EFiled: Apr 29 2009 2:25PM EDT
Transaction ID 24935616
Case No. 4241-VCN

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

SELECTICA, INC , Plaintiff, v VERSATA ENTERPRISES, INC , and TRILOGY, INC , Defendants and VERSATA ENTERPRISES, INC , and TRILOGY, INC , Counterclaim-Plaintiffs, v SELECTICA, INC , JAMES ARNOLD, ALAN B HOWE, LLOYD SEMS, JIM THANOS, and BRENDA ZAWATSKI, Counterclaim-Defendants	C A No 4241-VCN **REDACTED PUBLIC VERSION APRIL 29, 2009**

PRE-TRIAL BRIEF OF PLAINTIFF
SELECTICA, INC. AND COUNTERCLAIM-DEFENDANTS

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Dated April 22, 2009

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PRELIMINARY STATEMENT

This case revolves around a board's efforts to protect a potentially valuable corporate asset while trying to sell the business, and a much larger competitor's efforts to extract greenmail or to destroy the company That competitor, which began acquiring the company's stock mere weeks before the actions at issue, has taken the unprecedented step of deliberately triggering a poison pill rights plan, in the avowed hope of pressuring the company to buy off the threat The evidence at trial will show that the board acted reasonably and appropriately in adopting the rights plan, in deploying the plan in response to the competitor's knowing trigger, and in issuing new rights to replace the expended rights

Plaintiff Selectica, Inc ("Selectica" or the "Company") is actively engaged in a publicly-announced sales process with the assistance of reputable investment bankers and outside counsel The Company has accumulated a substantial amount of net operating loss carryforwards ("NOLs") over the years, and has recognized for some time that this tax asset constitutes a substantial contingent asset Under applicable tax law, however, the NOLs would become subject to severe limitation if the Company were to undergo a "change of ownership," a term of art that depends for present purposes on historical acquisitions of stock by 5%-or-greater stockholders The Company learned in November 2008 that open-market trading had brought the NOLs close to the point of impairment, that further trading by existing or new 5%-or-greater stockholders could trigger the "change of ownership" limitation, and that such further trading might happen very quickly and with no advance notice to the Company In light of the threat to the Company's NOLs, the board of directors (the "Board") amended an existing poison pill rights plan in a manner designed to deter new 5%-or-greater stockholders from emerging and existing 5%-or-greater stockholders from substantially increasing their holdings The evidence

at trial will show that the Board made this decision with due care upon the advice of reputable experts, and that the Board acted reasonably and proportionately to a properly identified threat to corporate policy and effectiveness

Defendants Versata Enterprises, Inc and Trilogy, Inc (jointly, "Trilogy") then took the unprecedented step of deliberately acquiring just enough additional Selectica shares to trigger the rights plan

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Trilogy's CFO, Sean Fallon, has referred to these three aspects of Trilogy's relationship to Selectica – Trilogy's status as stockholder, its status as intellectual property licensor, and its status as creditor – as a "three-legged stool." *See* Fallon Dep at 41-43; *see also* Price Dep at 164-65 That metaphor holds the key to understanding Trilogy's decision to take the unprecedented step of deliberately triggering a poison pill rights plan: A decision that plainly was economically irrational for Trilogy *qua* stockholder was designed to enhance Trilogy's bargaining position with respect to its interests *qua* intellectual property licensor and creditor

Trilogy's representatives have described the decision to trigger the rights plan as designed to bring "clarity and urgency" to Selectica's discussions with Trilogy concerning the companies' relationship *See* Fallon Dep at 200 Trilogy, knowing that the rights plan gave the Board a ten-business-day window in which to determine whether to exempt Trilogy's purchases from the economic consequences of triggering the rights, refused repeatedly to agree to a standstill in exchange for an exemption, again in an effort to force the Board's hand A duly empowered committee of the Board, compelled over the Christmas and New Year holidays to choose among (a) granting Trilogy an exemption, (b) allowing the rights (other than Trilogy's) to

trade separately from the common stock and to become exercisable for a potentially enormous number of new common shares at a deep discount, or (c) exchanging the rights (other than Trilogy's) for new common stock, chose the last option, and simultaneously issued a new rights dividend to replace the rights that Trilogy had forced the Board to deploy As the evidence will show, the Board and the committee made these decisions after due consideration of the alternatives and in a further good-faith effort to protect the NOLs

