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.	:	Court Below: Court of Chancery of the State of Delaware
	:	C.A. No. 10428-CJ

Appellee's Reply Brief

Team O
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February 6, 2015

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NATURE OF PROCEEDINGS

Appellees Alpha Fund Management L.P., Plaintiffs below, brought suit seeking injunctive relief against Appellants Talbot Inc. and its Board of Directors, Defendants below, in the Court of Chancery on claims of violation of fiduciary duty on December 22, 2014. Chancellor Junge granted a preliminary injunction on January 14, 2015 preventing Talbot and the Board from taking any action to enforce the recently adopted Proxy Fee-Shifting Bylaw in connection with any proxy contest for the election of directors to the board of Talbot at the annual stockholders meeting.

Appellants filed a notice of appeal on January 22, 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 Proxy Fee-Shifting Bylaw is facially invalid and, in the alternative, that the challenged bylaw was adopted for an inequitable purpose and therefore was a breach of Talbot's Board of Directors' fiduciary duties.

SUMMARY OF ARGUMENT

1. Denied. Corporate bylaws must conform to Delaware General Corporation Law (DGCL) which states that bylaws may not infringe upon the rights or powers of its stockholders. The Proxy Fee-Shifting Bylaw enacted by Talbot's Board of Directions ("the Board") violates this standard by rendering Alpha Fund Management's ("Alpha") ability to legally call for a proxy vote essentially null. This right of stockholders to voice dissent with a board or propose alternative business plans is vital to the underlying concepts of corporate consent and democracy. Because the bylaw so flagrantly violates the principles of corporate law in any factual scenario, this Court should find the Proxy Fee-Shifting Bylaw facially void and grant Alpha's request for an injunction.

2. Denied. In the alternative, the enactment of the Proxy Fee-Shifting Bylaw violates the Board's fiduciary duties as-applied. This Court should uphold the Chancery Court's Opinion (the "Opinion") which held that the Board acted in an "improper and inequitable way." In adopting the challenged bylaw immediately after Alpha filed notice of its intent to seek four new directors for election in the upcoming annual stockholder's meeting, the Board acted for an inequitable purpose in violation of the standard announced in Blasius. Furthermore, the Board's actions do not pass muster under Unocal as an appropriate defensive measure as the challenged bylaw is effectively preclusive. Thus, this Court should affirm Chancellor Junge's preliminary enjoinment of the Proxy Fee-Shifting Bylaw as it thwarts corporate democracy.

COUNTERSTATEMENT OF FACTS

Talbot is a publicly-traded Delaware corporation with a market capitalization of approximately $2.25 billion and around 75 million shares of common stock outstanding. Op. at 2. The company is comprised of three divisions: the Fasteners Division (which manufactures high-tech fasteners for aerospace markets and is the largest source of Talbot's revenue); the Components Division (which manufactures micro-electronic circuitry for use in consumer tablets and gaming devices); and the Software Division (which develops software for industrial manufacturing applications). Id.

Alpha Fund Management L.P. ("Alpha") manages an exclusive fund from investors that include insurance companies, pension funds, and university endowments. Op. at 2. Alpha's portfolio is valued at $1.1 billion, and regularly participates in stockholder voting functions to maximize the value of its investments. Id.

The Chief Executive Officer of Alpha, Jeremy Womack, directed Alpha to invest in Talbot in 2013. Op. at 2. Armed with a restructuring proposal ("Restructuring Proposal") that suggested that Talbot cut its operating expense and maximize its profits through the Fasteners Division, Womack presented his proposal to Talbot's Chairman and Chief Executive Officer, Timothy Gunnison. Op. at 3. Gunnison quickly rejected this proposal, suggesting that Talbot had other plans for cutting costs and maximizing the cohesiveness of the three Divisions. Op. at 4. Alpha ultimately acquired 7% of Talbot's outstanding shares by 2014 and subsequently filed a Schedule 13D with

the Securities and Exchange Commission (the "SEC") to disclose both its substantial holdings and plan to nominate four directors to Talbot's nine member Board of Directors at the next annual stockholders meeting in six months. Id.

