IN THE SUPREME COURT OF THE STATE OF DELAWARE

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

Appellee's Reply Brief

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NATURE OF PROCEEDINGS

Appellee, Plaintiff below, brought suit seeking injunctive relief against Appellants, Defendants below, in the Court of Chancery on claims that the Fee-Shifting Bylaw adopted by Defendant Talbot's board of directors is facially invalid, the Board violated fiduciary duties of care and loyalty, and that the Bylaw was adopted for an inequitable and improper purpose.

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

Appellees request that this Court affirm the Order of the Chancery Court. Specifically, Appellees ask this Court to hold that the Fee-Shifting Bylaw is facially invalid, that the Board breached fiduciary duties, and that the Bylaw was adopted for an improper purpose.

SUMMARY OF ARGUMENT

The Court of Chancery's grant of a preliminary injunction halting enforcement of Talbot Inc.'s Fee-Shifting Bylaw is proper. Talbot Inc. and the nine named Defendants, Talbot's Board of Directors, concede that if Alpha Fund Management L.P. can demonstrate reasonable success on the merits, the preliminary injunction is proper.

First, Alpha Fund Management L.P. can show reasonable success on the merits because the Bylaw is facially invalid. Although the Bylaw may be valid under the Delaware General Corporation Law (DGCL) and Talbot Inc.'s certificate of incorporation, the Fee-Shifting Bylaw fails to meet the standards of facial validity based on principles of common law.

Second, the board of directors breached their fiduciary duties of care and loyalty by failing to make well-informed decisions, failing to fully consider shareholders' and the corporation's interests, and by adopting the Fee-Shifting Bylaw in further promotion of the Board's own self interest. Talbot Inc. will be unable to assert the business judgment rule because the board of directors acted out of self-interest.

Third, The Fee-Shifting Bylaw was adopted for an improper purpose making the Bylaw unenforceable. The circumstance surrounding the adoption of the Fee-Shifting Bylaw show that the board of directors adopted the Bylaw for the improper purpose of thwarting Alpha Fund Management L.P.'s expected proxy contest.

Since Alpha Fund Management L.P. can demonstrate a reasonable success on the merits, injunctive relief is proper.

COUNTERSTATEMENT OF FACTS

This appeal and the underlying action arise out of Talbot Inc.'s ("Talbot" or the "Company") Board of Directors (the "Board") decision to adopt a Proxy Contest Fee-Shifting Bylaw (the "Fee-Shifting Bylaw" or "Bylaw") and the Board's announcement that it would not waive enforcement as to Alpha Fund Management L.P. ("Alpha"). Mem. Op. at 9. Talbot is a publicly traded Delaware corporation with approximately 75 million shares of common stock outstanding, market capitalization is approximately $2.25 billion, and revenues of $1.1 billion. Mem. Op. at 2.

Talbot's operations are divided among three divisions: Fasteners, Components, and Software. Mem. Op. at 2. Talbot's Board is comprised of nine members, the individually named defendants in the underlying action. Mem. Op. at 3. Only one Board member is an inside director, Chairman and Chief Executive Officer ("CEO") Timothy Gunnison. Mem. Op. at 3. All nine directors stand for election annually. Mem. Op. at 3. The next election will take place at Talbot's annual stockholders meeting in May 2015. Mem. Op. at 3.

Alpha is a small, exclusive investment manager formed as a limited partnership under Delaware law by founder and CEO Jeremy Womack in 2006. Mem. Op. at 2. As of the end of 2014, Alpha's equity portfolio was worth $1.1 billion. Mem. Op. at 2. Womack has previously succeeded in shareholder activism in the companies in which Alpha Fund holds equity by twice persuading the boards of publicly traded companies to elect its nominees to their boards. Mem. Op at 5.

Starting in late 2013, Alpha began acquiring stock in Talbot at Womack's direction. Mem. Op. at 3. By June of 2014, Alpha held 3 million shares of Talbot, or roughly 4% of the outstanding shares. Mem. Op. at 3. On July 10, 2014, Womack met with Talbot's CEO Gunnison to suggest a detailed restructuring proposal (the "Restructuring Proposal") for Talbot, which would substantially improve value for Talbot's shareholders. Mem. Op. at 3. Womack's Restructuring Proposal was in response to the Company losing value due to bloated operating expenses attributed to Talbot's three unrelated divisions' inability to cooperate. Mem. Op. at 3. The goal of the Restructuring Proposal Womack presented was to create immediate shareholder value. Mem. Op. at 3.

