IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

IN AND FOR NEW CASTLE COUNTY

ALPHA FUND MANAGEMENT L.P.,	)	
	)	
Plaintiff,	)	
	)	
v.	)	
	)	
TALBOT, INC., TIMOTHY GUNNISON, FRANCOIS PAYARD, NAOMI ROTHMAN, ROSARIA GABRIELLI, MARSHALL CANNON, AJEET GUTPA, DANIEL LEMON, CLARE LEONARD and PATRICK RHANEY,	)	Civil Action No. 10428-CJ
	)	
Defendants.	)	

January 12, 2015, Submitted
January 14, 2015, Decided

OPINION

Philip P. Seitz, John E. Traynor, and Stephen T. Reed, GEDDES, ARSHT, HERNDON, LESSNER & LAMB LLP, Wilmington, Delaware, *Attorneys for Plaintiff Alpha Fund Management L.P.*

Claire T. Westerduin, Eugene T. Sager, Estefenia P. Arroyo-Lopez, and Jared L. Weinstein, SLATE, WELCH, GRANT, TAYLOR & NICHOLS LLP, Wilmington, Delaware, Robert H. Hill and Luis C. Zavala, JACKSON and WYETH LLP, Baltimore, Maryland, *Attorneys for Defendant Talbot, Inc.*

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JUNGE, Chancellor

I. INTRODUCTION

This case involves the validity of a board-adopted corporate bylaw that requires a dissident shareholder group who launches an ultimately unsuccessful proxy contest to reimburse the corporation for reasonable professional fees and expenses incurred by the corporation in resisting the dissident group's unsuccessful campaign. This proxy contest fee-shifting bylaw (the "Proxy Fee-Shifting Bylaw") defines an unsuccessful proxy contest as one in which less than half of the dissident group's nominees win election to the board at the annual meeting of stockholders.

In this instance, the board of directors (the "Board") of Talbot Inc. ("Talbot" or the "Company") adopted the Proxy Fee-Shifting Bylaw in December 2014 in response to a then recent Schedule 13D filing (the "Schedule 13D") in which Plaintiff disclosed its 7% ownership stake in the Company and Plaintiff's intention to nominate up to four candidates for election to the Company's nine-person Board at the next annual meeting of stockholders in May 2015. The evidence submitted in the context of the pending motion for a preliminary injunction, as more fully described in this opinion, supports a provisional finding that the Board, though well informed in the matter, adopted the Proxy Fee-Shifting Bylaw for an inequitable purpose, namely, to obstruct the legitimate efforts of Plaintiff to undertake a proxy contest. Accordingly, I grant Plaintiff's motion for a preliminary injunction preventing Talbot and the Board from taking any action to enforce the Proxy Fee-Shifting Bylaw in connection with any proxy contest for the election of directors to the board of Talbot at the May 2015 annual stockholders meeting. I do not rule on Plaintiff's claim that the Proxy Fee-Shifting Bylaw is facially invalid, although I do have substantial concerns as to its fundamental legitimacy given the Proxy Fee-Shifting Bylaw's chilling effect on the stockholder franchise.

II. FACTUAL BACKGROUND

A. The Parties.

Plaintiff Alpha Fund Management L.P. ("Alpha" or the "Alpha Fund") is a relatively small but exclusive investment manager formed as a limited partnership under the laws of Delaware and headquartered in New York City. Alpha manages a fund that includes sophisticated investors ranging from insurance companies to pension funds and university endowments. It primarily invests in public equity in the United States. As of the end of last year, the Alpha Fund owned an equity portfolio worth $1.1 billion, which contains only 11 positions mainly in consumer goods, manufacturing and services stocks. The Alpha Fund was established in 2006 by its founder and Chief Executive Officer Jeremy Womack and under Womack's leadership, Alpha has regularly been an activist stockholder in the companies in which the Alpha Fund has invested.

