IN THE SUPREME COURT OF THE STATE OF DELAWARE

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

APPELLEE'S REPLY BRIEF

Team R
Attorneys for Appellee
February 6, 2014

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I. Nature of Proceedings

Alpha Fund Management L.P., Appellee, Plaintiff below, brought suit seeking injunctive relief against Talbot, Inc. and individually against its directors, Appellants, Defendants below, in the Court of Chancery seeking to prevent Talbot and its Board from taking any action to enforce its recently adopted Proxy Fee-Shifting Bylaw at Talbot's May 2015 annual stockholders' meeting. On January 15, 2015, Chancellor Junge granted a preliminary injunction ordering Talbot and its Board be enjoined from taking any action to enforce the Bylaw.

On January 22, 2015, Appellants filed a timely notice of appeal seeking relief from the interlocutory order. This Court accepted the interlocutory appeal on January 29, 2015.

Appellee requests that this Court affirm the Order of the Chancery Court by holding that the Proxy Fee-Shifting Bylaw was adopted for the purpose of thwarting corporate democracy and thus must be preliminarily enjoined.

II. Summary of Argument

A. A bylaw must relate to the business of a corporation, the conduct of its affairs, and its rights or powers or the rights or powers of its stockholders, directors, or employees. The Supreme Court of Delaware has held that "bylaws that may otherwise be facially valid will not be enforced if adopted for an inequitable purpose." If management passes a bylaw for the purpose of perpetuating itself in office and to obstruct dissident stockholders from exercising their rights to undertake a proxy contest, management's conduct is deemed to be for an inequitable purpose. Here, Talbot's board of directors unilaterally passed the Proxy Fee-Shifting Bylaw, which imposes and losing shareholder challenger to pay reasonable expenses for the Board in its effort to resist the shareholder's proxy. This bylaw services the purposes of (1) entrenching the Board in office, and (2) deter shareholders from exercising their right to nominate new board members. Therefore, the Board's purpose in passing the bylaw was inequitable and should be held invalid.

B. The Court should affirm the Chancery Court's Order that Alpha was entitled to injunctive relief from the Proxy Fee-Shifting Bylaw adopted by Talbot's Board. Because the Bylaw was adopted with the intent to disenfranchise the stockholder vote, the Board's decision to adopt it is not entitled to the deferential protection offered by the business judgment rule. Instead, this Court should apply the standard set forth in *Blasius*, which shifts the burden to Talbot's Board to prove that the bylaw was neither disproportionate nor improperly motivated. A burden the Board has not met.

III. Statement of Facts

This appeal and underlying action arise out of Defendant Talbot, Inc.'s ("Talbot") board of directors' ("Board") decision to unilaterally pass a Proxy Fee-Shifting Bylaw. *Alpha Fund Mgmt. L.P. v. Talbot, Inc.*, Del. Ch. C.A. No. 10428, 9, Junge, C. (Jan. 14, 2015)(Op.)[hereinafter Op. at ___]. Talbot is a publicly traded manufacturing corporation formed in Delaware. Op. at 2. It has three divisions; a fasteners division, which manufactures critical fasteners for the aerospace and other industrial markets; a components division, which manufactures micro-electronic circuitry components for use in consumer tablets and gaming devices; and software division, which has a small but growing stake in the development of software for industrial manufacturing applications. ("Fasteners Division," "Components Division," and "Software Division" respectively) *Id.*

Plaintiff Alpha Fund Management L.P. (Alpha) is an investment management limited partnership formed in Delaware. *Id.* Alpha manages a fund for sophisticated investors and invests primarily in public equity in the United States. *Id.* In July of 2014, Alpha owned approximately 4% of Talbot's stock and it reached out to Talbot's CEO, Timothy Gunnison ("Gunnison") and recommended a restructuring proposal that it believed would help Talbot to operate more efficiently. ("Restructuring Proposal") Op. at 3. Gunnison was skeptical and refused to consider the Restructuring Proposal. *Id.* By December of 2014, Alpha increased its holdings in Talbot to approximately 7% of the total Talbot shares outstanding. Op. at 4.

