IN THE SUPREME COURT OF THE STATE OF DELAWARE

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

APPELLANT'S OPENING BRIEF

Team N
Counsel for Defendants Below, Appellants

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TABLE OF CONTENTS

TABLE OF CITATIONS

DELAWARE SUPREME COURT CASES

DELAWARE COURT OF CHANCERY CASES

DELWARE STATUTES

Secondary Sources

William T. Allen, et al., *Function over Form: a Reassessment of Standards of Review in Delaware Corporate Law*, 56 Bus. Law. 1287, 1311-1316 (2001)

NATURE OF PROCEEDINGS

On December 22, 2014, Appellees, Alpha Fund Management ("Alpha"), brought action against Appellants, Talbot Inc. ("Talbot"), Timothy Gunnison, Francois Payard, Naomi Rothman, Rosaria Gabrielli, Marshall Cannon, Ajeet Gupta, Daniel Lemon, Clare Leonard, and Patrick Rhaney, on claims of breach of fiduciary duty by Talbot directors and seeking a preliminary injunction to prevent Talbot and the Board from taking any action to enforce a Proxy Fee-Shifting Bylaw in connection with any proxy contest for the election of directors to the board of Talbot at the May 2015 stockholders meeting.

On January 15, 2015, Chancellor Junge of the Delaware Court of Chancery granted the Appellees request for a preliminary injunction. On January 22, 2015, the Appellees filed a Notice of Appeal, in the Supreme Court of Delaware, seeking a reversal of the preliminary injunction. The Supreme Court of Delaware accepted the interlocutory appeal on January 29th, 2015.

SUMMARY OF THE ARGUMENT

1. First, this court should lift the preliminary injunction and uphold Talbot's Proxy Fee-Shifting Bylaw because it is not being used for an inequitable purpose. The proxy fee-shifting bylaw is a valid and legitimate response to costs incurred defending against a proxy contest. Talbot's board of directors did not conspire to adopt the amended bylaw for an inequitable purpose. Further, the fee-shifting bylaw was not created in an attempt to entrench the incumbent board of directions in office.

2. Second, the compelling justification standard should not apply in this case because the bylaw amendment is not an action requiring such a strict standard of judicial review under *Blasius Indus. Inc. v. Atlas Corp.*, 564 A.2d 651 (Del. Ch. 1988). Unlike in *Blasius*, the primary purpose of the fee-shifting bylaw was not to preclude or interfere with the shareholder franchise, but to preserve corporate resources during the corporation's restructuring period. Instead of the compelling justification standard, recent directional teachings from the Delaware judiciary favor applying *Blasius* within *Unocal* as part of a more practical reasonableness standard with a board that is able to satisfy the test receiving deference under the business judgment rule. *Mercier v. Inter-Tel, Inc.*, 9239 A.2d 786 (Del. Ch. 2007).

STATEMENT OF FACTS

Talbot's board of directors is composed of nine members, eight of whom are independent of the Company. On July 10, 2014, Jeremy Womack—the CEO of Alpha Fund Management L.P., which is a Talbot shareholder—approached the Talbot's Chairman and CEO Timothy Gunnison to push a restructuring proposal that would eliminate two of the Company's profitable Divisions. Gunnison disagreed with the plan praising the great synergy among the Company's current three Divisions and reassuring Womack of the significant cost savings attributed to the Company's existing restructuring program.

Soon thereafter, Alpha began an aggressive campaign to acquire more of Talbot's stock. In December 2014, Alpha filed a Schedule 13D indicating its intention to nominate four directors for election to

Talbot's board in an effort to usurp the Company's existing restructuring plan for its own.

Internally, Gunnison convened a special meeting of the Board to discuss both Womack's proposal and an appropriate course of action. After extensive review of the proposal, the Board agreed to stick with the existing plan because it offered greater short and long-term value. Additionally, the Board felt compelled in the best interests of the Company to adopt a Proxy Fee-Shifting Bylaw. This Bylaw, if not waived, stipulates that after a proxy contest is complete, any dissident shareholder who does not elect a majority of its nominees to the Board must reimburse the Corporation for all reasonable fees incurred in the contest.