Defendant Talbot is a publicly traded Delaware corporation headquartered in Chestertown, Maryland. Talbot's shares are traded on the New York Stock Exchange and it presently has outstanding approximately 75 million shares of common stock. With its recent stock market price of $30 per share, Talbot has a market capitalization of approximately $2.25 billion. For its most recent fiscal year ending September 30, 2014, Talbot posted net earnings after taxes of $120 million on revenues of $1.1 billion. Talbot in engaged primarily in the manufacture of highly engineered, critical fasteners for aerospace and other general industrial markets (the "Fasteners Division"). Talbot also manufactures micro-electronic circuitry components for use in consumer tablets and gaming devices (the "Components Division") and has a small but growing stake in the development of software for industrial manufacturing applications (the "Software Division").

The nine individual defendants comprise the members of the Board of Talbot. Of these nine members of the Board, only one is an inside director: Chairman and Chief Executive Officer Timothy Gunnison. The remaining eight members of the Board are: Francois Payard (lead independent director), Naomi Rothman, Rosaria Gabrielli, Marshall Cannon, Ajeet Gupta, Daniel Lemon, Clare Leonard and Patrick Rhaney. Talbot does not have a classified board of directors and thus all nine directors stand for election annually and will do so at the upcoming annual stockholders meeting in May 2015.

B. Alpha Acquires a Stake In Talbot and Proposes a Restructuring.

Beginning in late 2013, the Alpha Fund, under the direction of Womack, began to acquire shares of stock in Talbot. By June of 2014, Alpha had acquired 3 million shares of Talbot, or approximately 4% of the outstanding shares. Shortly after reaching this investment plateau, Womack reached out to and met with Defendant and CEO Gunnison on July 10, 2014, suggesting a detailed restructuring proposal (the "Restructuring Proposal") for Talbot that Womack argued would substantially improve value for Talbot's stockholders. In brief, Womack argued to Gunnison (and continues to assert) that the Company is losing value with bloated operating expenses attributable to managing three unrelated divisions that offer little to no synergy. Under the Restructuring Proposal as advocated by Womack, Talbot could create immediate shareholder value by shedding its Components and Software Divisions (both of which have lower profit margins than the more profitable Fasteners Division), either through outright sales or spin-off transactions, and thereby cutting overall operating expenses to focus on its core strength and most profitable business, the Fasteners Division.

Gunnison expressed immediate skepticism to Womack about the merits of the Restructuring Proposal and suggested that Womack's analysis, though detailed and highly sophisticated, vastly underestimated the synergy among the Company's current three Divisions. Moreover, argued Gunnison, Womack's analysis failed to account for significant cost cutting measures then already under way at the Company.

C. Alpha Files the Schedule 13D and Discloses Its Intention to Seek Directorships.

Between July and December, Alpha continued to acquire Talbot shares at prices ranging between $22 and $26 per share. On December 10, 2014 Alpha filed the Schedule 13D with the Securities and Exchange Commission (the "SEC") disclosing that Alpha holds 5.25 million shares of Talbot common stock, or 7% of the total Talbot shares outstanding. At the current market price of $30 per share, Alpha's stake in Talbot is currently worth nearly $160 million.[1]

Alpha also disclosed in the Schedule 13D that its purchase of Talbot shares was for investment purposes only and that Alpha would not seek to acquire a controlling stockholder position or otherwise try to acquire the Company outright.[2] However, Alpha further disclosed in in the Schedule 13D that it had presented the Restructuring Proposal to Gunnison and had been rebuffed, and thus would seek advance the Restructuring Proposal by subsequently nominating four directors for election to the board of Talbot at the annual stockholders meeting in May 2015.

[1] Alpha's Talbot stake is worth $157.5 million at the current market price of $30 per share. According to the Schedule 13D filing, Alpha's aggregate basis for its 5.25 million Talbot shares is approximately $132 million. The record shows that Alpha has made no additional purchases of Talbot stock after filing the Schedule 13D.