On December 10, 2014, Alpha filed a Schedule 13D with the Securities and Exchange Commission disclosing the following: (1) its purchase of Talbot shares was for investment purposes only; (2) it would not seek to acquire a controlling stockholder position or otherwise try to acquire Talbot outright; (3) it had presented the Restructuring Proposal to Gunnison and had been rebuffed; and (4) it would seek to advance the Restructuring Proposal by subsequently nominating four directors for election to Talbot's board at the annual stockholders meeting in May of 2015. *Id.*

In response to Alpha's Schedule 13D filing, Talbot's Board held a special meeting on December 18, 2014. Op. at 5. At this meeting, the Board reviewed the details of the Restructuring Proposal as well as Talbot's ongoing plans for cutting costs within its three divisions. *Id.* The Board members confirmed its belief that its current plan would provide greater long term value (and possibly greater short term value) for Talbot and its stockholders than the Restructuring Proposal. Op. at 5–6.

After reaching this conclusion, the Board proceeded to craft a method for derailing, or at least deterring, Alpha's plan to nominate four directors by proposing the adoption of a Proxy Fee-Shifting Bylaw. Op. at 6–9.

Gunnison urged the Board to approve the Bylaw stating that the Restructuring Proposal would harm the Company by steering it towards a flawed short-term business model. Op. at 8. At least three other Board members shared the same sentiments, and another member expressed strong support for the bylaw in order to "hold Alpha at bay." *Id.*

Many of the Board's fears were premised on media reports that characterized Alpha as a "determined activist investor that had successfully caused other companies to undergo one form of restructuring or another." Op. at 5.

The Bylaw would impose joint and several liability for any expenditures Talbot or its Board incurred in opposing the solicitation of proxies by any stockholder(s) to nominate one or more directors to the board if the stockholder(s) is(are) not successful in achieving the election of at least half of the number of the nominees they proposed, or, election of a majority if an odd number of nominees is proposed. Op. at 7, fn.6. Although the Bylaw included a provision affording the Board, in the exercise of the directors' fiduciary duties, the flexibility to waive any fee-shifting obligations imposed by the Bylaw, there would be no obligation for the Board to do so. Op. at 6.

After concluding its deliberation and consulting with counsel, the Board voted unanimously to adopt the Bylaw. Op. at 9. The Board also resolved not to waive the obligation in regard to the Alpha proxy contest, but reserved the right for the new board to revisit the issue after the May 2015 election. *Id.*

As a result of the adoption of the Bylaw, Alpha would be obligated to reimburse Talbot for the costs[1] Talbot incurred in

[1] The costs for which liability will be imposed under the Bylaw include all processional fees, costs, and expenses of every kind and description (including, but not limited to, all attorney's fees, proxy solicitor and advisory fees, and other expenses). Op. at 7, fn.6.

opposing Alpha’s director nominees if fewer than one win election at the May 2015 annual stockholders’ meeting. Op. at 7.

On December 22, 2014, Alpha sent a certified letter to Talbot formally giving notice of its intention to place the names of four persons as its stockholder nominees for election to the Talbot board at the May 2015 annual stockholder’s meeting. Op. at 9. Later that day, Alpha filed this suit attacking the Bylaw and seeking a preliminary injunction to prevent Talbot and the Board from taking any action to enforce the Proxy Fee-Shifting Bylaw in connection with the annual stockholders’ meeting in May, 2015. Op. at 10.

IV. Argument

A. INJUNCTIVE RELIEF WAS PROPER BECAUSE TALBOT'S BOARD OF DIRECTORS ADOPTED THE PROXY FEE-SHIFTING BYLAW FOR AN INEQUITABLE PURPOSE.

1. Question Presented

Whether the conduct of Talbot's Board of Director's in unilaterally adopting the Proxy Fee-Shifting Bylaw was inequitable because it promotes entrenchment of the board in office and deters stockholder participation.