In response, Gunnison called a special meeting of the Board of Directors on December 18th, 2014, eight days after Alpha filed its Schedule 13D with the SEC. Op. at 5. At the meeting, the full board agreed that the Board's current business plan was preferable to Alpha's Restructuring Proposal. Op. at 5-6. Also during the meeting, the Board heard presentations from Talbot's in-house General Counsel as well as counsel outside the firm regarding the adoption of a Proxy Fee-Shifting Bylaw ("Bylaw"). Op. at 6.

The Bylaw imposes upon any stockholder activist the financial obligation to reimburse Talbot for any expenses Talbot incurs in defending the incumbent Board if less than half of the stockholder's nominees do not win election to the Board by vote of the stockholders. Op. at 6. The outside counsel, Ellsworth, declined to provide an unqualified opinion on the legal validity of the Proxy Fee-Shifting Bylaw under Delaware law, but did explain that that proxy contests can cause significant costs, ranging from $4 million to $14 million among larger firms. Id. The Bylaw, as adopted, could be waived upon the discretion of the Board in accordance with their fiduciary duties. Id. In sum, the adopted Bylaw would force Alpha to reimburse Talbot for its proxy expenses if two or more of Alpha's nominees did not win a position on the Board at the upcoming annual stockholder's meeting. Id.

In discussing the Bylaw, Gunnison stated that Alpha's nominees presented a "potential camel in the tent problem." Op. at 8. Other directors shared similar concerns. Rosaria Gabrielli's suggested that "we need to raise the stakes for this guy [Womack]." Id. Marshall Cannon said the risk of added costs from the Bylaw "might get Alpha to think twice about all this," and Clare Leonard added, "if the [Bylaw] helps to stop Alpha, then I'm for it." Op. at 8-9. The directors also stated concerns that Alpha's Proposal would lead Talbot towards a flawed short term strategy. Id. The board unanimously approved the Bylaw, and resolved not to waive the fee-shifting obligation should Alpha engage in a proxy contest. Op. at 9.

Four days later on December 22, 2014, Alpha formally nominated its four nominees to Talbot's Board. Op. at 9. On the same day, Alpha filed this action against the Bylaw, claiming that the Proxy Fee-Shifting Bylaw is (1) facially invalid under Delaware law and (2) the product of inequitable conduct in violation of the fiduciary duties of the Board. Id. In lower court proceedings, the Court of Chancery of the State of Delaware granted Alpha's request for a preliminary injunction, from which Talbot moved for an expedited review on appeal before the Supreme Court of Delaware. Op. at 17.

ARGUMENT

I. THE FEE-SHIFTING BYLAW ENACTED BY TALBOT'S BOARD OF DIRECTORS IS FACIALLY INVALID BECAUSE IT VIOLATES 8 DEL. C. § 109(B) BY UNREASONABLY IMPINGING ON A PROTECTED, FUNDAMENTAL PRINCIPLE OF CORPORATE DEMOCRACY, NAMELY A STOCKHOLDER'S RIGHT TO VOTE.

A. Question Presented

Whether Talbot Proxy Fee-Shifting Bylaw is facially invalid under 8 DEL. C. § 109(b) because it violates fundamental principles of corporate democracy.

B. Scope of Review

This Court reviews the Court of Chancery's grant of a preliminary injunction *de novo*. Kaiser Aluminum Corp. v. Matheson, 681 A.2d 392, 394 (Del. 1996). Additionally, because the Court of Chancery declined to address the facial validity of the challenged bylaw, this determination is properly left for this Court to resolve *de novo*. See Schock v. Nash, 732 A.2d 217, 232 (Del. 1999)("Whether or not an equitable remedy exists or is applied using the correct standards is an issue of law and reviewed *de novo*").