[2] Talbot has in place a poison pill rights plan with a 15% flip-in trigger for any person acquiring a 15% stake without prior approval by the Talbot board. The parties agree that this 15% trigger only applies to shares actually acquired and owned and thus does not apply to voting proxies granted to any person conducting a proxy context for representation on the Talbot board. No claim challenging the Talbot poison pill is presented in this case.

D. The Board Adopts the Proxy Fee-Shifting Bylaw.

Alpha's Schedule 13D filing was immediate news both inside and outside the Company. Externally, various media sources reported on Alpha's Schedule 13D filing, describing Womack and the Alpha Fund as a determined activist investor that had successfully caused other companies to undergo one form or restructuring or another. In two recent instances, Alpha has persuaded the boards of other publicly traded companies to agree to nominate two of Alpha's nominees to the boards of those companies. Internally, CEO Gunnison immediately called a special meeting of the Board for December 18, 2014 to discuss this new development. The Board had already convened its regularly monthly meeting on December 5, 2014 and thus the December 18 meeting was devoted exclusively to the events surrounding the then recent Alpha Schedule 13D filing.

All nine members of the Board were present for the December 18 meeting. Also in attendance were (1) Mack Rosewood, Vice President for Finance and Operations; (2) Renee Stone, the Company's Vice President and General Counsel; and (3) Sandra Ellsworth, a partner with the Company's regular outside law firm of Jackson and Wyeth LLP ("Jackson and Wyeth").[3] The December 18 meeting lasted more than two hours and included a detailed presentation by Rosewood about the terms of the Restructuring Proposal, as originally presented by Womack to Gunnison in July 2014 and as similarly set forth in the Schedule 13D. Rosewood also reviewed the ongoing cost cutting plans for the Company's three divisions. All members of the Board were in agreement that the current business plan in effect for Talbot promises greater

[3] Jackson and Wyeth is located in Baltimore, Maryland. The Court notes that Ellsworth is a licensed Delaware attorney with substantial transactional experience involving Delaware corporations and other business entities.

long term value (and possibly greater short term value) for the Company and its stockholders than the Restructuring Proposal.

At the December 18 meeting, the Board also heard presentations from legal counsel, both from in-house General Counsel Stone and outside counsel Ellsworth, about the terms and mechanics of the Proxy Fee-Shifting Bylaw. Defendants waived the attorney-client privilege with regard to this legal advice and the deposition testimony of both Stone and Ellsworth demonstrates that the Board well understood the Proxy Fee-Shifting Bylaw before adopting it.[4] In her presentation to the Board, Ellsworth also reported on evidence[5] showing that proxy contests impose on corporations expenses ranging from $800,000 to $3 million in fees for small firms, and $4 million to $14 million for larger firms. Ellsworth further advised the Board that they could properly consider, in the exercise of their good faith business judgment in deciding whether to adopt the Proxy Fee-Shifting Bylaw, the potentially adverse financial impact of such proxy contest costs on the corporation and its stockholders. Finally, Stone explained that the terms of the proposed Proxy Fee-Shifting Bylaw would also afford the Board the flexibility (but not the obligation), in the proper exercise of the directors' fiduciary duties, to waive any fee-shifting obligations otherwise imposed by the Proxy Fee-Shifting Bylaw. As noted earlier, the Proxy Fee-Shifting Bylaw would, if adopted by the Board and not subsequently waived, impose upon Alpha (or any other unsuccessful proxy contestant) the financial obligation to reimburse the Company for all reasonable professional fees and expenses it might incur in resisting Alpha's

[4] Notably, but understandably, Ellsworth and her firm declined to provide an unqualified opinion as the legal validity of the Proxy Fee-Shifting Bylaw under Delaware, explaining correctly that no precedent had considered such a bylaw one way or the other. Ellsworth did offer the opinion of Jackson and Wyeth that there was a substantial legal basis on which to conclude that the Proxy Fee-Shifting Bylaw is valid under Delaware law. Ellsworth also made clear that her firm was not offering an opinion as to the viability of any equitable challenge to the Board's adoption of the Bylaw.