2. Scope of Review

Courts will review the grant or denial of a preliminary injunction for abuse of discretion without deference to the embedded legal conclusions of the trial court. *Kaiser Aluminum Corp. v. Matheson*, 681 A.2d 392, 394 (Del. 1996). The trial court must consider whether the plaintiff has established: (1) a reasonable probability of success on the merits; (2) that it will suffer irreparable harm if the injunction is not granted; and (3) the damage faced by the plaintiff if the injunction is not granted is greater than the damage to the defendant if the injunction is granted. *Id*.

3. Merits of Argument

The Proxy Fee-Shifting Bylaw passed by the Talbot board of directors is invalid since it was adopted for an inequitable purpose. If "management has attempted to utilize the corporate machinery … for the purpose of perpetuating itself in office," and to obstruct the legitimate efforts of dissident stockholders in the exercise of their rights to undertake a proxy contest against management, then management's conduct is deemed to be for an inequitable purpose.

Schnell v. Chris-Craft Indus., Inc., 285 A.2d 437, 439 (Del. 1971). In *Schnell*, the board of directors attempted to advance the date of the annual stockholder's meeting from January, 11, 1972, which was the date previously set in the by-laws, to December 8, 1981. The purpose of this change was to minimize the time that would otherwise have been available to the dissident shareholders to wage a proxy battle. *Id*. In coming to its decision the court reasoned that if a board of directors utilizes the corporate machinery for the purpose of perpetuating itself in office, and to obstruct legitimate efforts of dissident stockholders in the exercise of their rights to undertake a proxy contest against management, then the board is acting for an inequitable purpose. *Id*. The *Schnell* court eloquently explained, "inequitable action does not become permissible simply because it is legally possible." *Id*.

Here, the Board decided to pass a Proxy Fee-Shifting Bylaw in response to Alpha's Schedule 13D filing with the Securities and Exchange Commission, which declared its intention to nominate four directors. Op. at 9. In response to Alpha's filing, the Board called an emergency meeting where it proposed and subsequently passed the Proxy Fee-Shifting Bylaw. Op. at 9. This Bylaw imposes upon Alpha (or any other unsuccessful proxy contestant) the financial obligation to reimburse Talbot for all reasonable professional fees and expenses Talbot incurs in resisting Alpha's anticipated proxy contest if Alpha's campaign is "not successful." Op. at 6. The Board stated that it passed this bylaw quickly as a means of "keeping Alpha at bay," and that it "might get Alpha to think twice about [nominating

its own directors]." Op. at 8. As stated by the Board, this bylaw is intended to serve as a strong deterrent to minority stockholder participation by keeping minority stockholders (not just Alpha) from challenging (nominating new directors) the Board. *Id.*

In a manner similar to the defendants in *Schnell*, the Board here passed its Bylaw with grave ramifications – deterring dissident stockholders from participating in the nomination process. Therefore, following *Schnell*, the Court should find the Board's conduct to be inequitable.

The Supreme Court of Delaware has held that "bylaws that may otherwise be facially valid will not be enforced if adopted for an inequitable purpose." *ATP Tour, Inc. v. Deutscher Tennis Bund*, 91 A.3d 554, 558 (Del.2014). In *ATP*, the defendant's board of directors adopted a bylaw imposing joint and several liability on any stockholder who asserts a claim against the corporation for all fees, costs, and expenses, including attorney fees and other litigation expenses, incurred by the corporation if the stockholder does not obtain judgment on the merits in his or her favor. *Id.* at 556. Although neither Delaware law nor common law prohibit directors from enacting a fee-shifting bylaw, the *ATP* court determined that this particular bylaw could not be enforced. *Id.* at 558. Under Delaware General Corporation Law, a bylaw "must 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." 8 *Del. C.* § 109(b).