By comparison with Selectica's straightforward approach, Trilogy will attempt to deflect the Court's attention away from its own conduct Trilogy will seek to persuade the Court that the Board acted as it did out of an irrational desire to harm Trilogy and to benefit Steel Partners (the Company's largest stockholder) Trilogy likely will spend hours of the Court's time arguing that the Company's experts were incorrect in the highly technical advice they rendered to the Board But it makes no difference whether the Board or its expert advisors were right or wrong If the Board reasonably relied on its experts, then challenges to the *substance* of the experts' advice are simply unavailing Likewise, the evidence will show that the Board's relationship with Steel Partners has been at arm's length and that this shareholder has not been favored over any other

Notwithstanding Trilogy's exhortations to the contrary, this is at heart a simple case The Board, acting in good faith, with due care and in reasonable reliance on reputable expert advisors, reasonably identified threats to corporate policy and effectiveness and took lawful, reasonable and proportionate measures to forestall those threats The business judgment rule protects the Board's actions, and Selectica and its Board are entitled to judgment

NATURE AND STAGE OF PROCEEDINGS

This matter is scheduled for trial before the Court beginning April 27, 2009 This is the pre-trial brief of Selectica and its directors

STATEMENT OF FACTS

A. Selectica, Its Business And Its Assets.

Selectica is a Delaware corporation with its headquarters in San Jose, California Selectica provides enterprise software solutions for contract management and sales configuration systems [1] Selectica's common stock has been listed on the Nasdaq Global Market under the symbol SLTC since the Company's initial public offering in March 2000

Selectica's current board of directors consists of five members, four of whom were Board members at the time of the actions at issue [2] James Arnold, who was elected to the Board in October 2003 and chairs the Company's audit committee, is a senior vice president and former chief financial officer of Nuance Communications *See* Arnold Dep at 11-16 [3] Brenda Zawatski, who joined the Board in 2005, worked for IBM for 20 years and for other large technology companies for an additional five years, and currently serves as one of two co-chairs of the Board *See* Zawatski Dep at 13-19 The other co-chair of the Board, James Thanos, is a retired executive with over 30 years' experience in the software field, and has served on Selectica's Board since late 2007 *See* Thanos Dep at 11-17 The fourth director, Lloyd Sems, a hedge fund manager, joined the Board in June 2008 *See* Sems Dep at 4-6, 16

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[1] Contract management software assists businesses to manage multiple contracts Hospitals, for example, often have hundreds of contracts with different insurers covering similar services Configuration software allows a customer to "configure" a purchase, such as an airplane, with numerous permutations of available options and to price the "as built" product

[2] The fifth director, Alan Howe, was elected to the Board on January 12, 2009 He has not been charged with any breach of fiduciary duty and has not been served with process Mr Howe is not subject to personal jurisdiction in this Court under 10 *Del C* § 3114 or otherwise Trilogy acknowledges this in its Counterclaims, which purport to name Mr Howe as a defendant solely "in order to afford [Trilogy] complete relief" Counterclaim, ¶ 62

[3] The depositions taken in this matter are being lodged separately and cited by name of deponent A set of Selectica's expected trial exhibits (referenced herein as "PX __") is being delivered to the Court contemporaneously herewith, and those exhibits have been previously identified to Trilogy's counsel

Over the past decade, Selectica's business has faced a number of challenges, and the Company has lost a substantial amount of money The Company's value today consists primarily in its cash reserves, its intellectual property portfolio, its customer and revenue base, and its accumulated NOLs Over the past several years, Selectica has generated at least $150 million worth of NOLs for federal tax purposes (along with other carryforwards and tax credits available in various other jurisdictions) Assuming these NOLs are not lost or subjected to limitations, the Company may use the NOLs to offset future income and thereby greatly reduce its liability to pay income taxes on that future income [4]