C. Merits of the Argument

8 DEL. C. § 109(b), which governs bylaws of Delaware corporations, stipulates that bylaws may not contain any provision inconsistent with either "law" or "the rights or powers of its stockholders." And it is this Court's duty, as guardians of stockholder's rights, to void enacted bylaws found to be inconsistent with any statute or rule of common law. See Frantz Mfg. Co. v. EAC Indus., 501 A.2d 401, 407 (Del. 1985). Here, the fee-shifting bylaw enacted by Talbot's Board disenfranchises its stockholders and

presents a facial violation of the rights of the stockholders under the well-established principles of corporate democracy expounded by Delaware courts. Therefore, after applying the appropriate heightened scrutiny test from Blasius, this Court should render Talbot's Proxy Fee-Shifting Bylaw void.

1. The Proxy Fee-Shifting Bylaw is facially invalid because it fails to pass muster under the appropriate Heightened Scrutiny test this Court outlined in Blasius.

While bylaws are generally presumed to be valid, this Court is regularly tasked with reviewing the facial validity of bylaws, see Boilermakers Local 154 Ret. Fund v. Chevron Corp., 73 A.3d 934, 947 (Del. Ch. 2013), and any bylaw found to be in conflict with the DGCL is void. Crown EMAK Partners, LLC v. Kurz, 992 A.2d 377, 398 (Del. 2010). Courts will first attempt to interpret a challenged bylaw in a manner consistent with the law rather than striking it down, Edward P. Welch et al., Folk on the Delaware General Corporation Law § 109.4 (2009), but when the bylaw so impinges on the "rights and powers of its stockholders" to such a degree that its application would never be permissible, then the bylaw is facially invalid. See Boilermakers Local 154 Ret. Fund, at 947.

a. 8 DEL. C. § 109(B) governs the validity of corporate bylaws in Delaware.

In order for a bylaw to be facially valid, it (1) "must be authorized by the Delaware General Corporation Law (DGCL), (2) consistent with the corporation's certificate of incorporation, and (3) its enactment must not be otherwise prohibited." ATP Tour, Inc. v. Deutscher Tennis Bund, 91 A.3d 554, 557 (Del. 2014)(numericals added).

At issue in the current litigation is the third analytical inquiry. A bylaw is "otherwise prohibited" when its content runs afoul of any statute or principles of common law. Id. at 558. The DGCL states in § 109(b) that bylaws can contain provisions that relate 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" as long as the bylaws are consistent with the law and certificate of incorporation. 8 DEL. C. § 109(b). Here, Talbot's Proxy Fee-Shifting Bylaw fails the facial validity test because the bylaw substantially interferes with the rights and powers of its stockholders to hold a fair election.

b. The appropriate standard of review for whether the challenged Proxy Fee-Shifting Bylaw is valid is the Blasius Heighten Scrutiny test.

Directors owe a fiduciary duty of loyalty to all stockholders, which forbids directors from deriving "any personal benefit through self-dealing." 1 R. FRANKLIN BALOTTI & JESSE A. FINKELSTEIN, DELAWARE LAW OF CORPORATIONS AND BUSINESS ORGANIZATIONS, § 4.16 (2015) (citing Andarko Petroleum Corp. v. Panhandle E. Corp., 545 A.2d 1171, 1174 (Del. 1988)). Indeed, Delaware courts consistently finds a violation of the duty of loyalty where directors act to entrench their positions on the board for the personal benefits of board membership. Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985); Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651, 658 (Del. Ch. 1988). As stated in Blasius, a provision violates the duty of loyalty where it purposely interferes with the stockholder voting franchise without any compelling justification. Blasius, 564 A.2d at 662.

i. The primary purpose of the Talbot bylaw was to thwart a stockholder vote on Alpha's directors.