In reaching its decision that the defendant adopted the bylaw for an inequitable purpose, the *ATP* court first had to determine that the defendant acted for an improper purpose. *Id. at 559.* To determine whether a board of directors acted for an improper purpose a court must analyze (1) the board of directors' motive for amending or adopting the bylaw, and (2) the effect the bylaw would have on stockholders. *Id*. Here, following *ATP*, *because* the Board's actions were taken simply to entrench themselves within office, and were not in the best interest of the stockholders, the action is improper. Even if the board's motive is not for an improper purpose, a bylaw can have an inequitable effect upon stockholders if it hampers stockholder participation, or restricts stockholders in the exercise of their rights to undertake proxy contests against management. *Lerman v. Diagnostic, Inc.*, 421 A.2d 906, 908 (Del.Ch.1980).

The board's motives should be in the best interest of the company and the stockholders. *Petty v. Penntech Papers, Inc.*, 347 A.2d 140, 143 (Del.Ch.1975). Examples of unacceptable motives are when then the board of directors use corporate machinery in order to entrench themselves in office, or if they act out of a pure purpose of personal gain. *Schnell*, 285 A.2d at 439. However, if the board's decision to pass a bylaw or make a certain decision for the company that yields personal gain for the board is permissible if it also is in the best interest of the stockholders. This is seen where a board acts unilaterally in order to prevent a hostile takeover. *Williams v. Geier*, 671 A.2d 1368, 1377 (Del. 1996).

Here, the Board has shown a strong dislike towards Alpha based on comments made in the December 18th meeting. Op. at 8. This position of dislike stems from media reports that characterized Alpha as "determined activist investor that had successfully caused other companies to undergo one form of restructuring or another." Op. at 5. Independent of the Board's dislike of Alpha, this bylaw has the effect of deterring all shareholders from nominating directors to the Board since, the possibility of having to reimburse the Board for its expenses fighting the proxy may be too high.

While this deterrent is not absolute, it effectively works as a bar against all minority shareholders since the cost of losing is so high that they literally cannot afford to try to nominate anyone to the Board. First, the purpose of passing a bylaw simply to keep one shareholder away because the Board is scared of any proposals the shareholder may make is not in the spirit corporate democracy. Secondly, the effect that this bylaw has on all shareholders is so devastating that it constitutes an inequitable effect. Not only is this bylaw solely passed in response to the dislike of one shareholder, but it punishes all shareholders from attempting to do what corporate democracy encourages; active participation. The fear that Alpha is attempting to take over Talbot is irrational since pursuant to Alpha's Schedule 13D filing, its purpose in buying Talbot shares was to serve investment purposes and it would *not* seek to acquire the company outright. Op. at 4.

While the principles set for in *Schnell* are important, their "application … should be reserved for those instances that threaten

the fabric of the law, or which by an improper manipulation of the law, would deprive a person of a clear right." *Accipiter Life Sciences Fund, L.P. v. Helfer*, 905 A.2d 115, 124 (Del. Ch. 2006). In *Accipiter*, the defendant announced the date of its annual stockholders' meeting in a press release that focused primarily on the company's earnings results in an attempt to eliminate stockholder proposals. *Id.* at 117. The press release required stockholders to give notice of their intent to nominate a slate of directors within ten days. *Id.* However, this information was printed at the end of the earnings release, just before the boilerplate language preceding the financial tables. *Id.* at 119. The plaintiff stockholder alleged that the notice was not adequate due to its placement, which caused him to miss the notice window. *Id.* at 120.

The *Accipiter* court concluded that the placement of the meeting notice did not constitute an unfair manipulation of the voting process in such a manner as to constitute a grave intrusion into the fabric of corporate law articulated in *Schnell* and its progeny. *Id.* at 127. In *Lerman*, the directors' conduct was determined to be inequitable where the board passed a bylaw requiring stockholders to announce their intent to wage a proxy war 70-days before the next annual stockholders' meeting. *Lerman*, 421 A.2d at 914. The board then proceeded to set the date for the next annual stockholders' meeting 63-days away. *Id.* at 911. The *Lerman* court reasoned that because the board's action made it impossible for any stockholder to comply with the new bylaw, it was invalid. *Id.* at 907.