ARGUMENT

I. THIS COURT SHOULD LIFT THE PRELIMINARY INJUCTION AND UPHOLD TALBOT'S PROXY FEE-SHIFTING BYLAW BECAUSE IT IS NOT BEING USED FOR AN INEQUITABLE PURPOSE.

A. Question Presented

Whether a board of directors acts inequitably in adopting a bylaw that reimburses the corporation for all fees reasonably incurred in defense of an unsuccessful proxy contest by an insurgent faction?

B. Scope of Review

"Generally, the grant or denial of a preliminary injunction is reviewed for abuse of discretion." *Kaiser Aluminum Corp. v. Matheson*, 681 A.2d 392, 395 (Del. 1996). Conversely, "this Court reviews the grant of a preliminary injunction [*de novo*] without deference to the embedded legal conclusions of the trial court." *Id.*

C. Merits of Argument

As a preliminary matter, Section 109 of Delaware General Corporation Law (DGCL) permits a corporation's bylaws to "contain any provision, not inconsistent with the law or with the certificate of incorporation … " 8 *Del.C.* § 109. As a result, this Court has held that a facially valid bylaw must meet three separate requirements, namely (1) "be authorized by the [DGCL][;]" (2) be "consistent with the corporation's certification of incorporation[;]" and (3) "not be otherwise prohibited." *ATP Tour, Inc., v. Deutscher Tennis Bund*, 91 A.3d 554, 557 (Del. 2014). Therefore, bylaws distributing risk between factions engaged in "intra-corporate litigation" fulfill the DGCL's stipulation that all bylaws are required to "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." *ATP Tour*, 91 A.3d at 558 (citing 8 *Del.C.* § 109(b)).

1. The fee-shifting bylaw is a legitimate response to costs incurred defending against a proxy contest and is not adopted for an inequitable purpose.

This court has held that under Delaware General Corporation Law, fee-shifting bylaws that require a losing faction of an intra-corporate proxy contest to pay all reasonable fees incurred, are regarded *valid and enforceable*. *See ATP Tour*, 91 A.3d at 554 (emphasis added). "Whether [a] fee-shifting bylaw is enforceable ... depends on the manner in which it was adopted and the circumstances under which it was invoked." *Id.* at 558. This is because a facially valid bylaw is null *only* "if adopted or used for an inequitable purpose." *Id.*

(emphasis added). Put differently, the imposition of a fee-shifting bylaw "turn[s] on the circumstances surrounding its adoption and use." *Id.* at 559.

The Delaware Supreme Court has made it clear that "bylaws of a Delaware corporation constitute part of a binding broader contract" between parties. *Airgas, Inc. v. Air Prod. & Chem., Inc.*, 8 A.3d 1182, 1188 (Del. 2010). This contract is designed to be "subject to change in the manner *the DGCL spells out and that investors know about* when they purchase stock in a Delaware corporation." *Boilermakers Local 154 Ret. Fund. v. Chevron Corp.*, 73 A.3d 934, 939 (Del. Ch. 2013) (emphasis added). For that reason, precedent set by this court concerning bylaws requires courts to attempt "to enforce [facially valid bylaws] to the extent that is possible to do so without violating anyone's legal or equitable rights." *Id.* at 949. This is because a plaintiff challenging the validity of a corporate bylaw under Delaware law "must show that the bylaws cannot operate lawfully or equitably *under any circumstances*." *Frantz Mfr. Co. v. EAC Indus.*, 501 A.2d 401, 407 (Del. 1985) (emphasis added).

a. Alpha provides no evidence that the fee-shifting bylaw was created for an inequitable purpose.

Without exception, the alleged unjust bylaw under scrutiny must both be "clearly adopted for an inequitable purpose and have an inequitable effect" to be regarded as impermissible. *Hollinger Int'l v. Black*, 844 A.2d 1022, 1080 (Del. Ch. 2004), aff'd sub. nom., *Black v. Hollinger Int'l Inc.*, 872 A.2d 559 (Del. 2005). Moreover, the process for determining the likelihood of inequitable construction of a facially valid bylaw in a certain circumstance "is for the party

facing a concrete situation to challenge the case-specific application of the bylaw . . . ." *Chevron*, 73 A.3d at 949.