In order for the Blasius standard to be invoked, the challenged action of the Board had to be taken for the sole or primary purpose of thwarting a stockholder vote. Kallick v. Sandridge Energy, Inc., 68 A.3d 242, 258 (Del. Ch. 2013) (internal citations omitted). In Blasius, the board elected two new directors to dilute the proportional value of a dissident's proposal before stockholders could vote on the matter. Blasius, 564 A.2d at 662. Although the court did not find that the directors were acting in self-interest, the court concluded that the board's actions violated stockholder voting rights and was therefore invalid barring a compelling business justification. Id. Just like the board in Blasius, Talbot's Board adopted a bylaw to thwart Alpha's legitimate attempt to nominate directors to Talbot's board and in so doing violated stockholder voting rights.

2. A stockholder's challenge to a corporate fee-shifting bylaw that impinges on a stockholder's right to vote presents a question of first impression.

In his lower court opinion, Chancellor Junge acknowledged the novelty of the question presented in this case. Op. at 12. The legality of fee-shifting bylaws has only been address by this Court on one prior occasion, but never in the context of a publically traded company. ATP, 91 A.3d at 555. In ATP, the United States District Court for the District of Delaware certified a number of "questions of law concerning the validity of a fee-shifting provision in a Delaware non-stock corporation's bylaws to this Court." Id. (emphasis added).

Although this Court held that the fee-shifting bylaw for a non-stock corporation was facially valid, there exist a plethora of reasons why ATP's holding should not be extended further to include publicly traded corporations with stockholders like Talbots. The strongest of those rationales is that the issuance of stock and the rights of stockholders of a corporation implicate underlying principles of corporate democracy that are not at issue when non-stock corporations are involved. Simply put, stockholders in publicly traded corporations have critical rights and responsibilities in corporate governance that do not exist in non-stock corporations.

3. Fee-Shifting Bylaws enacted by the Board after stockholders already have purchased stock flagrantly violate the principles of corporate democracy and underlying theories of consent.

The cornerstone of corporate democracy rests on the ability of stockholders to reasonably elect their representatives. See Harvey Frank, The Future of Corporate Democracy, 28 Baylor L. Rev. 39 (1976). These elected representatives – here, The Board – only derive their legitimacy to manage the corporation and unilaterally enact bylaws from the consent of the stockholders through the election process. See MM Companies, Inc. v. Liquid Audio, Inc., 813 A.2d 1118, 1126 (Del. 2003). This separation of control, a "fundamental tenet[] of Delaware corporate law," Malone v. Brincat, 722 A.2d 5, 9 (Del. 1998), is checked by the rights of stockholders to vote out the board when "stock stockholders are displeased with the action of their elected representatives." Unocal Corp., 493 A.2d AT 959. So when the elected representatives pass bylaws that are self-serving, incentivize

entrenchment, and manipulate corporate elections, Delaware courts have routinely invalidated such bylaws based on this common law notion of corporate democracy. See Paramount Commc'ns Inc. v. QVC Network Inc., 637 A.2d 34, 42 (Del. 1994).

In Aprahamian v. HBO & Company, 531 A.2d 1204 (Del.Ch. 1987), an incumbent board, fearful of a proxy challenge, changed the date of the annual meeting the day before it was set to take place. Invalidating the board's actions as a violation of the principles of corporate democracy, the court reaffirmed that the validity of corporate election process is so fundamental to corporate law that actions taken by a board of directors which facially violate these principles are void. Id., at 1206. Here, the stockholders' right to vote and hold a fair election free from the Board's manipulation has been jeopardized to an even greater degree than the stockholders in Aprahamian. Rather than simply moving back the date of the annual meeting to impede a pending proxy contest, as the board did in Aprahamian; Talbot's Board has effectively ended any opportunity for Appellees to ever exercise its right to a proxy contest. Op. at 14 (finding that "[Appellees] will abandon the upcoming proxy context if judicial relief invalidating or otherwise restraining enforcement of the Proxy Fee-Shifting Bylaw is not obtained"). Therefore, just as the Court in *Aprahamian* used common law principles of corporate democracy to invalidate a board's decision regarding the election process, this Court should void the challenged fee-shifting bylaw because through its enactment, the Talbot Board violated the most fundamental principle of corporate democracy — legitimacy of the election process.