The next case the *Accipiter* court examined in the line of *Schnell* cases was *Aprahamian v. HBO & Co.*, 531 A.2d 1204, 1205 (Del. Ch. 1987). In *Aprahamian*, the board postponed the annual stockholder's meeting for roughly a month based on a report that stated a group of dissident stockholders might win its proxy contest. *Id.* The *Aprahamian* court explained that, although an annual meeting could be postponed if it was in the interests of the stockholders, the burden of proof would be on the board to show that the postponement was in the best interest of the stockholders. *Id.* at 1207. The court concluded that the board's purpose of rescheduling the annual meeting only in light of the fact that it may lose the proxy contest was not in the best interest of the stockholders and thus, the bylaw was invalid. *Id.* at 1208.

In distinguishing *Schnell*, *Lerman*, and *Aprahamian*, the *Accipiter* court explained that the *Accipiter* defendants did not act with the same specific intent to limit the shareholder's rights to nominate and elect a dissident slate. *Accipiter,* A.2d at 126. Furthermore the board of directors was not faced with a proxy contest, expected proxy contest, nor did it reschedule the meeting after it had already been scheduled. *Id.* The court focused on the board's intent in concluding that it did not meet the *Schnell* standard, which is required for equitable relief. *Id.* at 127. This case was distinguished from the *Schnell* line of cases because equitable relief can only be granted under "compelling circumstances that suggest that the company unfairly manipulated the voting process in such a serious way as to constitute an evident or grave incursion into the fabric of corporate law." *Id.*

Unlike the defendants in *Accipiter*, the Board here acted with the specific intent to deter shareholders from nominating new directors. Here, the Board's primary purpose was to create a strong deterrent to keep Alpha from nominating new people for the board of directors. Subsequently, in passing the Proxy Fee-Shifting Bylaw, the Board created a strong deterrent for all shareholders (not just Alpha) to seriously reconsider any moves to nominate a new slate of directors. The Board's actions more closely resemble the *Schnell* line of cases in that the Board acted with the direct intent to entrench itself in a position of power by hampering shareholder rights.

While the conduct of the *Accipiter* board was not applaud-worthy it still did not manipulate the voting process. The stockholders in *Accipiter* could have discovered the new bylaw requirement had they read the press release more carefully. Here, the Board has not even afforded the stockholders with a legitimate opportunity to simply have their opinions heard. The effect of the Proxy Fee-Shifting Bylaw is oppressive on the stockholders since it deters them from actively participating, makes it more expensive for any minority stockholder who may consider nominating a new slate, and almost entirely ensures that the incumbent board members will not be challenged. These are not the attributes that corporations should strive for, since they are not in the spirit of corporate democracy and equity. Corporations should encourage shareholder input in order to gain better ideas, and to have a board of directors that actually reflects the ideas of *all* the shareholders rather than a few. For this reason, the Board's

actions here are more in sync with the "*Schnell* cases," and thus the Chancery Court was correct in holding the bylaw invalid.

The nature of the board of director's relationship to the stockholders is unique in that, the board stands in a position of trustee. *Petty*, 347 A.2d at 143. Because of this relationship, the utmost good faith and fair dealings is required of the board, especially where their individual interests are concerned. *Id*. In *Petty*, the defendants, two of the four board members, attempted to redeem all of the company's outstanding Series A Preferred shares except for those owned by them personally. *Id*. at 141. The consequence of this decision was that defendants would be given full control of the corporation thereafter, which would be accomplished by spending $1.9M of corporate funds to redeem all the outstanding Series A shares. *Id*. In concluding that the plaintiff was entitled to enjoin the defendants from taking such action, the court reasoned that the fact a bylaw provision permits a given action does not automatically insulate the directors against scrutiny of purpose. *Id*. at 143.