For example, in *Schnell v. Chris-Craft Industries*, this court established that a corporate board of directors adopted an amended bylaw to effectively push forward the date of an annual stockholder meeting 30 days prior to the originally scheduled meeting date. *Schnell v. Chris-Craft Indus., Inc.*, 285 A.2d 437, 438-40 (Del. 1971). It was ascertained that the board underhandedly behaved in this manner in order to "perpetuat[e] itself in office" and "obstruct[] the legitimate efforts of dissident stockholders in the exercise of their rights to undertake a proxy contest against management." *Id.* at 439. The *Schnell* Court held that an "inequitable action does not become permissible simply because it is legally possible" even though the board retained the legal right under Delaware law to unilaterally amend a facially valid bylaw. *Id.*

Similarly, in *Hollinger International*, this Court affirmed the Court of Chancery's holding that bylaw amendments endorsed by a majority shareholder "were clearly adopted for an inequitable purpose and have an inequitable effect." *Hollinger*, 844 A.2d at 1080. This is because the bylaws prohibited the board of directors "from acting on any matter of significance except by unanimous vote", "set the board's quorum requirement at 80%," etc. *Id.* at 1077. It is important to note that the outcome in this case was based on an all-encompassing evaluation of facts surrounding the decision to amend the bylaws. *Id.* at 1030-57.

On the other hand, inquiries into the fairness of an amended bylaw require courts to take action only when there is an exposure of a "clear[] wrong and the doing of justice requires their overturn." *Levitt et al. v. Bouvier*, 287 A.2d 671, 673 (Del. 1972). The fact remains, corporate "bylaws only regulate suits brought by stockholders as stockholders in cases governed by the internal affairs doctrine" of a company. *Chevron*, A.3d at 939. Instituting "procedural rules for the operation of [a] corporation, plainly relate to the 'business of the corporation[]," the 'conduct of [their] affairs,' and regulate the 'rights or powers of [their] stockholders.'" *Id.* This is because "bylaws must be reasonable in their application" while maintaining consistency with statutes and rules of common law. *Frantz*, 501 A.2d at 407.

For instance, in *Chevron*, the Chevron board of directors unilaterally adopted a bylaw that commanded all matters of adjudication concerning company internal affairs take place in the state of Delaware. *Chevron*, A.3d at 937. As a result, company stockholders sued the board for adoption of "forum selection bylaws." *Id.* Interestingly, the plaintiffs "attempted to prove their point by presenting to this court a number of hypothetical situations in which, they claim, the bylaws might operate inconsistently with law or unreasonabl[eness]." *Id.* at 938. This Court held that the forum selection bylaws were valid under Delaware statutory law. *Id.* at 939. Moreover, "plaintiffs cannot evade [the burden of proving that bylaws were adopted for an inequitable purpose] by conjuring up imagined

future situations where the bylaws might operate unreasonably." *Id.* at 940.

In *ATP Tour*, the ATP board of directors amended ATP's bylaws to include "Article 23" which specifies a proxy fee-shifting stipulation that obligated any current or prior member or owner of a professional men's tennis tournament who brings forth action against the tennis tour, its owners, or members reimburse same in the event of non-achievement of the remedy sought. *ATP*, 91 A.3d at 555-57. Two of ATP's entities commenced action against ATP and several of its board members. *Id.* at 556. Consequently, judgment was awarded in ATP's favor and ATP subsequently "moved to recover its legal, fees, costs, and expenses ... ." *Id.* Upon certification of a "novel question of Delaware law", this court upheld the facial validity of the amended bylaw that transferred ATP's litigation fees to a failed adverse party. *Id.* at 560. This was because "[u]nder Delaware law, a fee-shifting bylaw is not invalid per se," and this Court could not say that the ATP fee-shifting provision was "adopted for an improper purpose" and "unenforceable in equity." *Id.*

b. Alpha alleges hypothetical future scenarios and has never proved existence of inequitable effects.