The Board's actions in this case also violate the doctrine of corporate consent. This fundamental principle of corporate democracy is concerned with the outer limits of corporate structural changes, enacted by elected representatives, that stockholders can be presumed to have consented by owning stock. Lawrence A. Hamermesh, Consent in Corporate Law, 70 Bus. Law. 161 (2015). In Boilermakers Local 154 Ret. Fund v. Chevron Corp., 73 A.3d 934, 940 (Del. Ch. 2013), plaintiffs brought facial challenges to forum selection clauses in the corporate bylaws. Holding that the bylaws were facially valid because the plaintiffs failed to satisfy their burden of proof, the Court of Chancery elucidated the theory of consent as follows:

> [I]nvestors bought stock in Chevron and FedEx, they knew (i) that consistent with 8 *Del. C.* § 109(a), the certificates of incorporation gave the boards the power to adopt and amend bylaws unilaterally; (ii) that 8 *Del. C.* § 109(b) allows bylaws to regulate the business of the corporation, the conduct of its affairs, and the rights or powers of its stockholders; and (iii) that board-adopted bylaws are binding on the stockholders.

Id. at 939-40.

This logic, that because stockholders, upon purchasing corporate stock, willingly enter into a contract that allows for unilateral changes by the Board and therefore have consented to such changes, was extended to justify this Court's holding in ATP. See 91 A.3d 554, 558 (Del. 2014). Here, however, this logical rationale breaks down. See Lawrence A. Hamermesh, Consent in Corporate Law, 70 Bus. Law. 161, 171 (2015) (arguing that a fee-shifting provision like the one found in ATP would violate the doctrine of corporate consent if "adopted by directors after public investors are in place"). First, the fact that a stockholder could be compelled by a bylaw to undertake liability

beyond what he invested in the company violates the very premise of corporation's limited liability; such a concern is not necessarily implicated with a non-stock corporation. Second, the fee-shifting bylaw places a much greater burden on stockholders than the challenged forum selection clause in Boilermakers. Having to pay for both party's litigation expenses is vastly different than having to litigate a matter in different jurisdiction. Stockholders cannot be presumed to have consented to a bylaw that effectively eviscerates their rights to elect representatives of their choosing. Finally, ATP's holding that fee-shifting bylaws are facially valid for non-stock corporations should not be extended to publically traded corporations because the difference in degree creates a difference in kind. Cf. United States v. Jones, 132 S. Ct. 945, 964, 181 L. Ed. 2d 911 (2012) (noting that short term GPS surveillance was so different in degree from 4 weeks of continuous GPS monitoring as to create a difference in kind).

In ATP, the corporation at issue was a non-stock corporation comprised of members who were "men's tennis players and entities that own and operate professional men's tennis tournaments." ATP, 91 A.3d at 555. All of the members of ATP were highly sophisticated participants in the specific purpose of the corporation's formation. In comparison, Talbot is a publicly held corporation where most investors are not directly familiar with the Board. This gargantuan difference of degree is such that it creates a difference in kind. Talbots is a multi-billion dollar firm with over 75 million shares of common stock outstanding. Op. at 2. The idea that Talbot's Board of Directors was legitimately acting with the consent of the stockholders

when it enacted a fee-shifting bylaw that rendered stockholder's fundamental right to bring a proxy contest effectively null is beyond plausibility and violates both the doctrine of corporate consent and corporate democracy. See Lawrence A. Hamermesh, Consent in Corporate Law, 70 Bus. Law. 161, 171 (2015).

4. Talbot's Proxy Fee-Shifting Bylaw violates Board of Directors violated their duty of loyalty to investors under *Blasius*.