Gunnison rejected Womack's Restructuring Proposal out of hand accusing Womack of grossly underestimating the synergy between the Company's three divisions. Mem. Op at 4. Gunnison discounted Womack's analysis of Talbot's operations as failing to adequately consider cost cutting measures Talbot was already enacting. Mem. Op. at 4.

From June to December 2014, Alpha increased its position in Talbot. Mem. Op. at 4. The Board conducted its regular monthly meeting on December 5, 2014. Mem. Op. at 5. On December 10, 2014, Alpha filed the Schedule 13D with the Securities and Exchange Commission (the "SEC") disclosing that Alpha holds 5.25 million shares of Talbot common stock, or 7% of Talbot's total shares outstanding valued at $157.5 million. Mem. Op. at 4, note 1.

Alpha's Schedule 13D filing also disclosed that its purchase of Talbot shares was for investment purposes only and it had no intention

of seeking to become a controlling stockholder or otherwise acquire the Company. Mem. Op. at 4. Additionally, Alpha's Schedule 13D indicated that Gunnision had rejected Womack's Restructuring Proposal and Alpha would, therefore, seek to advance the Restructuring Proposal by nominating four directors for election to Talbot's Board at the May 2015 stockholders meeting. Mem. Op. at 4.

Gunnison responded by immediately calling a special meeting of the Board on December 18, 2014, entirely devoted to discussion of Alpha's Schedule 13D filing. Mem. Op. at 5.

All nine members of the Board attended the December 18 meeting along with the three other employees. Mem. Op. at 5. The meeting lasted just over two hours. Mem. Op. at 5. Although Womack was not included in the meeting, an overview of his Restructuring Proposal was given but the Board favored the current business plan. Mem. Op. at 5-6.

Next the Board heard presentations about the Fee-Shifting Bylaw.[1] Mem. Op. at 6. The Fee-Shifting Bylaw, if adopted and not waived, would impose upon Alpha the fees and expenses Talbot would incur in resisting Alpha's anticipated proxy contest if Alpha's campaign is "not successful" meaning less than half of the dissident group's nominees win election to the Board. Mem. Op. at 6-7. Alpha would be forced to reimburse Talbot for costs associated with the proxy contest if just one or none of Alpha's nominees are elected to the Board at the May meeting. Mem. Op. at 7.

[1] The full text of the Bylaw is attached here as an Appendix.

After excusing the employees from the meeting, the Board discussed the Fee-Shifting Bylaw privately and Gunnison strongly urged the Board to adopt it. Mem. Op. at 8. Most board members expressed opposition to the Restructuring Proposal. Mem. Op. at 8-9. The Board unanimously voted to approve the resolution adopting the Fee-Shifting Bylaw additionally deciding not to waive enforcement of the Fee-Shifting Bylaw against Alpha. Mem. Op. at 9.

On December 22, 2014, Alpha sent a certified letter formally notifying Talbot of its intention to put forward four nominees for election to the Talbot board at the May stockholders meeting. Mem. Op. at 9. Also on December 22 Alpha filed suit in the Delaware Court of Chancery contesting the Fee-Shifting Bylaw on two bases: facial invalidity and inequitable conduct in adopting the Bylaw, which is a breach of the Board's fiduciary duty. Mem. Op. at 10. Alpha moved for preliminary injunction to stop Talbot and the Board from enforcing the Fee-Shifting Bylaw against Alpha for any proxy contest in advance of the May shareholders meeting. Mem. Op. at 10. Alpha requested and received an order granting expedited discovery on the motion for preliminary injunction. Mem. Op. at 10. On January 12, 2015, the Court of Chancery heard argument on Alpha's motion for preliminary injunction and granted the motion on January 14, 2015. Mem. Op. at 17.

ARGUMENT

I. THE COURT OF CHANCERY PROPERLY GRANTED A PRELIMINARY INJUNCTION BECAUSE IN ADDITION TO DEFENDANTS' CONCESSION THAT PLAINTIFF WILL SUFFER IMMINENT THREAT OF IRREPARABLE INJURY AND THAT THE BALANCING OF THE EQUITIES WEIGHS IN PLAINTIFF'S FAVOR, PLAINTIFF CAN SHOW PROBABILITY OF SUCCESS ON THE MERITS.

A. Question Presented

Whether the Court of Chancery's grant of preliminary injunction was appropriate given Talbot's reactionary decision to adopt the Fee-Shifting Bylaw in response to Alpha's intended proxy contest.

B. Scope of Review

Preliminary injunction is properly granted where a plaintiff can establish: (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. *SI Management L.P., v. Wininger*, 707 A.2d 37, 40 (Del. 1998). The grant of preliminary injunction shall be reviewed for abuse of discretion. *Id.* The Court of Chancery's legal conclusions are reviewed *de novo*. *In re Unitrin, Inc.*, 651 A.2d 1361, 1385 (Del. 1995).