Selectica has monitored the value of its NOLs for several years [5] In 2006, the Company retained Alan B Chinn, a California CPA, to perform a high-level analysis of the availability of its NOLs under Section 382 *See* Chinn Dep at 25, 29-30 Chinn delivered a preliminary draft of his report to the Company in September 2006 *See* PX 13

In March 2007, the Company retained a second accountant, John Brogan of Burr Pilger & Mayer LLP, to analyze and report on Chinn's Section 382 analysis [6] *See* PX 2 Brogan had been

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[4] As the Court will learn during trial, Section 382 of the Internal Revenue Code of 1986, as amended ("Section 382") in general limits the ability of a company to use its NOLs after an "ownership change" An "ownership change" under Section 382 generally occurs if there is a greater than 50 percentage point increase in ownership by greater-than-5% stockholders in a three-year period After an "ownership change," the company may use only a small portion of its pre-change NOLs in a given year Thus, an "ownership change" under Section 382 significantly impairs the value of pre-change NOLs

[5] Trilogy likewise has given consideration to the potential value of Selectica's NOLs over the years Trilogy's witnesses have confirmed that Trilogy as a matter of practice analyzes potential acquisition targets' NOLs for potential value *See* Johnston Dep at 25-26; Price Dep at 156-57 Trilogy made an offer to acquire Selectica in 2005, in conjunction with which Trilogy's tax director, Sherie Johnston, performed "a pretty detailed analysis" of Selectica's NOLs *See* Johnston Dep at 21 Trilogy also sought advice from its outside tax provider, an Austin-based accountant named David Pope, concerning the value of Selectica's NOLs in 2005, again in late 2006 and again in the fall of 2008 *See* PX 55, PX 56

[6] Brogan testified at deposition that over the past twenty years he has prepared dozens of Section 382 analyses at varying levels of completeness, including five to ten studies similar to the one he performed for Selectica *See* Brogan Dep at 27-28, 31 Brogan and Chinn agreed that the analysis

recommended to the Company as a leading expert in the arcana of NOL preservation and use by Steel Partners, the Company's largest stockholder Members of the Board will testify that they valued Steel's recommendation in this regard given that Steel was believed to be knowledgeable in the area

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See PX 4 at SEL 4425 Based on his prior work with the Company, Brogan was asked to advise the Board in the fall of 2008 when it acted to amend its stockholder rights plan

B. Trilogy And The "Three-Legged Stool" Of Its Relationship With Selectica.

Trilogy is a Delaware corporation headquartered in Austin, Texas Its stock is not publicly traded, and **REDACTED** *See* PX 58 A Trilogy subsidiary competes with Selectica, and Trilogy has been familiar with Selectica for many years[7] Trilogy competes with Selectica in the contract management and sales

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required under Section 382 can be highly complex and that reasonable practitioners can and do reach differing results on the same data *See* Brogan Dep at 93-95, 203; Chinn Dep at 29 ("Frankly, to my knowledge, it is almost impossible to get a perfect Section 382 analysis [b]ecause there are so many assumptions and so many details of information that would be required It's extremely difficult "); *see also* Pellervo Report, PX 123 at 5 ("the performance of a comprehensive Section 382 ownership change analysis is a complex undertaking that usually requires significant judgment calls and assumptions ") Trilogy's tax director, Sherie Johnston, confirmed the point *See* Johnston Dep at 33 ("To get to the actual numbers and get it correct is a pretty daunting task "), 44

[7] *See* Counterclaim, ¶¶ 76, 79, 82 Trilogy's earlier dealings with Selectica involved similar efforts to extract advantage through a multi-pronged strategy of claims of patent infringement, stockholder activism and lowball acquisition proposals A Trilogy affiliate sued Selectica for patent infringement in April 2004 *See id* ¶ 79 While that suit remained pending, in January 2005, Trilogy made an offer to buy Selectica *See id* ¶ 82 After Selectica's board rejected that offer, during March and April of the same year, a Trilogy affiliate acquired over two million shares of Selectica's stock, or nearly 7% of the Company, through open market trades In September 2006, the same affiliate sent the Company a letter questioning whether certain stock options granted in 2001 – years before any of the individual counterclaim-defendants joined the Board – may have been backdated *See id* ¶ 76 The