Directors owe a fiduciary duty of loyalty to all stockholders, which forbids directors from deriving "any personal benefit through self-dealing." 1 R. FRANKLIN BALOTTI & JESSE A. FINKELSTEIN, DELAWARE LAW OF CORPORATIONS AND BUSINESS ORGANIZATIONS, § 4.16 (2015) (citing Andarko, 545 A.2d at 1174). Indeed, Delaware courts consistently find a violation of the duty of loyalty where directors act to entrench their positions on the board for the personal benefits of board membership. Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985); Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651, 658 (Del. Ch. 1988). As stated in Blasius, a provision violates the duty of loyalty where it purposely interferes with the stockholder voting franchise without any compelling justification. Blasius, 564 A.2d at 662.

1. Talbot does not have a compelling justification for thwarting a vote on Alpha's proposed slate of directors.

Delaware courts have zealously defended the stockholder voting franchise, limiting the ability of incumbent directors to perpetuate their position in office without a compelling justification. The Court of Chancery recently defined the compelling justification as "a very high standard drawing on the closest scrutiny used in cases involving

racial discrimination and restrictions on political speech." Kallick v. Sandridge Energy, Inc., 68 A.3d 242, 258 (Del. Ch. 2013). In Unocal, the Court offered a balancing test to evaluate defensive efforts of an incumbent board against a hostile tender offer. 493 A.2d 946 (Del. 1985). To find a compelling justification, the Court stated that defensive measures are protected by the business judgment rule only where the action "is reasonable in relation to the threat posed." Unocal, 493 A.2d at 955. The Unocal court identified justifiable concerns as "inadequacy of the price offered, nature and timing of the offer, questions of illegality, the impact on "constituencies" other than stockholders..., the risk of nonconsummation, and the quality of securities being offered in the exchange." Id. Notably, the Unocal court does not include self-perpetuation as a viable concern.

Applying that standard, Delaware courts have consistently rejected attempts to justify actions that frustrate corporate democracy. In Aprahamian a board's concurrent business reasons were insufficient for changing the date and time of the stockholder meeting because the board was aware that a dissident stockholder group was prepared to present proxies for a majority of stockholders. Aprahamian, 531 A.2d 1204. In Phillips v. Insituform of North America, Inc., No. CIV.A. 9173, 1987 WL 16285 (Del. Ch. Aug. 27, 1987), the court concluded that the board could not issue more stock merely to dilute the shares and prevent a stockholder from becoming a majority holder. Although the court did not find that actions to thwart a stockholder vote were invalid per se, the court reserved such a justification for which some "extraordinary step might be justified in

some circumstances." Id. at 24. This question was tested in Carmody v. Toll Brothers, 723 A.2d 1180 (Del. Ch. 1998), where the board adopted a "dead hand" stockholder rights plan to defend against a hostile takeover. The court concluded that a dead hand provision violates the duty of loyalty in that it both "purposefully interferes with the stockholder voting franchise without any compelling justification" under Blasius, and is a "'disproportionate' defensive measure" under Unocal.

2. The Talbot bylaw is a disproportionate defensive measure under Unocal.

Talbot may assert that the fee-shifting proxy bylaw is a defensive measure justified by a concern that long-term stockholder value may be jeopardized by Alpha's proposal. However, this assertion lacks grounding in the corporate law or the function of the markets. Unocal does allow the board to consider "the basic stockholder interests at stake" where a short term investor is positioned against long term investors, but the Court has not given heavy weight to such speculative concerns. Unocal, 493 A.2d at 956. Indeed, subsequent rulings have emphasized that such a distinction is "largely irrelevant" given the duty of directors to act in the best interest of the corporation "without regard to a fixed investment horizon." Paramount Commc'ns, Inc v. Time, Inc., 571 A.2d 1140, 1150 (Del. 1989). Here, Alpha seeks to unlock stockholder value by advancing a proposal to split up Talbot's business — a common stockholder interest and critical aspect of the function of capital markets. Op. at 3. Allowing Talbot's board to adopt prohibitive bylaw provisions could