[5] *See Bus. Roundtable v. SEC*, 647 F.3d 1144, 1150 (D.C. Cir. 2011).

anticipated proxy contest if Alpha's campaign is "not successful."[6] The Proxy Fee-Shifting Bylaw defines a proxy context as "not successful" if less than half of the dissident group's nominees win election to the board at the annual meeting of stockholders. Thus in this instance, Alpha would be obligated to reimburse Talbot for the Company's proxy contest costs if just one or none of of Alpha's four nominees win election to the Talbot board at the May 2015 annual stockholders meeting.[7] Conversely, Alpha would have no obligation to reimburse Talbot if two or more of its four nominees are elected.

The parties are in sharp disagreement about the amount of professional fees and expenses that Talbot might reasonably incur (and then subsequently impose on Alpha if it is "not

[6] The full text of the Proxy Fee-Shifting Bylaw is a follows:

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

[7] Though not relevant here, the Proxy Fee-Shifting Bylaw would impose costs on an insurgent group nominating an odd number of nominees unless a "majority" of those nominees (*e.g.*, 3 of 5) won election to the Talbot board in a contested election.

successful") in resisting Alpha's proposed proxy campaign. Rosewood estimated to the Board, and subsequently testified in deposition, that in his opinion such costs might approximate $8 million "give or take," including legal and proxy consulting fees and printing and other costs. Alpha's proxy solicitor, Bantry & Bandon LLP ("Bantry & Bandon"), estimates this anticipated cost as likely in excess of $12 million.[8]

Rosewood, Stone and Ellsworth were all simultaneously excused from the December 18 Board meeting after all three of their presentations were concluded. Thereafter the nine members of the Board continued their discussions among themselves and the deposition testimony of these directors offers interesting insight into the Board's mindset.[9] Gunnison urged the Board to approve the Proxy Fee-Shifting Bylaw. Gunnison disparaged the Restructuring Proposal as an "ill-conceived short term plan at best" that would harm the Company in the long run. Gunnison warned the Board that he saw the proxy contest with Alpha as a "potential camel in the tent problem" that could eventually steer the Company toward a flawed short-term business model. At least three other Talbot directors shared a similar sentiment. Gabrielli expressed strong support for adopting the Proxy Fee-Shifting Bylaw as a means of holding Alpha at bay, stating that "we need to raise the stakes for this guy [Womack]." Cannon agreed, suggesting that the risk of added costs imposed by the Proxy Fee-Shifting Bylaw "might get Alpha to think twice about all this." Leonard also disparaged Womack and Alpha as "playing financial games for purely short term wins" and that "if the [Proxy Fee-Shifting] Bylaw helps to

[8] At his deposition Rosewood was skeptical about the possibility that the Company's reimbursable costs would approach this $12 million figure. However, Rosewood also acknowledged that the Company would be within its rights under the Proxy Fee-Shifting Bylaw to demand reimbursement from Alpha for $12 million if in fact Talbot incurred professional fees and costs of $12 million to defeat the Alpha proxy campaign.

[9] All quotations by directors are from transcripts of deposition testimony that is not appended to this opinion.

stop Alpha, then I'm for it." Not all directors expressed these views but apparently no one expressed disagreement with them. The only other testimony available to the Court in this context is that of lead independent director Payard who couched his support of the Proxy Fee-Shifting Bylaw as allowing the Company to recoup its costs if an insurgent's proxy contest was not successful.