Akin to Chevron, Alpha alleged hypothetical situations where the bylaw might be perceived as inequitable, namely, creating an "improper chilling effect by effectively preventing it from conducting a proxy contest ... ." (R. at 12.) Consistent with the Court's reasoning in Chevron, Alpha cannot evade the burden of proving bylaw creation for

an inequitable purpose by way of future situations where the mere chance of prejudice may theoretically occur.

Similar to *ATP* but distinguishable from *Schnell*, Talbot's board of directors adopted a bylaw for the sole purpose of "allowing the Company to recoup its costs if an insurgent's proxy contest was not successful." (R. at 9.) However, Talbot's situation distinguishes itself from both *Schnell* and *Hollinger* due to the Court of Chancery's lack of an "all encompassing" evaluation of facts regarding allegations of improper and inequitable actions. (R. at 14.) Moreover, Alpha never proved its burden displaying that Talbot's proxy fee-shifting bylaw was created specifically for an "inequitable purpose and [had] an inequitable effect" as prescribed in this Court's holding in Frantz.

2. The fee-shifting bylaw was not created in an attempt to entrench the incumbent board.

"Schnell prohibits incumbent management from entrenching itself by taking action which, through legally possible, is inequitable." *Frantz,* 501 A.2d at 407. Accordingly, a corporate board of directors "may not utilize corporate machinery for the purpose of perpetuating themselves in office." *Schnell*, 285 A.2d at 439. Section 160(a) awards a board of directors "the authority to make and amend bylaws and to manage the business of the corporation ..." 8 *Del.C.* § 160(a). "This broad authority allows a Delaware corporation to deal selectively with its stockholders, so long as the directors have not acted out of the sole or primary purpose to entrench themselves in office. *Unocal Corp. v. Mesa Petroleum Co.,* 493 A.2d 946, 953-54 (Del. 1985).

A plaintiff must demonstrate that a board adopted a corporate bylaw "which had the effect of protecting [the board's] tenure and that the action was motivated *primarily* or *solely* for the purpose of achieving that effect." *Benihana of Tokyo, Inc. v. Benihana, Inc.*, 891 A.2d 150, 186 (Del. Ch. 2005) (emphasis added). However, "[t]he fact that a plan has an entrenchment effect, ..., does not mean that the board's primary or sole purpose was entrenchment." *Williams v. Geier*, 671 A.2d 1368 (Del. 1996). In short, "[w]here a board's actions are shown to have been taken for the purpose of entrenchment, they may not be permitted to stand." *Schnell*, 285 A.2d at 439.

a. Talbot's fee-shifting bylaw has no effect on the longevity of the incumbent board.

Put differently, only "where the entrenching actions of a corporate board have the purpose and effect of reducing the voting power of stockholders, the affected stockholders may bring an [] action." *See, e.g., In re Tri-Star Pictures, Inc., Litig.*, 634 A.2d 319, 330; *Lipton v. News Int'l*, 514 A.2d 1075, 1084-85 (Del. 1986). "For that reason, ... a motive to retain corporate control," plus "other facts sufficient to state a cognizable claim that the [board of directors] acted disloyally" must be offered as proof of prevention of a proxy contest leading to entrenchment of an incumbent board. *Gantler v. Stephens*, 965 A.2d 695, 707 (Del. 2009).

Talbot's situation is unique, initially distinguishing itself from other cases turning on the issue of entrenchment. This is because Alpha has never met the burden of establishing that the board's action was motivated primarily by achieving an entrenchment effect. In fact, Alpha is silent on the issue of "entrenchment" and

alleges only "the Proxy Fee-Shifting Bylaw [] has an improper chilling effect by effectively preventing it from conducting a proxy contest for seats on the Talbot board." R. at 12. In fact, the Court of Chancery comes to its own independent conclusion that the bylaw would "result in an uncontested election of the incumbents." R. at 12.

b. Alpha provides no evidence that the sole motive of the bylaw was to keep the present board in power.

