholders. *Van Gorkom*, 488 A.2d at 872. In executing that duty, the board must act in an informed manner. *See Unocal*, 493 A.2d at 955. Directors can inform themselves by obtaining advice from legal counsel, financial advisors, or by gathering information independently. *See, e.g.*, *In re Walt Disney Co. Derivative Litig.*, 906 A.2d 27, 72 (Del. 2006); *Cinerama, Inc. v. Technicolor, Inc.*, 663 A.2d 1156, 1179 (Del. 1995). *See also* 8 Del. C. § 141(e) (protecting directors for relying in good faith on reports and opinions made by officers of corporation).

The board engaged in a good faith reasonable investigation to identify a legitimate threat to the corporation. During a two-hour meeting, the board heard detailed presentations about the terms of Alpha's Restructuring Proposal. Op. at 5. They also reviewed Talbot's

ongoing cost cutting plans for its three divisions and learned from legal counsel about the mechanics of the Bylaw. Op. at 5-6. After the presentations, the board members continued to deliberate among themselves before voting. Op. at 8. The board adopted the Bylaw promptly because a quick decision was necessary to give adequate notice to stockholders. Although the annual stockholders meeting was not until May 2015, Op. at 4, delaying the decision might preclude Alpha from conducting its proxy contest. The board's due diligence, coupled with the independent status of all but one of the nine directors, Op. at 3, constitutes a *prima facie* showing of good faith and reasonable investigation. *See Polk*, 507 A.2d at 537. Thus, the board offered sufficient evidence to satisfy the first prong of *Unocal*.

b. The board's action also satisfies the proportionality prong of *Unocal*, and therefore the business judgment rule should apply.

Under the second prong of *Unocal*, the court must determine whether the board's defensive actions were proportional to the threat posed. Proportionality hinges on determining whether defensive actions are preclusive or coercive. *See Unitrin*, 651 A.2d at 1387. Board actions are preclusive when they make the ability to wage a successful proxy context realistically unattainable. *Versata Enters., Inc. v. Selectica, Inc.*, 5 A.3d 586, 601 (Del. 2010). Alternatively, board actions are coercive when they force upon the stockholders one proposal over another. *Brazen v. Bell Atl. Corp.*, 695 A.2d 43, 50 (Del. 1997) (citing *Williams*, 671 A.2d at 1382-83).

The Bylaw is not preclusive because it does not make Alpha's

ability to launch a proxy contest realistically unattainable. It merely provides for appropriation of proxy costs. Op. at 1. The court below concluded that the Bylaw did not create a situation that precludes Alpha from actually conducting a proxy contest. Op. at 16. Furthermore, the Bylaw does not discourage or prevent voters from choosing Alpha's nominees and thus has no bearing on Alpha's chances of success in the election. In fact, the Court of Chancery concluded that the Bylaw would have no effect on Alpha's ability to win a proxy contest. Op. at 15. Because adoption of the Bylaw did not render a successful proxy contest realistically unattainable, the board's action was not preclusive.

The board's action is not coercive. Although Alpha contends that the Bylaw will deter stockholders from voting for Alpha's nominees, the Court of Chancery explicitly rejected that argument. Op. at 15. Alpha may still launch a proxy contest, and stockholders may still vote for any nominee they choose. Therefore, stockholders are not forced to accept one slate of directors over another. Because the Bylaw does not prevent stockholders from voting for Alpha's nominees, Op. at 15, the defensive action is not coercive.

Finally, if the defensive measure is not preclusive or coercive, then the court will assess whether the board action was within a "range of reasonableness" considering the threat posed. *Unitrin*, 651 A.2d at 1387-88. While reasonableness in this context is a fact-intensive inquiry, several factors enhance the probability that a court will find a board acted reasonably. *See, e.g.*, *Invanhoe Partners v. Newmont Mining Corp.*, 535 A.2d 1334, 1343 (Del. 1987); *Moran*, 500

A.2d at 1356. This Court has articulated several considerations for determining whether a defensive action falls within a range of reasonableness, notably: (1) whether the act was a statutorily authorized decision the board could make; and (2) whether the defensive action was proportional to the threat posed. *Unitrin*, 651 A.2d at 1389.

The Bylaw fell within the "range of reasonableness" required under *Unocal*. The Court of Chancery found that Talbot's board had the statutory authority to adopt bylaws. Op. at 11 (citing 8 Del. C. § 109(a)). Furthermore, because the Bylaw is not preclusive or coercive, it is a proportional response to Alpha's threat to the corporation. Therefore the Bylaw is well within the range of reasonableness required under *Unocal*. Because the Bylaw satisfies both prongs of *Unocal*, this Court should defer to the board's business judgment.

CONCLUSION

The Court of Chancery erred in granting Alpha's motion for a preliminary injunction because Talbot's Bylaw is facially valid and because the board adopted it for a proper purpose. For the foregoing reasons, this Court should reverse the Court of Chancery's grant of a preliminary injunction.

Respectfully submitted,

Team L,

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