Following their discussion, the Board unanimously approved a resolution adopting the Proxy Fee-Shifting Bylaw. The Board then resolved not to waive the fee-shifting obligation for the Alpha proxy contest, but agreed that this non-waiver determination could be revisited after the conclusion of the contest. Immediately following the December 18 meeting, Stone drafted and disseminated a press release announcing the Board's adoption of the Proxy Fee-Shifting Bylaw and, describing its essential components. This December 18 press release also disclosed that the Board had decided not to waive the fee-shifting provision for any proxy contest by Alpha and that the Board could (but was not required to) reexamine this non-waiver determination after conclusion of the proxy contest.

E. Alpha Nominates Its Four Nominees to the Talbot Board and Files Suit.

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 stockholders meeting. Alpha's four nominees are: (1) Womack, (2) Barbara Kempner, CFO of BSL, Inc., a publicly traded financial firm; (3) Jonah Kudlow, Dean and Distinguished Professor of Economics with the Wharton School of the University of Pennsylvania; and (4) Randall Zappa, Executive Vice President of Concord Inc., a publicly traded manufacturer of household furniture.

Later that same day, Alpha filed suit in this Court attacking the Proxy Fee-Shifting Bylaw as facially invalid under Delaware law and otherwise the product of inequitable conduct and thus a violation of fiduciary duty by the Board. Alpha also filed a motion for a preliminary injunction to prevent Talbot and the Board from taking any action to enforce the Proxy Fee-Shifting Bylaw in connection with any proxy contest for the election of directors to the board of Talbot at the May 2015 annual stockholders meeting. Alpha sought and obtained an order granting expedited discovery on the motion for a preliminary injunction. Following expedited document and deposition discovery and the submission of excellent briefs, the Court heard argument on Plaintiff's motion for a preliminary injunction on January 12, 2015. This opinion sets forth the reasons for the Court's decision to grant Plaintiff's motion.[10]

III. LEGAL ANALYSIS

A. Standards for a Motion for a Preliminary Injunction.

Under our well settled standards for evaluating a motion for a preliminary injunction, the moving party must demonstrate that there is a reasonable probability of success on the merits of the underlying claim, that there is an imminent threat of irreparable harm and that a balancing of the equities of the case tips in its favor.[11] Defendants concede that if plaintiff were to demonstrate a reasonable probability of success on the merits at a final hearing, a preliminary

[10] As sometimes occurs in expedited cases of this nature, additional events transpired after the completion of discovery that are relevant to the litigation. Thus counsel for Talbot advised the Court at oral argument on January 12 that the Board had met on January 9 to consider Alpha's four nominees. It is apparently undisputed that the Board decided not to support Alpha's nominees and, acting upon the recommendation of the Board's nominating committee, unanimously decided to nominate the nine incumbent directors of Talbot for reelection by the Talbot stockholders at the annual stockholders meeting scheduled for May 21, 2015.

[11] *SI Management L.P. v. Wininger*, 707 A.2d 37, 40 (Del. 1998); *In re Micromet, Inc. Shareholders Litig.*, 2012 Del. Ch. LEXIS 1, *13-14 (Del. Ch. Feb. 29, 2012).

injunction would be appropriate. Accordingly, the balance of this opinion addresses that probability.

B. Plaintiff Makes a Colorable Claim for Facial Invalidity of the Proxy Bylaw.

Section 109(a) of the Delaware General Corporation Law ("DGCL") permits stockholders and -- as here, when a company's certificate of incorporation expressly confers such power on the board -- the directors, to adopt, amend or repeal bylaws.[12] DGCL Section 109(b) provides in relevant part that bylaws "may contain any provision not inconsistent with law or the certificate of incorporation, relating to the business of the corporation, the conduct of its affairs … or the rights or powers of its stockholders…."[13]

Under our corporation law, bylaws are "presumed to be valid."[14] However, as our Supreme Court explained in the recent *ATP* case, a facially valid bylaw must meet each of three separate requirements. The bylaw must (1) be authorized by the DGCL; (2) be consistent with the corporation's certificate of incorporation; and (3) "not be otherwise prohibited."[15] The Court in *ATP* also made clear that this third analytical inquiry into facial validity encompasses an examination of a bylaw based on our "principle[s] of common law…."[16]