Also, in *Schnell*, this Court found that the board of directors engaged in inequitable activity "for the purpose of perpetuating itself in office[.]" The fact that the board "contend[ed] that it has complied strictly with the provisions of [] Delaware Corporation law" had no bearing on the Court's holding of an inequitable action. *Schnell*, 285 A.2d at 439. Talbot distinguishes itself from Schnell by because "Talbot does not have a classified board of directors and [] all nine directors stand for election annually." R. at 3. Therefore, the proxy fee-shifting bylaw has no direct impact on Alpha's ability to nominate individuals for election to the board.

Conversely, in *Axcelis Technologies*, this court held that "because [a] record provides no credible basis to infer that the Board's rejections of [] proposals ... were other than good faith business decisions" a claim of entrenchment without an affirmative showing is insufficient. *City of Westland Police & Fire Ret. Sys. V. Axcelis Tech., Inc.*, 1 A.3d 281, 288 (Del. 2010). Talbot is similar to *Axcelis* because Alpha provides no credible evidence of explicit attempts at prohibiting a proxy contest from occurring in order to keep the present board of directors intact.

In sum, Alpha has not provided any plausible evidence that the Talbot board of directors has intentionally created the proxy fee-shifting bylaw as a mechanism to prevent it from participating in a proxy contest. Additionally, Alpha has not provided a shred of support indicating Talbot's creation of the fee-shifting bylaw is aimed at deterring proxy contests for the sole purpose of protecting and preserving the incumbent board of directors. For the above listed reasons, this Court should lift the preliminary injunction.

II. THE COURT OF CHANCERY ERRED IN CONCLUDING THAT THE *BLAISUS* STANDARD OF REVIEW WAS APPLICABLE TO THE TALBOT BOARD'S AMENDMENT TO THE CORPORATION'S BYLAW TO ADD A FEE-SHIFTING PROVISION IN SITUATIONS WHERE A PROXY CONTESTANT FAILS TO ELECT AT LEAST ONE-HALF OF ITS NOMINEES TO THE BOARD.

A. Question Presented

Whether the Court of Chancery erred in applying the *Blasius* compelling justification standard to a bylaw amendment to the certificate of incorporation enacted for the primary purpose of protecting a legitimate corporate interest in preserving corporate resources in the face of a failed proxy contest.

B. Scope of Review

The grant of a preliminary injunction is reviewed for abuse of discretion. *SI Management L.P. v. Winniger*, 707 A.2d 37, 40 (1998). However, review of legal principles is considered *de novo*. *Lambrecht v. O'Neal*, 3 A.2d 277, 281 (Del. 2010).

C. Merits of Argument

This Court should reverse the Court of Chancery's decision to grant the Plaintiff's motion for a preliminary injunction because the

Court of Chancery incorrectly applied the *Blasius* compelling justification standard of review.

1. The bylaw amendment is distinguishable from the board action in *Blasius* because the primary purpose of the bylaw amendment was not to thwart the stockholder franchise.

a. The *Blasius* compelling justification standard is a form of judicial review that should not be applied except in the most rare of situations.

The *Blasius* standard requires directors to provide a compelling justification for a board action taken for the primary purpose of interfering with stockholders' franchise rights. *Blasius Indus. Inc. v. Atlas Corp.*, 564 A.2d 651, 661 (Del. Ch. 1988). This Court has stated that the compelling justification standard is "quite onerous" and redolent of the almost impossible standards used under the First and Fourteenth amendments. *Williams v. Geier*, 671 A.2d 136, 1376 (Del. 1996); *Mercier v. Inter-Tel, Inc.*, 929 A.2d 786, 806 (Del. 2007). This Court has similarly noted that the trigger for the application of the compelling justification test—directorial action taken for the primary purpose to disenfranchise stockholders—is so pejorative that its application is almost always outcome determinative. *Mercier,* 929 A.2d at 806 (citing *Geier*, 671 A.2d at 1376); *Chesapeake Corp. v. Shore,* 771 A.2d 293, 320 (Del. Ch. 2000.