Here, the Board unilaterally passed the Proxy Free-Shifting Bylaw, which imposes all reasonable costs including attorney fees on any challenger who is unsuccessful in having their nominees elected to the board. This Bylaw acts as a deterrent to any minority stockholder since the cost of potentially losing a proxy will be too costly for the stockholder to incur. In this way, the bylaw promotes keeping the existing Board in office and thus, serves as an entrenchment tool. As stated in *Petty*, a board's relationship to its stockholders requires the "utmost good faith and fair dealing," especially when the

individual board members' interest are concerned. Here, the act of deterring stockholders from participating is not in the best interest of the stockholders since it discourages their input on what direction the company should go in. Therefore, the Board's decision to pass the Bylaw serves an inequitable purpose since it promotes the Board's entrenchment in office and is not in the best interest of the stockholders.

B. THE CHANCERY COURT'S IMPOSITION OF INJUNCTIVE RELIEF WAS PROPER BECAUSE PLAINTIFF DEMONSTRATED A REASONABLE PROBABILITY OF SUCCESS ON THE MERITS CONCERNING THE PROXY FEE-SHIFTING BYLAW.

1. Question Presented

Whether the Proxy Fee-Shifting Bylaw adopted by the Talbot Board of Directors was intended to disenfranchise the stockholder vote and whether Alpha has a reasonable probability of success on the merits because the bylaw was disproportionate to the threat presented by Alpha's intention to nominate four directors and was, additionally, improperly motivated.

2. Scope of Review

The decision to grant a preliminary injunction is appropriate if a plaintiff has established a reasonable probability of success on the merits; irreparable harm; and a balance of equities in its favor. *Revlon, Inc. v. Macandrews & Forbes Holdings*, *Inc.*, 506 A.2d 173, 179 (Del. 1986). Talbot has conceded that Alpha will be entitled to a preliminary injunction if it is able to demonstrate a reasonable probability of success on the merits. Op. at 10-11. The applicable standard of appellate review of a decision to grant or deny a preliminary injunction is abuse of discretion without deference to the

embedded legal conclusions of the lower court. *Kaiser Aluminum*, 681 A.2d at 394.

3. Merits of Argument

a. By adopting the Proxy Fee-Shifting Bylaw, Talbot's Board of Directors intended to disenfranchise the stockholder vote.

The scope of the stockholders' right to vote has been held to include the right to nominate a contesting slate of candidates. *Hubbard v. Hollywood Park Realty Enterprises, Inc.*, 1991 WL 3151 (Del. Ch.). Nothing in Delaware General Corporation Law ("DGCL") forbids the enactment of fee-shifting bylaws. *ATP Tour*, 91 A.3d at 558. However, it is well-established that inequitable conduct by directors that interferes with a fair voting process is not permissible and requires relief. *Linton v. Everett*, 1997 WL 441189 (Del. Ch. 1997). For example, the Delaware Superior Court has held that board action intended to obstruct the legitimate efforts of dissident stockholders to exercise their rights is inequitable and contrary to established principles of corporate democracy. *Schnell*, 285 A.2d at 439. Likewise, when another board changed the date of the annual meeting in order to frustrate the stockholders' attempt to replace incumbent management, that court held that the date change was an inequitable restraint on the stockholder's franchise. *Lerman*, 421 A.2d at 907. Similarly, another court held that board action to delay the annual meeting so that stockholder proxies would expire interfered with the stockholders' franchise because it would likely defeat the efforts of the nominees and the will of the stockholders. *Aprahamian*, 531 A.2d at 1208-09.

Here, the Proxy Fee-Shifting Bylaw threatens to impose an exorbitant financial obligation, estimated to be $8 million to $14 million, on unsuccessful nominees. Op. at 8. The threat of incurring this expense will effectively bar the stockholders from exercising their corporate right to nominate directors in a manner similar to the restraint the *Lerman* court held to be inequitable. In fact, Talbot's Board members have testified that they adopted the Bylaw for the purpose of discouraging Alpha from proceeding with nominating its slate of directors. Op. at 8-9. Therefore, following *Aprahamian*, Talbot's Proxy Fee-Shifting Bylaw was intended to interfere with the stockholders' franchise which, following *Hubbard*, includes their right to nominate a contesting slate of candidates.

b. Because the Proxy Fee-Shifting Bylaw was intended to disenfranchise the stockholder vote, the burden shifts to Talbot to prove that the bylaw was neither disproportionate nor improperly motivated.