The parties have submitted extensive argument on whether the Proxy Fee-Shifting Bylaw contravenes the DGCL. Most importantly, however, Plaintiff asserts that the Board has unilaterally and improperly imposed substantial added costs upon it, or at least created the ominous threat of such costs, as the price of exercising its right of corporate democracy to

[12] 8 *Del.C.* § 109(a).
[13] 8 *Del.C.* § 109(b).
[14] *Frantz Mfg. Co. v. EAC Indus.*, 502 A. 2d 401, 407 (Del. 1985).
[15] *ATP Tour, Inc. v Deutscher Tennis Bund*, 921 A.3d 554, 557-558 (Del. 2014).
[16] *Id*. at 558.

undertake a proxy contest against management and the incumbent Board. Plaintiff asserts that the Proxy Fee-Shifting Bylaw thus has an improper chilling effect by effectively preventing it from conducting a proxy contest for seats on the Talbot board. Indeed, Plaintiff has represented to this Court, and stated publicly in its press releases and SEC filings that it will abandon the upcoming proxy context if judicial relief invalidating or otherwise restraining enforcement of the Proxy Fee-Shifting Bylaw is not obtained.

The Court acknowledges that Plaintiff makes a colorable if not substantial claim regarding the facial validity of the Proxy Fee-Shifting Bylaw. It is troubling to the Court that the Proxy Fee-Shifting Bylaw would prevent an otherwise robust proxy contest for the composition of the Talbot board from going forward and would result in an uncontested election of the incumbents. On the other hand, the facial validity issue presents an important question of first impression and in recent cases our Courts notably have upheld board-adopted bylaws that arguably impinged on the rights of stockholders to hold boards accountable through shareholder litigation.[17] Because I conclude, for the reasons set forth below, that the Proxy Fee-Shifting Bylaw was adopted by the Board for an inequitable purpose and thus will be preliminarily enjoined on that basis, the Court declines to rule on its facial validity.

[17] *ATP*, 91 A.3d 554 (upholding facial validity of a board-adopted bylaw for non-stock corporation that shifted the company's litigation fees to an unsuccessful stockholder plaintiff); *City of Providence v. First Citizens BancShares, Inc.*, 99 A.3d 229 (Del. Ch. 2014) (upholding facial validity of a board-adopted exclusive forum bylaw for Delaware corporation that required any shareholder litigation to be brought in North Carolina where company was headquartered); *Boilermakers Local 154 Ret. Fund v. Chevron Corp.*, 73 A.3d 934 (Del. Ch. 2013) (upholding facial validity of a board-adopted exclusive forum bylaw for Delaware corporation that required any shareholder litigation to be brought in Delaware).

C. The Board Adopted the Proxy Bylaw for an Inequitable Purpose.

The enforceability of a facially valid bylaw "depends on the manner in which it was adopted and the circumstances under which it was invoked."[18] As our Supreme Court explained in *ATP*, an otherwise facially valid bylaw "will not be enforced if it was adopted or used for an inequitable purpose."[19] To illustrate this important principle, the Supreme Court in *ATP* referred to the "landmark" case of *Schnell v. Chris-Craft Industries*[20] in which the Court set aside a board-adopted (and facially valid) bylaw amendment that accelerated the date of the corporation's annual stockholder meeting in an effort to thwart an emerging proxy contest. [21]

I regard the Court's citation of *Schnell* in *ATP* to be of utmost significance to the disposition of Plaintiff's challenge to the Proxy Fee-Shifting Bylaw in this case. As here, the board in *Schnell* adopted the bylaw in that case in reaction to the threat of a then recently disclosed proxy contest to challenge the board's incumbency.[22] The board in *Schnell* knew that the dissident group had only recently filed their preliminary proxy materials with the SEC, *i.e.*, in mid-October, anticipating the originally scheduled January 11 stockholder meeting date. By amending the bylaw and moving up the stockholder meeting sooner, from January 11 to early December 8, the board in *Schnell* thus acted to prevent the dissident group from conducting an election contest at all, because the dissident's proxy materials would likely not clear SEC review in time to allow for a meaningful electoral challenge by the dissidents. Consequently, the Court