As a result, such an exacting standard has been viewed as "more a label for a result" than a useful guide to help courts determine a standard of review. *Mercier,* 929 A.2d at 806; *Chesapeake*, 771 A.2d at 323 ("In reality, invocation of the *Blasius* standard usually signals that the court will invalidate the board action under examination."); *See also* William T. Allen, et al., *Function Over Form: A Reassessment*

of Standards of Review in Delaware Corporation Law, 56 Bus. Law. 1287, 1298 & 1311-16 (2001) ("[T]he truly functional standard of review is the test actually used by the judge to reach a decision, not the ritualistic verbal standard that in truth functions only as a conclusory statement of the case's outcome"). For this reason, the Delaware judiciary rarely applies the *Blasius* compelling justification standard because it is too stringent a form of judicial review to be useful. 671 A.2d at 1376; *MM Companies, Inc. v. Liquid Audio, Inc.*, 813 A.2d 1118, 1128 (Del. 2003).

b. Unlike the board in *Blasius*, the Talbot board's primary purpose for enacting the bylaw amendment was not to disenfranchise stockholders.

In *Blasius*, the Atlas board amended the corporate bylaws to increase the size of its board to nine and elected two new directors to the unfilled vacancies. 564 A.2d at 654-57. *Blasius* held that the primary purpose the board's actions was to impede Blasius' stockholder consent provision and preclude Blasius from electing a new majority to the staggered board except by winning not one, but two elections. *Id.* at 655-56. Chancellor Allen viewed the board's bylaw amendment as contrary to the principles of corporate democracy and the "ideological underpinning upon which the legitimacy of directorial power rests." *Id.* at 659. Framing his inquiry as more of a question of power allocation than of bad-faith situational equity,[1] Chancellor Allen proceeded to set forth a cogent explanation of why judicial review

[1] Chancellor Allen found that the Atlas board acted with a good faith belief that Blasius's plan was injurious to Atlas and thus he could not enjoin the board's actions as inequitable based on the *Schnell* principle. *Blasius*, 564 A.2d at 659-60.

under the business judgment standard is inappropriate in circumstances involving directorial action taken for the primary purpose of preventing the effectiveness of the stockholder franchise. *Id.* at 659-60.

Yet, the narrow confines of the *Blasius* decision have led the Delaware courts to eschew application of the stringent compelling justification standard in matters that merely touch on the stockholder franchise. *Stroud v. Grace*, 606 A.2d 75, 90-91 (Del. 1996). Indeed, the Delaware judiciary has been reluctant to extend the compelling justification standard beyond two narrow situations: (1) the "ultimate defensive measure", that is, board actions that preclude stockholders from exercising their voting rights by altering the composition of the board; and (2) bylaws that reduce the voting power of stockholders by changing the threshold level required to achieve victory in a franchise vote. *Liquid Audio*, 813 A.2d at 1131; *Chesapeake*, 771 A.2d at 345.

The issue in the present case is distinguishable from *Blasius* and its progeny, which involved boards who took clear steps to prevent stockholders from exercising their franchise rights. The Atlas board in *Blasius* precluded the stockholder vote in a very fundamental way—the will of the stockholders was frustrated because the board prevented the stockholders from electing nominees to capture control of the board. Unlike *Blasius, Liquid Audio* and *Chesapeake,* which involved board actions that affected the stockholder franchise before any vote could be taken, the bylaw amendment concerns post-election matters. In truth, Talbot's stockholders are still able to vote on any

slate of nominees to challenge the incumbent board—nothing about the bylaw amendment actually precludes a stockholder from nominating and electing new directors.

As a practical matter, any proxy contestant must muster significant resources to wage a campaign against the incumbent board. Simply because Alpha states that it will not wage a proxy contest if the bylaw stands doesn't prevent Alpha from soliciting proxies. Alpha could seek to raise funds to offset the corporation's expenses, or it could proceed with the proxy contest with confidence that its recapitalization plan will be attractive enough to stockholders that at least two of its four nominees will defeat incumbent board members. Indeed, Alpha has multiple options whereas the stockholders in *Blasius* and its progeny had no effective alternative. Since Alpha has these options to proceed, one cannot say that the Talbot board enacted the fee-shifting bylaw with the primary purpose of preventing a stockholder proxy vote. Accordingly, *Blasius* is an inappropriate standard to apply in this case.