C. Merits of the Argument

Defendants concede that a preliminary injunction would be appropriate if Alpha demonstrates a reasonable probability of success on the merits. Thus, Defendants recognize that the other two prongs of the standard for preliminary injunction are met. Alpha can establish a reasonably probability of success on the merits on each of its underlying claims.

1. Plaintiff would suffer irreparable harm from application of the Fee-Shifting Bylaw to its proxy contest with Defendants because Plaintiff would be forced to abandon the proxy contest if relief cannot be obtained.

Irreparable harm is defined as an injury that has "no fair and reasonable redress may be had in a court of law." *Kohls v. Duthie*, 765 A.2d 1274, 1289 (Del. Ch. 2000). The alleged injury may not be merely speculative, rather it must be "imminent and genuine." *Aquila, Inc. v. Quanta Servs., Inc.*, 805 A.2d 196, 208 (Del. Ch. 2002). Additionally, plaintiff must show that "to refuse the injunction would be a denial of justice." *Kohls*, 765 A.2d at 1289.

Because of the significant costs the Bylaw pushes onto unsuccessful proxy contesters, stockholders cannot afford to put forth nominees for election to the Board. Instead stockholders are discouraged by the risk of paying millions to mount a proxy contest if they are unsuccessful in electing their nominees. Thus, if the Fee-Shifting Bylaw were enforced, shareholders would lose their right to nominate and vote for qualified directors of their choosing. For this reason Defendants concede that irreparable harm would result if the Bylaw is enforced against Alpha.

2. Plaintiff stands to suffer far greater harm from enforcement of the Bylaw than Defendants would sustain from the grant of injunctive relief.

Plaintiff must show that "the Court's refusal to grant an injunction would cause more harm to Plaintiff than granting of the injunction would cause Defendants." *Mitchell Lane Publishers, Inc. v. Rasemas*, No. CIV.A 9144-VCN, 2014 WL 4925150, at *10 (Del. Ch. Sept. 30, 2014). Additionally, "Plaintiff must show that the harm it will suffer 'discounted by its likelihood, is greater than harm to any

other person that the granting of the relief would occasion, discounted by its probability of its occurring.'" *Id. quoting Crown Books Corp. v. Bookstop, Inc.*, No. CIV. A. 11255, 1990 WL 26166 (Del. Ch. Feb. 28, 1990).

Before Talbot's Board enacted the Fee-Shifting Bylaw, Talbot would have paid all the costs of a proxy contest regardless of the outcome of the election. By granting the preliminary injunction, the Court of Chancery did nothing to alter Talbot's position from what it was before the adoption of the Fee-Shifting Bylaw. Alpha, on the other hand, would suffer significant harm if the Court of Chancer had not granted the preliminary injunction because Alpha would end up paying the Company's costs for an unsuccessful proxy contest. Essentially, Alpha would be paying for the Board to fight off their nominees. This injury is a certainty, not a speculation because Talbot has pledged to enforce the Bylaw against Alpha. For this reason, Defendants concede that a balancing of the equities weighs heavily in Alpha's favor.

3. Plaintiff can show success on the merits of each of its claims: facial invalidity, breach of fiduciary duties, and improper purpose.

The standard for probability of success on the merits is only applied to requests for interlocutory relief. *Id.* at 3. The movant only needs to show "a reasonable probability of success on the merits, not that it will undoubtedly succeed." *Id.*

> On a motion for preliminary injunction, where there are factual disputes between the parties, the Court will find that "Plaintiff has a reasonable probability of success on the merits if, after considering all evidence currently in the record, the court believes it to be reasonably likely that, at the final hearing, Plaintiff will establish the necessary facts by a preponderance of the evidence."

Id. at 8, *quoting Cantor Fitzgerald, L.P. v. Cantor*, 724 A.2d 571, 579 (Del. Ch. 1998). The facts indicate that Alpha can demonstrate probability of success on the merits in several ways. First, Alpha is likely to prevail in showing the Bylaw to be facially invalid by distinguishing Talbot's Fee-Shifting Bylaw from other bylaws that have recently been held facially valid. Second, Alpha is likely to prevail in showing that the Board breached its fiduciary duties in adopting the Bylaw. Third, Alpha is likely to prevail in showing that the Board adopted the Bylaw for the improper purpose of halting Alpha's proxy contest. For these reasons, the Court should affirm the Court of Chancery's grant of preliminary injunction in Alpha's favor because Alpha can demonstrate reasonable success on the merits.