configuration product spaces; the two companies' relationship as competitors in a field heavily dependent on intellectual property is the "leg" in the "stool" of the longest standing In October 2007, Trilogy became Selectica's largest creditor when the two companies settled certain patent litigation The settlement agreement granted each company certain licenses to the other's intellectual property and required Selectica to make an upfront payment to Trilogy, followed by additional quarterly payments in an aggregate amount up to $7 5 million, with the amount of each installment determined by reference to Selectica's quarterly revenues, subject to a minimum of $200,000 per quarter *See* Counterclaim, ¶ 79; Jurkowski Dep at 97 Due to disappointing operating results in 2007 and 2008, Selectica was required to pay (and did timely pay) only the minimum amount This settlement brought temporary peace, but gave Trilogy an opportunity to exert pressure at a future time of its choosing by claiming a breach of the license terms

Trilogy inserted the third "leg" into the "stool" in October 2008, by beginning to purchase Selectica shares in the open market Trilogy has confirmed that between late 2006 and October 2008, Trilogy did not own any shares of Selectica stock *See* Fallon Dep at 231-32 Almost contemporaneously with Trilogy's decision to begin acquiring Selectica stock, Trilogy made one of its several acquisition proposals, discussed in further detail below

C. <u>Trilogy's Renewed Consideration Of Selectica In 2008.</u>

In early 2008, within months after settling the patent litigation, Trilogy was again looking actively at potential transactions with Selectica

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following month, Trilogy filed another patent lawsuit, which was eventually settled in October 2007 *See id* ¶ 79 Then, in the late fall of 2006, Trilogy suddenly sold down its Selectica holding *See* Johnston Dep at 21; Fallon Dep at 231-32

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See Price Dep at 114-16; PX 60

Trilogy broached the possibility of selling to Selectica with the Company's then-CEO, Robert Jurkowski, and the general manager of Selectica's configuration business, Michael Shaw (a former Trilogy employee) *See* Jurkowski Dep at 60-63; PX 60 Those discussions fell by the wayside after Selectica's Board fired Jurkowski and Shaw in early July

By mid-2008, however, Trilogy's focus shifted from **REDACTED** to buying Selectica or its businesses, in part because Trilogy believed Selectica would not pay a satisfactory price for **REDACTED** , and in part because Trilogy came to believe that Selectica had again become an attractive acquisition target [8] As Trilogy pondered an investment in or an acquisition of Selectica, Trilogy considered the potential value of Selectica's NOLs, and how an outsider might take advantage of the NOLs In late April 2008, Liemandt, Fallon and Andrew Price exchanged emails seeking to understand how Steel Partners may have intended to take advantage of the NOLs of another company, with Liemandt expressly noting, "[i]f they can find a way, we should be able to as well, and Steel just bought 10% of [Selectica] " PX 62 Price testified:

> On or around this time frame [*i e* , April 2008], we did some investigation to better understand possible ways to structure transactions to maintain NOLs And there might be some possible ways in a private transaction where there were some very large shareholders like venture capitalists that perhaps wanted to ride

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> along in the new company We all agreed to consider that anytime we ran into one of those with a lot of NOLs, but expected that we'd be better off just doing a clean, quick deal, making our operating money and not fussing around with that

Price Dep at 128 Price admitted that he sought advice from a "382 expert," Price Dep at 129, but ultimately concluded that structuring a transaction to preserve the usability of NOLs, although possible, "did not seem worth the effort for public companies "[9] Price Dep at 131

D. Summer 2008: Selectica's Board Decides To Restructure And To Explore Strategic Alternatives.

While Trilogy monitored Selectica's stock price and considered making a bid, the Board acted to stem the tide of the Company's losses and to turn the Company's fortunes around At the beginning of July, the Board removed the CEO (Jurkowski), and eliminated the positions of the two general managers overseeing the configuration and contract management business units The Board announced later in July that it was in the process of choosing an investment banker to evaluate strategic alternatives for the Company *See* PX 47 Trilogy, sensing its opportunity, promptly began to reach out to the Company concerning a potential transaction