[18] *ATP*, 91 A.3d at 558.
[19] *Id.* .
[20] *Schnell v Chris-Chart Industries*, 285 A.2d 437 (Del. 1971).
[21] *Id*.
[22] *Schnell*, 285 A.2d at 439.

in *Schnell* concluded that the board had inequitably misused its otherwise lawful power to amend the bylaws and the Court set aside the board-adopted bylaw in that case.[23]

Here, the Board has acted in a comparably improper and inequitable way. Significant though not dispositive to my analysis, I note initially that the Board hurriedly adopted the Proxy Fee-Shifting Bylaw on a "cloudy" day, little more than a week after Plaintiff's Schedule 13D filing, and thus in direct response to what the Board regarded as the looming threat of a contested election challenging their incumbency. Indeed, the record shows that many of the Talbot directors explicitly saw the adoption of the Proxy Fee-Shifting Bylaw as a deterrent, if not a show stopper, that could potentially dissuade Alpha from undertaking its proxy contest at all.[24] Thus the Board appears to have adopted the Proxy Fee-Shifting Bylaw for the subjective purpose of preventing, or at least discouraging, the Company's largest stockholder from exercising its "right[] to undertake a proxy contest against management."[25] Only lead director Payard couched the decision to adopt the Proxy Fee-Shifting Bylaw in a more reasonable light of helping the Company to recoup potentially significant expenses in the event of an unsuccessful proxy context by an insurgent group. In the Court's view, Payard's lone voice is insufficient to alter the conclusion that the Board adopted the Proxy Fee-Shifting Bylaw for the inequitable purpose of thwarting Alpha's expected proxy contest against their incumbency.

Defendants emphasize that the Board's decision to adopt the Proxy Fee-Shifting Bylaw was well informed and legitimately responsive to the potentially significant costs the Company could reasonably expect to incur in defending against a proxy contest from Alpha or any other

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[23] Id.

[24] *See e.g.* Gunnison Dep. (describing the proxy contest with Alpha as a "potential camel in the tent problem"); Gabrielli Dep. ("we need to raise the stakes for this guy"); Cannon Dep. (the Proxy Bylaw "might get Alpha to think twice about all this."); Leonard Dep. ("if the Bylaw helps to stop Alpha, then I'm for it.")

[25] *Schnell*, 285 A.2d at 439.

insurgent group. Whether or not evidence of such concerns might be sufficient to protect a similar proxy fee-shifting bylaw in another setting I decline to say, but it falls short of overcoming the substantial evidence of inequitable purpose by the Board in this particular case. With the exception of Payard, the four other directors who were deposed during expedited discovery all demonstrated a purpose (improper in the Court's view) of seeking to thwart Alpha's proxy contest altogether, not a concern for recovering the Company's expenses.

I also reject Defendants' argument that the Proxy Fee-Shifting Bylaw nevertheless withstands equitable review because the Board is authorized to subsequently waive the fee-shifting obligation for the benefit of Alpha or any other insurgent group. First, the possibility of such a waiver is simply too uncertain to remove the *ex ante* deterrent effect of the Proxy Fee-Shifting Bylaw for Alpha or any other potential insurgent group. Second, the record already shows that the Board is demonstrably hostile towards Alpha's advances and thus the Board cannot defend the inequitable purpose for which the Proxy Fee-Shifting Bylaw was adopted by suggesting that a subsequent change of heart is always possible.