II. PLAINTIFF HAS A HIGH PROBABILITY OF SUCCESS ON THE MERITS BECAUSE THE CASE LAW DOES NOT SUPPORT A FINDING THAT THE BYLAW IS FACIALLY VALID EVEN THOUGH IT MAY CONFORM WITH THE DELAWARE GENERAL CORPORATION LAW AND THE COMPANY'S OWN CERTIFICATE OF INCORPORAITON.

A. Question Presented

Whether principles of common law support a finding that the Bylaw is facially valid when existing case law does not address fee-shifting bylaws that negatively impact shareholder rights in stock corporations.

B. Scope of Review

According to the Court's reasoning in *ATP Tour, Inc. v. Deutscher Tennis Bund*, 91 A.3d 554 (De. 2014), a facially valid bylaw must meet three separate requirements. The bylaw must (1) be authorized by the DGCL; (2) be consistent with the corporation's certificate of incorporation; and (3) "not be otherwise prohibited." *Id.* at 557-58.

The third factor in the analysis is based on "principle[s] of common law…." *Id.* at 558.

C. Merits of the Argument

1. The Bylaw is authorized by the Delaware General Corporation Law.

Review of the pertinent provisions of the DGCL reveals that the Board was operating within its statutory ability to adopt bylaws. 8 *Del.C.* § 109(a). "The bylaws may contain any provision, not inconsistent with law or with the certificate of incorporation, relating to the business of the corporation, the conduct of its affairs, and its rights or powers or the rights or powers of its stockholders, directors, officers or employees." 8 *Del.C.* § 109. Alpha, therefore, concedes that the Bylaw is authorized by the DGCL.

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

There is nothing in the record to indicate that the Bylaw runs afoul of Talbot's certificate of incorporation. Accordingly, Alpha concedes that the Bylaw is consistent with Talbot's certificate of incorporation.

3. The Bylaw cannot be upheld as facially valid because it is prohibited by principles of common law.

Fee-shifting bylaws are relatively new in Delaware common law and the case law that does exist is very limited. Ning Chiu, *The Trend for Fee-Shifting Bylaws*, Davis Polk Briefing: Governance (July 10, 2014), http://www.davispolk.com/briefing/corporategovernance/trend-fee-shifting-bylaws/. Most importantly, the cases that have been decided differ in critical respects from the matter now under consideration by this Court. The key distinction is that the cases on

fee-shifting and forum selection bylaws only pertain to the litigation context. The cases do not concern any issues of shareholder voting rights and therefore the reasoning of these cases should not be applied here.

In *ATP*, this Court held that a bylaw that shifted litigation expenses to an unsuccessful plaintiff was facially valid and that the bylaw was permissible under the DGCL. The bylaw could be enforceable if adopted by the appropriate corporate procedures and for a proper corporate purpose. *ATP* at 557-58. The bylaw was deemed to be valid as a contractual modification of the American Rule of litigation expenses that each party bears his own costs. *Id.*

This Court has likewise upheld the facial validity of choice of forum bylaws. In *City of Providence v. First Citizens BancShares, Inc.*, 99 A.3d 229 (Del. Ch. 2014) and *Boilermakers Local 154 Ret. Fund v. Chevron Corp.*, 73 A.3d 934 (Del. Ch. 2013) the Court of Chancery upheld forum selection bylaws on the basis that parties to a contract can alter litigation rights.

These cases deal with litigation, not shareholder voting rights, which are regarded as sacrosanct. Shareholders have a legitimate interest in "the exercise of their right to participate in selecting the contestants" for an election and the board should not adopt bylaws for the purpose of encouraging shareholders not to exercise their rights. *CA, Inc. v. AFSCME Employees Pension Plan*, 953 A.2d 227, 237 (Del. 2008). Courts have determined that "shareholder voting in corporate elections is a hallowed right, that it is of 'central importance,' that it is a 'supreme right, and that obstacles to its

proper exercise should be reviewed under a heightened standard of judicial review." Lee Harris, The Politics of Shareholder Voting, 86 N.Y.U. L. Rev. 1761, 1765-66 (2011).

The Talbot Fee-Shifting Bylaw concerns the shareholders' right to nominate candidates for election to the board. It cannot be analogized to cases concerning either litigation fee-shifting or forum selection bylaws. Forum selection does not affect the fundamental rights of the parties to bring suit. Plaintiff shareholders can still bring the same claims against a corporation in which they own shares. Their fundamental rights are not impacted.

Another critical difference between the instant case and *ATP* is that ATP was a non-stock corporation. ATP had no shareholders whose voting rights could be impacted by a fee-shifting bylaw. Fees would only be shifted under the ATP bylaw based on the outcome of litigation, as determined by the courts. Talbot's Bylaw would shift fees based on the outcome of a proxy contest and shareholder voting. Unlike the court system, elections for corporate directors are highly susceptible to political pressures. *Id.* at 1786-88.