On July 15, **REDACTED**

See PX 107; Zawatski Dep at 248-49 On July 29, Fallon, Price and Randy Jacops participated in a conference call with the Company's co-chairs, Zawatski and Thanos, during which Thanos specifically asked how Trilogy would go about valuing the Company's

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[9] At the same time that Trilogy investigated the potential value and usability of Selectica's NOLs, Price prepared several models valuing potential transactions with Selectica, including acquisitions of the entire Company *See* PX 64, Price Dep at 132-39 Trilogy's internal valuation model assumed that the post-transaction company would be able to use some of Selectica's pre-transaction NOLs, subject to the change-of-ownership limitation imposed by Section 382 Price Dep at 137 Trilogy's top decision-makers evaluated the various potential transactions and eventually settled on a proposed asset purchase, for which the return on investment was projected to exceed 50% *See* Price Dep at 139-40 Trilogy also continued to seek to understand how Selectica's stockholders might derive a benefit from NOLs, and even reached out to Steel Partners in an apparent effort to understand Steel's strategy for capitalizing on NOLs generally and/or Steel's interest in Selectica's NOLs specifically *See* Fallon Dep at 45-46; Howard Dep at 49-51; PX 61, PX 62

NOLs *See* PX 47 According to a contemporaneous summary prepared by Jacops, Fallon replied that Trilogy "really [did not] pursue them with as much vigor as other[s] might since that is not our core strategy " *See* PX 47 at VERSL 39

1. July 30, 2008: Trilogy Makes A Lowball Bid.

The following evening, Fallon telephoned Zawatski and made a proposal to acquire Selectica's business *See* Fallon Dep at 91-100 The same evening, Fallon prepared an email to Zawatski outlining two potential proposals *See* PX 78

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see Fallon Dep at 91, Zawatski Dep at 250-51, Fallon confirmed that the email accurately reflects the oral proposal he made on July 30 *See* Fallon Dep at 91-93 Notably, Fallon's email expressly refers to the possibility that the post-transaction Selectica would "retain options to further enhance shareholder value through a sale of its entity," an expression Mr Fallon confirmed included a potential use for Selectica's NOLs *See* PX 78, Fallon Dep at 99 As he would do repeatedly in the months to come, Fallon emphasized Trilogy's belief that "moving forward with urgency is critical to retaining the value of the operations " *See* PX 78

2. August 2008: Trilogy Declines to Participate in the Needham Process.

Zawatski took Trilogy's offer to the Board, although the record suggests she did so informally The Board directed Zawatski to invite Trilogy to participate in the process being overseen by the Company's investment banker, Jim Reilly of Needham & Co On approximately

August 8,

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See Zawatski Dep at 253 Trilogy, however, chose not to participate in the strategic process the Board had set up [10]

During September, Selectica hired a new Chief Financial Officer, Richard Heaps,

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See Brogan Dep at 125-27; Heaps Dep 42, 51-52, 67-68; *see also* PX 36

After two months of relative quiet, Trilogy slightly increased its bid for Selectica and simultaneously began to accumulate Selectica stock through open market purchases On approximately October 9,

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See Fallon Dep at 125-26; Zawatski Dep at 263-65; PX 52; PX 81 Fallon again emphasized that Trilogy wanted Selectica "to move forward in an urgent manner, in order to preserve shareholder value " Fallon Dep at 124

E. November 2008: Trilogy Emerges As A New Greater-Than-5% Stockholder, And Selectica Realizes That Its NOLs Could Be In Danger.

On the evening of Monday, November 10, Fallon telephoned Zawatski to advise her that Trilogy had purchased over 5% of Selectica's outstanding common stock, and would file a Schedule 13D soon *See* Fallon Dep at 151; PX 109 at SEL 17320 When Zawatski and Reilly

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[10] Trilogy was aware that Selectica had chosen Needham as its investment banker no later than August 14, 2008, when Selectica announced that fact during a quarterly earnings call *See* PX 66; Price Dep at 192-93 Trilogy's witnesses recalled only one communication between Trilogy and Needham, a telephone call in mid-November *See* Fallon Dep at 107-10

returned Fallon's call, Fallon again sounded the theme of urgency, stating that Trilogy "believed that . the company should work quickly to preserve whatever shareholder value remained and that we were interested in seeing this process that they had announced with Needham, that we were interested in seeing that accelerate . " Fallon Dep. at 144.