2. The fee-shifting bylaw is entitled to deference under the business judgment rule because the board's actions satisfy the *Unocal* standard of review for defensive actions that only implicate the stockholder franchise.

a. Recent directional teachings from the Delaware judiciary favor applying *Blasius* within *Unocal* as part of a more practical reasonableness standard.

In the context of an unsolicited corporate takeover, *Unocal* requires a reviewing court to apply an enhanced standard of review to determine whether the board reasonably perceived the proposed takeover as a genuine threat to the corporation's effectiveness and policy. *Unocal*, 493 A.2d 946, 955 (Del. 1985). Additionally, the board carries the burden to show that the defensives measures were neither preclusive nor coercive, and thus reasonable in response to the threat. *Id.* If the board can satisfy this two-part test, then directors are accorded the protection of the business judgment rule and the burden shifts to the plaintiff to rebut the presumption. *Unitrin, Inc. v. American General Corp.*, 651 A.2d 1361, 1373 (Del. 1995); *See also Mercier*, 929 A.2d at 808 (explaining the utility of the *Unocal* standard).

There is obvious interplay between the *Blasius* and *Unocal* standards because boards often take defensive measures that affect the stockholder franchise "in response to some threat to corporate policy and effectiveness which touches upon issues of control." 813 A.2d at 1130 (quoting *Gilbert v. El Paso Co.,* 575 A.2d 1131, 1144 (Del.1990)). *Mercier v. Inter-tel* represents a leading attempt by the Court of Chancery to reconcile this relationship by integrating the *Blasius* standard into the context of the *Unocal* standard. Then Vice-Chancellor Strine, the author of *Mercier* remarked that such a reformulation was

"consistent with prior decisions recognizing the substantial…redundancy of the *Blasius* and *Unocal* standards." *Mercier*, 929 A.2d at 788.

In *Mercier*, a plaintiff petitioned the court to apply *Blasius* and enjoin a special committee of the defendant board of directors from postponing a meeting at which stockholders were to consider a proposed merger. *Id.* at 804-05. For its part, the special committee petitioned the court to review its actions under the business judgment rule[2] relying heavily on the court's earlier opinion *In re the MONY Group, Inc. S'holder Litigation*. 853 A.2d 661 (Del. Ch. 2004) (declining to apply *Blasius* to review the defendant directors' actions in favor of the business judgment rule).

Upon review, *Mercier* did not apply either standard, and it chose instead to adopt a "legitimate objective" test consistent with the reasonableness standard in *Unocal*. 929 A.2d at 810. The legitimate objective test requires that the board act in good faith without the primary purpose of disenfranchising stockholders. *Id.* As an initial matter, the test places the burden on directors to identify a legitimate corporate objective served by its decision to take board action that postponed a stockholder vote. *Id.* at 810-11. The directors must show that their actions were reasonable in relation to their

[2] The business judgment rule is "a presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company." Smith v. Van Gorkom, 488 A.2d 858, 872 (Del. 1985) (quoting Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984)).

legitimate objective, and neither precluded stockholders from voting nor coerced them into voting a particular way. *Id.*

The *Mercier* court viewed the legitimate objective test as consistent with the directional teachings of *Liquid* Audio, Chesapeake, and *MONY*, all of which noted the substantial congruence between the two standards and the practicality of subsuming *Blasius* into *Unocal*. *Liquid Audio,* 813 A.2d at 1129; *Chesapeake,* 771 A.2d at 323 ("If *Unocal* is applied by the court with a gimlet eye out for inequitably motivated…preclusive or coercive [electoral manipulations]…it may be optimal simply for Delaware courts to infuse our *Unocal* analyses with the spirit animating *Blasius*…". Applying the reformulated *Unocal* standard, *Mercier* found, unlike the boards in *Blasius*, *Liquid Audio*, *Chesapeake* and *Schnell*, that the board did not act with the primary purpose of perpetuating themselves in office and that the board action advanced a legitimate corporate interest that neither precluded a stockholder vote nor coerced the stockholders into voting a certain way. 923 A.2d at 818.