The Fee-Shifting Bylaw adopted by Talbot's Board only targets the shareholders' rights to nominate and vote for qualified board members and thereby fully exercise their franchise. Accordingly, this Court should not apply the case law that currently exists regarding fee-shifting and forum selection bylaws to Talbot's Fee-Shifting Bylaw.

III. PLAINTIFF HAS A HIGH PROBABILITY OF SUCCESS ON THE MERITS BECAUSE TALBOT'S BOARD OF DIRECTORS BREACHED FIDUCIARY DUTIES IN ADOPTING THE FEE-SHIFTING BYLAW.

A. Question Presented

Whether Talbot's board of director's violated their fiduciary duty of care and fiduciary duty of loyalty owed to the corporation and shareholders when the Board adopted the Fee-Shifting Bylaw.

B. Scope of Review

Corporate directors owe fiduciary duties to both the corporation and its shareholders. *Polk v. Good*, 507 A.2d 531, 536 (Del. 1986). Directors owe a triad of fiduciary duties: loyalty, care, and good faith. *Emerald Partners v. Berlin*, 726 A.2d 1215, 1221 (Del. 1999). Shareholders may bring suit for the breach of fiduciary duties. *McMullin v. Beran*, 765 A.2d 910, 917 (Del. 2000). The duty of care relates to a director's duty to "exercise an informed business judgment." *Id.* at 921. Director's duty of loyalty "mandates that the best interest of the corporation and its shareholders takes precedence over any interest possessed by a director, officer, or controlling shareholder and not shared by the stockholders generally." *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 361 (Del. 1993).

C. Merits of the Argument

Talbot's Directors owe fiduciary duties to all of its shareholders and the corporation itself. The Board breached their fiduciary duties in adopting the Fee-Shifting Bylaw because the Board did not take steps to become fully informed, nor did they put the best interests of the corporation and its stockholders ahead of the Board's own interests. Additionally, the Board cannot use the business

judgment rule as a shield against Alpha's claim for breach of fiduciary duties because they acted primarily to thwart the shareholder franchise when adopting the bylaw. Because the facts show that the Board breached its fiduciary duties in adopting the Bylaw, Alpha has a high probability of success on the merits and injunctive relief was proper.

1. Talbot's Board of Directors breached its fiduciary duties of care and loyalty in adopting the Fee-Shifting Bylaw.

Various courts have invited shareholders to challenge bylaws on the basis that the board of directors violated their fiduciary duties in the adoption of a bylaw. *Chevron Corp.*, 73 A.3d at 963. It is the primary duty of a board to deal fairly and justly with both the shareholders and the corporation. *Condec Corp. v. Lunkenheimer Co.*, 230 A.2d 769, 775 (De. Ch. 1967). In situations where a bylaw was adopted by a board for the purpose of thwarting the shareholders voting rights, the conduct is in violation of the board's fiduciary duties and in violation of Delaware Law. *Stroud v. Grace*, 606 A.2d 75, 91 (Del. 1992).

In adopting the bylaw, the Board must live up to its fiduciary duty of care and make informed decisions that are in the best interest of both the corporation and its stockholders. At the Board's special meeting held on December 18, 2014, Sandra Ellsworth, a partner with Talbot's outside law firm, told the Board that they "could properly consider, in the exercise of their good faith business judgment in deciding whether to adopt the Fee-Shifting Bylaw, the potentially adverse financial impact of such proxy contest costs on the corporation and its stockholders." Mem. Op. at 6. Sandra Ellsworth

suggested that the Board *could* consider the adverse impact on stockholders, when in fact the Board *had* to consider the impact of the Bylaw on shareholders and the corporation.

The discussions that took place during the special meeting were limited to the Board deciding how to deal with Alpha's Restructuring Proposal and forthcoming proxy contest. The Board did not discuss the future impact that the Bylaw would have on other shareholders and failure to consider all of the shareholder's interests is a breach of the Boards fiduciary duties.

The Board breached their fiduciary duty of care in that they took no steps to adequately inform themselves prior to deciding to adopt the bylaw. Aside from the nine board members, Mack Rosewood, Vice President of Finance and Operations, Renee Stone, the Company's Vice President and General Counsel, and Sandra Ellsworth, a partner with the Company's regular outside law firm, were in attendance at the special meeting. Mem. Op. at 5. All twelve individuals present were employees of Talbot.