effectively deter all stockholder activism and the normal functions of private equity investment. The Talbot bylaw is effectively preclusive, because it makes Alpha's proxy contest "prohibitively expensive and effectively impossible." Toll Brothers, 723 A.2d at 1195. Therefore, the Proxy Fee-Shifting Bylaw makes proxy contest "'realistically unattainable' and therefore, disproportionate and unreasonable under Unocal." *Id.*

Because Talbot's Board enacted a bylaw that is "otherwise prohibited" by common law principles of corporate law, this Court should find that the challenged Proxy Fee-Shifting Bylaw is facially invalid under Delaware law. ATP, 91 A.3d at 558.

II. THE CHANCERY COURT PROPERLY CONSTRUED THE BOARD'S PROXY FEE-SHIFTING BYLAW AS ADOPTED FOR AN INEQUITABLE PURPOSE, VIOLATING THE BOARD'S DUTY OF LOYALTY TO STOCKHOLDERS.

A. Questions Presented

Whether the Court of Chancery correctly ruled that the Talbot Proxy Fee-Shifting Bylaw was adopted for an inequitable purpose and therefore the board violated its duty of loyalty to stockholders.

B. Scope of Review

The Supreme Court of Delaware reviews actions relating to a preliminary injunction at the lower court level *de novo*, and will reverse upon a finding of abuse of discretion. Kaiser Aluminum Corp. v. Matheson, 681 A.2d 392, 394 (Del. 1996). The court should consider whether the plaintiff has established: (1) a reasonable probability of success on the merits; (2) irreparable harm; and (3) a balance of equities in its favor. Id. Given that the lower court determined that a preliminary injunction was appropriate, the Supreme Court of Delaware should now review for abuse of discretion in a *de novo* review of legal issues.

C. Merits of the Argument

1. Talbot's Proxy Fee-Shifting Bylaw was adopted to effect an inequitable purpose, and is therefore invalid under Delaware law.

The novel Proxy Fee-Shifting Bylaw adopted by Talbot's board of directors is transparently designed to undermine the mechanics of corporate democracy. Delaware courts have established the most exhaustive body of corporate law in the nation for nearly a century,

yet the Talbot board has managed to engineer a tool of corporate governance that is one of first impression in this Court not because it embraces emerging technologies or corporate forms, but because the Talbot board has strayed into the realm of inequitable purpose established in Schnell that had previously required no explanation. In adopting this bylaw, Talbot's board was motivated by an inequitable purpose, and violated their duty of loyalty to stockholders. As a result, the Court should now affirm the Court of Chancery's injunction upon Talbot's perverse bylaw shifting proxy fees upon dissident stockholders.

a. Board actions to perpetuate the entrenchment of the directors and obstruct legitimate dissident efforts to engage in proxy contests manifest an inequitable purpose, and are invalid under Delaware law.

Delaware courts have forcefully rejected attempts to subvert corporate democracy. Where a corporation's board of directors seeks to entrench itself in office and obstruct dissident exercise of the established democratic processes vital to corporate democracy, this court has found an inequitable purpose driving the board's action. ATP, 91 A.3d at 558 (Del. 2014); Schnell, 248 A.2d at 439. Subsequently, the Court of Chancery has interpreted Schnell to invalidate a facially legal use of a bylaw if that bylaw is determined as inequitable. See Accipiter Life Sciences Fund, L.P. v. Helfer, 905 A.2d 115, 124 (Del. Ch. 2006); Hollinger Intern., Inc. v. Black, 844 A.2d 1022, 1078 (Del. Ch. 2004). Therefore, even if this court does not agree that the Proxy Fee-Shifting Bylaw employed by Talbot is

facially invalid, the court should rule that the bylaw effects an inequitable purpose in violation of Schnell.