Although the reformulated legitimate objective test carefully subsumes *Blasius* to such a refined degree that one could argue that *Blasius* no longer functions as an independent standard of review, it would have been impossible for *Mercier* to ignore cases like, among others, *Liquid Audio* which "seem to give continuing life to the compelling justification usage." *Id.* at 818-19. Paying deference to these cases, *Mercier* found that even if the *Blasius* standard applied the board demonstrated a compelling justification for its action. *Id.* The court concluded that because the Delaware judiciary views non-

preclusive, non-coercive action as not having the primary purpose of disenfranchisement, the board satisfied its requirement under *Blasius*.

b. Talbot has a legitimate objective to preserve corporate resources during its restructuring period, and the fee-shifting bylaw is reasonable in relation to this objective since its primary purpose is to defray corporate expenditures and not to preclude or coerce the voting franchise.

The Talbot board had already entered a restructuring period when Alpha approached the Talbot CEO with its own proposal. Although Alpha's announcement that it would seek to nominate four directors to the Talbot board spurred the board to adopt the fee-shifting bylaw, the primary purpose of the amendment was not to disenfranchise the stockholders from exercising their right to vote on competing referendums for the future of the company. Instead, the fee-shifting bylaw represents a legitimate corporate objective to enact cost cutting measures to preserve limited corporate resources during a period in which the corporation is seeking to maximize value.

This legitimate corporate objective is similar to that of the board in *Mercier*. In *Mercier*, the court found that the special committee acted out of a good faith concern that the merger was in the best interests of the company and, if the meeting was not rescheduled, the advantages of the merger would be irretrievably lost. 929 A.2d at 813. In the present case, the Talbot board acted out of good faith that the restructuring proposal was in the best interests of the corporation. The Court of Chancery overlooked the fact that regardless of whether the stockholders prefer the Talbot board's restructuring

plan or Alpha's restructuring plan, the corporation required a cost-saving vision to secure its future.

Waging a proxy contest is extremely expensive, and if Alpha or, for that matter, any dissident stockholder failed to elect its slate of nominees to the board, then the corporation would have expended vast amounts of corporate resources just to maintain the status quo. In this way, the lost resources represent the same type of lost opportunity as in *Mercier*—the lost opportunity to preserve corporate funds during a period in which the corporation is seeking to cut costs. In this way, the bylaw amendment had nothing to do with "the question [of] who should comprise the board of directors." Mem. Op 16 (quoting *Blasius*, 564 A.2d at 663). The bylaw amendment represents a board action reasonably related to the corporation's legitimate objective to save money during the restructuring period. Moreover, the bylaw neither precludes stockholders from freely choosing to reject the Talbot's restructuring period nor does it coerce the stockholders into voting for the incumbent board. The fee-shifting provision is simply another cost cutting measure, and thus survives the legitimate objective test.

c. Even if the *Blasius* standard applies, the Talbot board demonstrated a compelling justification for enacting the fee-shifting bylaw.

Even if this Court chooses not to implement the legitimate objective test, the Talbot board demonstrates a compelling justification in enacting the fee-shifting bylaw. As previously discussed, the primary purpose of the bylaw was not to disenfranchise the Talbot stockholders. Rather, the bylaw serves as a cost-cutting

mechanism during Talbot's restructuring period. As the Court of Chancery has already ruled that the fee-shifting bylaw would not have an effect on Alpha's ability to win a proxy contest, the bylaw cannot be viewed as either preclusive or coercive in nature. Like the board in *Mercier*, who believed in good faith that the merger was value-maximizing offer, the Talbot board enacted the bylaw to ensure that the value of the corporate treasury is maximized in the event of a failed attempt by dissident shareholders to elect directors to the board.

CONCLUSION

For the foregoing reasons, this Court should reverse the Court of Chancery's order granting the Appellee's motion for a preliminary injunction against the Talbot Board.

Respectfully submitted,

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