The Board did not seek any outside input, nor did they solicit independent, expert advise on the relative merits of Alpha's restructuring plan versus Talbot's current business plan. The Board did not hear any outside opinions on adopting the Fee-Shifting Bylaw. The only individuals involved in the discussion were current employees of Talbot. The Board failed to consult with outside experts leaving them ill-informed. Talbot could afford to solicit additional help in considering which path to take, yet the Board chose not to and thus

violated their fiduciary duty of care. The Bylaw was then adopted to prevent Talbot's plan from surfacing.

Since Womack was absent from the meeting, it is probable that Rosewood gave a biased presentation considering his source of information was Gunnison who had already voiced his disapproval to Womack. In presenting and discussing the two business plans, there was only representation from one side, demonstrating that the Board was not well-informed. By failing to allow an accurate analysis of Womack's plan, the Board's decision was motivated only by their desire to ward off Womack's shareholder activism and the Board therefore violated their fiduciary duty of care.

In a presentation conducted by Sandra Ellsworth, the Board was given information related to the expenses incurred by proxy contests. Mem. Op. at 6. The presentation revealed that proxy contests can incur expenses ranging from $800,000 to $3 million for small firms, and $4 million to $14 million for larger firms, such as Talbot. Mem. Op. at 6. Mack Rosewood, Talbot's Vice President for Finance and Operations, predicted that a proxy contest would cost of approximately $8 million "give or take." Mem. Op. at 8. Alpha's proxy solicitor, Bantry & Bandon LLP, estimates that the cost of Alpha's proxy contest with Talbot would likely exceed $12 million. Mem. Op. at 8.

The Board failed to consider the harm a Fee-Shifting Bylaw would have on Talbot's stockholders. The costs of fighting a proxy contest are extremely high, yet the Board voted to shift these costs to the shareholders in the event of an unsuccessful proxy contest. Shareholders who bring an unsuccessful proxy contest will be

responsible for not only the costs they generated in bringing the proxy contest, but also any costs the corporation incurs while fighting the proxy contest. The Board had a fiduciary duty to consider the shareholder's best interest in this matter, yet failed to do so. While forcing the costs onto the shareholders may benefit the corporation financially, the Board needed to balance both the stockholders and the corporation's interests, including those beyond the scope of finances.

Additionally, it is in shareholders best interest to have choices amongst who should serve on the board of directors. Competition is healthy for a corporation and shareholders should always have the option to choose whom to nominate and elect to the board. The Fee-Shifting Bylaw has a chilling effect in that it discourages shareholders from nominating non-incumbent board members in fear that if they are not "successful," as defined by the Bylaw, the shareholders would have the burden of paying the corporation's costs and fees. The Bylaw serves as a deterrent to stockholders to participate in the nomination and election process freely as is their right. It will often be in a corporation's best interest to have newly elected members to the board to serve as a voice of fresh ideas.

Further, the Board violated their fiduciary duty of loyalty because they acted in favor of their own self-interest in adopting the Bylaw. Every member of the Board of Directors feared loosing his or her incumbency so the Board collectively chose to eliminate the competition by enacting the Bylaw. Failure to make a decision without consideration of the corporation and stockholder's best interests is a

breach of fiduciary duties. *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 182-83 (Del. 1986). The Board acted out of pure selfishness in adopting the Bylaw with the intention of securing their position and power and therefore violated their fiduciary duty of loyalty.

2. The Board of Directors' decisions are not entitled to the protection of the business judgment rule because the Bylaw infringes on shareholder rights.

The Directors cannot assert that the presumption of the business judgment rule applies because they were acting out of self-interest and not putting the rights of their shareholders and the needs of the company first.

> Once it is determined that the prerequisites for the business judgment rule's application are satisfied and that the rule applies, the effect of its application includes the rebuttable presumption that the board's action was proper. "The burden falls upon the proponent of a claim to rebut the presumption by introducing evidence either of director self-interest, if not self-dealing, or that the directors either lacked good faith or failed to exercise due care."

R. Franklin Balotti and Jesse A. Finkelstein, Balotti and Finkelstein's Delaware Law of Corporations and Business Organizations § 4.19 THE BUSINESS JUDGMENT RULE, 2006 WL 2450349. The Delaware Court of Chancery determined that "the ordinary considerations to which the business judgment rule originally responded are simply not present in the shareholder voting context." *Blasius Indus., Inc. v. Atlas Corp.*, 564 A.2d 651, 659 (Del. Ch. 1988). The court held that "the board is afforded no deference if it acts primarily to thwart the shareholder franchise." Jay B Kesten, Towards A Moral Agency Theory of the Shareholder Bylaw Power, 85 Temp. L. Rev. 485, 502 (2013). When a

bylaw is adopted that interferes with shareholders' voting rights, the board must demonstrate a compelling justification instead of being awarded the protection of business judgment rule. *MM Companies, Inc. v. Liquid Audio, Inc.*, 813 A.2d 1118, 1132 (Del. 2003).