Novel legal maneuvers that appear to be procedurally sound violate Delaware law where the act violates the principles of corporate democracy and effect an inequitable purpose. Although incumbent boards understandably tend to view activist stockholder nominations with hostility, proxy contests are a fact of corporate life, with an average of 55 contests per year from 1994-2008. Vyacheslav Vos, The Disciplinary Effects of Proxy Contests 1 (University of Illinois at Urbana-Champaign, Working Paper, Sept. 9, 2013). To enable stockholder participation, Delaware law provides numerous protections for stockholders who instigate proxy contests with management in order to preserve this essential machinery of corporate democracy.

In Schnell v. Chris-Craft Industries, 285 A.2d 437 (Del. 1971), a corporation's board of directors adopted a bylaw to change the date of the stockholder meeting in response to a dissident stockholders' nomination of a hostile slate of directors. The Court did not require plain statements suggesting malice towards the dissident stockholders, but instead focused on the clear consequences of the board action. The Court found that an inequitable board action occurs where a board has employed "the corporate machinery and Delaware law for the purpose of perpetuating itself in office" or "obstructing the legitimate efforts of dissident stockholders" who endeavor to wage a proxy contest. Schnell, 285 A.2d at 439. The Court noted that requiring stockholders to vote before the annual meeting, and in a more remote area, would

create an "inequitable advantage in the contest" favoring the entrenched directors. Id. Because the change in date would limit the time available to campaign and file required documents with the Securities and Exchange Commission, the Court concluded that the dissident stockholders are "given little chance." Id. As a result, Delaware law deters legal maneuvering that aims to undermine the democratic process and legitimate contests for corporate control among stockholders.

b. Talbot's Proxy Fee-Shifting Bylaw is invalid because the board was motivated by an inequitable purpose.

Talbot cannot adopt any bylaw that is designed to effect an inequitable purpose. The consequences of the challenged bylaw, as well as the plain statements of the board members in effecting the law, reflect contempt for the stockholder voting process. In Schnell, the board adopted a bylaw to change the date and location of the stockholders meeting in direct response to a dissident stockholder nomination. It was apparent to the Schnell court that the purpose of the bylaw was to frustrate the aspirations of the competing nominees because the bylaw was changed immediately after the nomination occurred. Here, Talbot adopted the Proxy Fee-Shifting Bylaw in direct response to Alpha's Restructuring Proposal and apparent intent to nominate competing board members.

The Proxy Fee-Shifting Bylaw would make it impossible for Alpha to nominate a slate of directors in the upcoming stockholder's meeting. The Court in Schnell noted that the bylaw obstructions would create an "inequitable advantage" by changing the date and location of

the stockholder meeting. Schnell, 285 A.2d at 439. In the same way, this fee-shifting bylaw would make it implausible for Alpha to exercise its legitimate stockholder rights to engage in a proxy contest in the manner in which Alpha has represented to the press and the Securities and Exchange Commission (CC12) it intends to do. Op. at 12. Although not required to show intent of inequitable purpose, Talbot's board provides ample evidence that the bylaw is designed solely to deter Alpha's legitimate exercise of stockholder nomination rights. The statements of Talbot's board of directors also shed light on their intentions. One Talbot director wanted the bylaw to force Alpha to "think twice" before nominating a competing slate of directors to Talbot's board. Op. at 8. The CEO of Talbot warned that the proxy contest posed "a potential camel in the tent problem," while another director wanted to "raise the stakes for this guy [Womack]." Id. Given the timing, substance and context of Talbot's action, this Proxy Fee-Shifting Bylaw satisfies, and perhaps exceeds, the Schnell standard for inequitable purpose.

CONCLUSION

For the aforestated reasons, this Court should affirm the preliminary injunction against the enforcement of Talbot's illegal Proxy Fee-Shifting Bylaw.