Because of the statutory authority vested in a board to manage a corporation, courts apply the business judgment rule when reviewing the acts of a board. *MM Companies, Inc. v. Liquid Audio, Inc.*, 813 A.2d 1118, 1127 (Del. 1983). 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." *Id.* (*quoting Aronson v. Lewis*, 473 A.2d 805, 811 (Del. 1984). However, due to the importance of the stockholders' franchise to corporate governance, when the action taken by a board interferes with the effectiveness of that franchise, stricter scrutiny is

required. *Blasius Indus. V. Atlas Corp.*, 564 A.2d 651, 659 (Del. 1988).

In *Blasius*, defendant Atlas' board added two members to its seven-member board in direct response to notification that Blasius, a 9% stockholder that had previously proposed a leveraged recapitalization or sale of Atlas, intended to solicit stockholder approval to increase the size of the board to fifteen. *Id.* at 652. As a result of the Atlas board's action to increase the size of the board preemptively, the stockholders were precluded from obtaining a majority on the board, even if they were successful in their attempt to increase the board to fifteen. *Id.* at 655.

The court began its analysis of the Atlas board's actions by noting that "[g]enerally, shareholders have only two protections against perceived inadequate business performance. They may sell their stock (which, if done in sufficient numbers, may so affect security prices as to create an incentive for altered managerial performance), or they may vote to replace incumbent board members." *Id.* at 659. The court held that although the Atlas board may have been justified in taking certain steps to combat the threat it perceived in Blasius' strategy, its decision to exercise its power for the primary purpose of foreclosing the stockholders from exercising their rights was not justified. *Id.* at 663. It opined that the only rationale evident in the board's action was the mistaken belief that the board knew better than the stockholders what would be best for Atlas. *Id.* The court concluded that when board action is taken with the primary purpose of interfering with stockholders' rights, the

board "bears the heavy burden of demonstrating a compelling justification for such action" despite having acted in good faith. *Id. at 661.*

Here, the facts are similar to those taken in *Blasius.* Upon learning of Alpha's intent to nominate four directors to the board, Talbot's board reacted to what it perceived to be a risk to Talbot. As in *Blasius*, the Board reacted with the same mistaken belief that it knew better than the stockholders. The Board sprang into action to devise a plan intended to deter stockholders from exercising their right to nominate directors by imposing the oppressive threat in the form of the Proxy Fee-Shifting Bylaw. Therefore, following *Blasius*, because the Bylaw interfered with the stockholder franchise, the Board bears the burden of demonstrating that it had compelling justification for adopting it.

This Court has developed a less stringent standard for reviewing the actions of boards taken in response to the threat of a hostile takeover. *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985). The *Unocal* standard consists of a two-part test in which the reasonableness of the board's action is weighed against the threat posed by the hostile third party. *Id.* at 955. In *Unocal,* the Court determined that where a hostile takeover bid was inadequate and coercive, the exchange offer the board offered in response was in direct proportion to the threat and was, therefore, justified because of the board's fiduciary duty to act in the best interests of the corporation and its stockholders. *Id.* at 958. Here, however, the facts are distinguishable because Talbot's Board was not reacting to

the hostile threat of takeover from a third party. Instead, the Board was attempting to prevent stockholders from exercising their right to nominate directors. Therefore, because the facts here are distinguishable from those in *Unocal* the Board’s actions here were not justified.

V. Conclusion

The Chancery Court’s Order granting preliminary injunction should be affirmed because Talbot’s Proxy Fee-Shifting Bylaw is inequitable. It was adopted for the purpose of impairing or impeding the stockholder franchise and Talbot has not presented any evidence of a compelling justification warranting the infringement of the stockholders’ rights.