The board's primary purpose in adopting the bylaw was to "imped the effectiveness of the stockholder vote in a contested election for directors" invoking the use of the *Blasius* standard requiring the Board to demonstrate a compelling justification for the adoption of the Bylaw. *Id.* at 1132. The board and Talbot cannot demonstrate any compelling justification for the adoption of the bylaw because their only purpose in adopting the bylaw was to thwart the Alpha's proxy contest. Alpha has a high probability of success on the merits because the Board violated their fiduciary duty of care and loyalty in adopting the Bylaw.

IV. PLAINTIFF HAS A HIGH PROBABILITY OF SUCCESS ON THE MERITS BECAUSE TALBOT'S BOARD OF DIRECTORS ADOPTED THE FEE-SHIFTING BYLAW FOR AN IMPROPER PURPOSE.

A. Question Presented

Whether Talbot's board of directors adopted the Fee-Shifting Bylaw for an improper purpose.

B. Scope of Review

To determine if a fee-shifting bylaw is enforceable, courts examine "the manner in which" the bylaw "was adopted and the circumstances under which it was invoked." *ATP*, 91 A.3d at 558. A bylaw may be deemed facially valid but "will not be enforced if adopted or used for an inequitable purpose." *Id.* If a bylaw is adopted for an improper purpose, it is not enforceable. Herbert F. Kozlov,

Lawrence J. Reina, *Delaware Supreme Court Approves Fee-Shifting Bylaw for Non-Stock Corporations*, Bus. L. Today, June 2014, at 1, 2. Courts have closely and extensively examined the circumstances surrounding the adoption of a bylaw in order to determine if the bylaw was adopted for an improper purpose. *Hollinger Int'l, Inc. v. Black*, 844 A.2d 1022, 1060 (Del. Ch. 2004).

C. Merits of the Argument

Case law supports the notion that the Bylaw was adopted for an improper purpose because the Bylaw was adopted with the intention to thwart Alpha's proxy contest. The circumstances surrounding the adoption of the Bylaw, including the deposition testimony, further supports that the Bylaw was adopted for an improper purpose.

1. Case Law supports that the Fee-Shifting Bylaw was adopted for an improper purpose because the courts have held interference with shareholders' voting rights is an improper purpose.

While this Court has yet to determine what is deemed a proper purpose versus an improper purpose for adopting a bylaw, this Court has provided guidance as to what circumstances may point to the determination of an inadequate, improper purpose rendering a bylaw unenforceable.

In *Schnell v. Chris-Craft Indus., Inc.*, 285 A.2d 437, 438-39 (Del. 1971) shareholders sought injunctive relief to prevent the board of directors from advancing the date of a stockholder meeting which would limit the amount of time stockholders would have to wage a proxy battle. On October 16, 1971, the group of shareholders filed its intention to wage a proxy contest, and in direct response to the filing, the board of directors enlarged the scope of their October 18,

1971, director's meeting to include bylaw amendments. *Id.* at 439. The Board amended a bylaw moving the annual stockholder meeting from January 11, 1972, to December 8, 1971, in hopes of preventing the stockholders from bringing a proxy contest. *Id.*

The board of directors in *Schnell* moved the date of the annual stockholder meeting for "the purpose of obstructing the legitimate efforts of dissident stockholders in the exercise of their rights to undertake a proxy contest against management." *Id.* This Court held that the bylaw was invalid because it was adopted for an improper purpose. *Id.*

Talbot's board of directors did the same thing here. On December 5, 2014, Talbot's board of directors held their regular, monthly meeting in which all matters of importance were discussed. Mem. Op. No. 5. Immediately following Alpha's filing of the Schedule 13D and disclosure of its intention to nominate directors on December 10, 2014, Gunnison called for a special meeting on December 18, 2014. Mem. Op. No. 5. At the special meeting, the Board adopted the Fee-Shifting Bylaw in direct response to Alpha's stated intentions to seek directorships by waging a proxy contest. Mem. Op. No. 4.

Here, the Board took the same steps driven by the same motivation as the directors in *Schnell*. Following the discovery of an emerging proxy contest, both boards adjusted bylaws to stop proxy contests. Had it not been for the filing of intent to seek directorship in either *Schnell* or here, the boards would not have amended their bylaws. The Bylaw was adopted for an improper purpose, which was to prevent Alpha from bringing a proxy contest.