On the other hand, I reject as speculative Plaintiff's additional argument, based on the Affidavit of Warren Davis of Bantry & Bandon (Plaintiff's proxy solicitor), that the Proxy Fee-Shifting Bylaw will deter other Talbot stockholders from voting for Plaintiff's nominees. Davis, an expert in proxy contests with more than twenty years of experience, cites no empirical studies to support this opinion but instead offers what in effect is his professional hunch that Talbot stockholders might be less inclined to support Plaintiff's nominees if Plaintiff is at risk for fee-shifting. Absent something more concrete, I see no substantial evidence that the Proxy Fee-Shifting Bylaw would have any effect on Alpha's ability to win a proxy contest against the incumbent Board *if* Alpha saw fit to continue. The problem with the Proxy Fee-Shifting Bylaw

in this case is not that an insurgent group is precluded from actually conducting a successful proxy contest, but rather that the Board adopted the Proxy Fee-Shifting Bylaw for the purpose of discouraging and/or preventing Alpha from conducting such a proxy contest in the first instance.

I accept the Board's good faith in preferring the status quo of the Company's cost cutting business plan to Alpha's and Womack's more aggressive Restructuring Proposal. However, such good faith business disagreements, even if well meaning, cannot sanction the Board's attempt to disrupt the exercise of the stockholder franchise. In *Blasius Industries, Inc. v. Atlas Corporation,*[26] another landmark case involving the stockholder franchise, then Chancellor Allen invalidated the action of the board in attempting to undermine a stockholder consent solicitation to expand and thereby obtain control of the board of Atlas Corporation. As here, the board in *Blasius* had a good faith basis on which to reject as unwise the strategic business proposals of the insurgent group seeking control of the board. But such good faith disagreements on business strategy could not justify purposeful board interference with the electoral process in that case, nor may it do so here. In the memorable and emphatic words of the Court in *Blasius*, the premise that the board may know better than do the stockholders as to what is in the corporation's best interest "is irrelevant ... when the question is who should comprise the board of directors."[27]

A proxy context may be noisy, expensive, combative and even distracting to management, and in this case as in *Blasius*, likely will involve a stockholder referendum on two dramatically different business visions for Talbot's immediate and long term future. But none of these realities of robust corporate democracy can justify the Board's attempt to use its lawful

[26] *Blasius Industries, Inc. v. Atlas Corporation*, 564 A.2d 651 (Del. Ch. 1988).
[27] *Id*. at 663.

power to adopt a bylaw to obstruct the legitimate efforts of Plaintiff to undertake a proxy contest for representation on the Talbot board. Under our otherwise "board-centric" model of corporate governance,[28] the election of the directors is the stockholders' space.[29] In this instance, the Board's attempt to control that space by using the threat of substantial costs as a deterrent to Alpha's lawful stockholder challenge to the directors' incumbency cannot withstand a *Schnell* analysis.[30]

For all of these reasons, the Court concludes that the Proxy Fee-Shifting Bylaw, like the amended bylaw at issue in *Schnell*, was adopted for the inequitable purpose of thwarting corporate democracy and thus must be preliminarily enjoined.

IV. CONCLUSION

For the foregoing reasons, Plaintiff's motion for a preliminary injunction is granted, and an appropriate order will be entered upon notice.

/s/ Gary Junge
Chancellor

[28] *In re CNX Gas Corp. S'holders Litig.*, 2010 WL 2705147, *10 (Del. Ch. July 5, 2010) (citing cases).

[29] *See e.g. Blasius*, 564 A.2d at 659. ("The shareholder franchise is the ideological underpinning upon which the legitimacy of directorial power rests.")

[30] The Court's decision is based on an application of the "inequitable purpose" analysis of *Schnell* as directed by our Supreme Court in *ATP*. *See ATP*, 91 A.3d at 558, *citing Schnell* ("Bylaws that may otherwise be facially valid will not be enforced if adopted or used for an inequitable purpose.") Thus I do not apply the *Blasius* "compelling justification" standard of review. *See Blasius*, 564 A.2d at 661.