2. The Board of Directors' actions and statements surrounding the adoption of the Bylaw demonstrate that the Bylaw was adopted for an improper purpose because they were focused on halting Plaintiff's proxy contest.

The Board's incumbency was threatened by the emerging proxy contest. In response, the Board adopted the Bylaw to prevent Alpha's proxy contest and to secure their own positions as board members. It is clear that the intentions of the Board in passing the Fee-Shifting Bylaw was to prevent, or strongly discourage, Alpha's proxy contest from progressing in fear of Alpha's success. If Alpha succeeded on any level, some directors would lose their seats on the Board. A bylaw adopted for the purpose of preventing stockholders from exercising their right to bring a proxy contest is an improper purpose making the bylaw unenforceable. *Id*.

The Board's deposition testimony further demonstrates that the Board adopted the Bylaw for an improper purpose. At the special meeting, Gunnison disparaged Womack's Restructuring Proposal calling it an "ill-conceived short term plan at best" and went on to say the plan would harm the company in the long run. Mem. Op. at 8. Gunnison further warned the Board that the proxy contest with Alpha was a "potential camel in the tent problem" that would force the Company to adopt a flawed short-term business model. Mem. Op. at 8. At least three other directors shared Gunnison's views. Mem. Op. at 8.

Gabrielli also strongly urged the Board to adopt the Fee-Shifting Bylaw as a way to hold off Alpha. Mem. Op. at 8. He went so far as to say that "we need to raise the stakes on this guy [Womack]." Mem. Op. at 8. Cannon agreed with both Gunnison and Gabrielli and suggested that the risk of added costs imposed on Alpha by the Fee-

Shifting Bylaw "might get Alpha to think twice about all this." Mem. Op. at 8. Leonard joined in disparaging Womack and Alpha characterizing them as "playing financial games for purely short term wins." Mem. Op. at 8. Leonard also expressed that he was in favor of adopting the Fee-Shifting Bylaw "if [it] helps to stop Alpha." Mem. Op. at 8-9. None of the Board members expressed disagreement with these views. Mem. Op. at 9.

The statements made by the directors during the Board meeting are clear indications that the Board adopted the Bylaw for the purpose of preventing shareholders, specifically Alpha, from waging a successful proxy contest. Interfering with stockholders rights such as their right to bring proxy contests is the definition of an improper purpose. Gunnison compares Talbot's situation involving Alpha as a "camel in the tent" problem demonstrating his fear that if Alpha were to successfully get one of its nominees elected, it would only be a matter of time Alpha would control the Board. Gunnison feared losing control and therefore adopted the Bylaw for the improper purpose of thwarting Alpha's proxy contest. This was even after the 13D filing that stated that Alpha would not seek to take control of Talbot. The Bylaw was adopted by the Board for an improper purpose and therefore, Alpha has a high probability of success on the merits.

CONCLUSION

For the foregoing reasons, this Court should affirm the order granting preliminary injunction preventing Talbot's enforcement of the Fee-Shifting Bylaw.

Respectfully submitted,

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APPENDIX

TWELFTH. In the event that (i) any stockholder or anyone acting on their behalf (a "Contesting Party") undertakes to nominate one or more persons (the "Stockholder Nominees") for election to the board of directors of the Corporation at the Corporation's annual meeting of stockholders in opposition to any of the persons nominated by or on behalf of the Board of Directors, (ii) the Contesting Party solicits proxies of other stockholders of the Corporation authorizing the Contesting Party or designee to vote such stockholders' shares in favor of any of the Stockholder Nominees, and (iii) at the annual meeting of stockholders for which such proxies were solicited by the Contesting Party, the Contesting Party is not successful in achieving the election of at least half of the number of the Stockholder Nominees to the board of directors of the Corporation (or where the Contesting Party solicits proxies for the election of an odd number of Stockholder Nominees and the Contesting Party is not successful in achieving the election of at least a majority of the number of the Stockholder Nominees to the board of directors of the Corporation), then in such event each Contesting Party shall be obligated jointly and severally to reimburse the Corporation for all professional fees, costs and expenses of every kind and description (including, but not limited to, all attorneys' fees, proxy solicitor and advisory fees, and other expenses) that the Corporation, and/or any director, officer, employee or affiliate thereof (each, a "Company Party") reasonably incurs in opposition to the solicitation of proxies by the Contesting Party on behalf of any of the Stockholder Nominees. The Board of Directors may, with respect to any or all Contesting Parties, waive the obligations established by this Article TWELFTH. Any person or entity purchasing or otherwise acquiring any interest in the shares of capital stock of the Corporation shall be deemed to have notice of and consented to the provisions of this Article TWELFTH. Mem. Op. at 7.