After buying through the 5% level and filing its Schedule 13D on Thursday, November 13, Trilogy acquired over 320,000 more shares (more than an additional 1% of the Company) in trading on Friday, November 14, and Monday, November 17.[11] *See* PX 20, PX 102. Trilogy's Schedule 13D explicitly stated that Trilogy "plan[ned] to acquire additional shares of common stock of [Selectica] in open market or privately negotiated transactions."[12] PX 102.

On or about November 13, shortly after Selectica released its quarterly earnings data,

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See Heaps Dep. at 159-60.

F. <u>Sunday, November 16: Selectica's Board Meets And Determines To Act To Protect Selectica's NOLs.</u>

The Selectica Board met on Sunday evening, November 16, 2008, for two and a half hours

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[11] The Company's CFO and General Counsel, Mr. Heaps, testified that,

REDACTED *See* Heaps Dep. at 97-99; *see also* PX 37.

[12] Trilogy's internal documents reflect consideration in November of potentially acquiring as much as 15% of Selectica's outstanding stock. *See* PX 14; Fallon Dep. at 37-40.

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The Board also heard a presentation from Reilly,

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The strong sense of the Board was that, especially in light of the ongoing process of evaluating strategic alternatives, the Company should take immediate and reasonable precautions to preserve the NOLs, as the NOLs could potentially enhance the value stockholders would receive in a sale of assets, or enhance the long-term value of the Company if no transaction took place Noting the speed with which Trilogy in particular had accumulated its stake, and the fact that 677,000 shares (or 2 3% of the outstanding stock) had changed hands since Trilogy had filed its Schedule 13D the preceding Thursday, the Board determined that prompt action was necessary [13]

The Board heard a presentation from Richards, Layton & Finger, P A , its Delaware counsel,

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The Board then decided to revise the

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[13] As the Board learned later, Trilogy had acquired 261,120 of these 677,000 shares on Friday, November 14, and would acquire an additional 60,000 shares on Monday, November 17 *See* PX 103

Company's shareholder rights plan to lower the triggering threshold to 4 99%, effective at the close of business on the day of public announcement of the amended plan (the "NOL Pill," PX 99) Because the "change of ownership" calculation under Section 382 depends on purchases by 5%-or-greater stockholders, the Board's decision to set the new threshold at 4 99% was intended specifically to discourage the emergence of any new 5%-or-greater stockholders without Board approval The Board also determined to allow stockholders who already owned 5% or more – including Trilogy – to acquire up to an additional 0 5% (subject to a 15% cap) without becoming an "Acquiring Person" Given the number of then-existing 5%-or-greater stockholders, allowing each to acquire up to an additional 0 5% was consistent with ensuring that the tax law "change of ownership" calculation remained under 50% The Board further decided to retain limited authority to exempt specific purchases or specific stockholders subject to a determination that such exemptions would not jeopardize the value of the Company's NOLs The Board finally decided to establish a committee (the "Review Committee"), consisting of Messrs Arnold and Sems

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G. Trilogy's Reaction To The NOL Pill.

Selectica announced the NOL Pill on Monday, November 17 Early on Tuesday morning, November 18, Fallon emailed Trilogy's broker and instructed him, "We need to stop buying SLTC They announced a new pill and we need to understand it" *See* PX 22 The same afternoon, Fallon sent Liemandt a copy of Selectica's 8K containing the text of the NOL Pill *See* PX 21 Although neither Fallon nor Liemandt actually read the text of the NOL Pill, both

testified that Trilogy immediately sought legal advice about the NOL Pill. *See* Fallon Dep at 158-61, Liemandt Dep at 97-100 Trilogy clearly learned of the NOL Pill promptly after Selectica announced its adoption

The same morning, Liemandt emailed Price a revealing question: "Andy, What percentage of SLTC would we need to buy to ruin the tax attributes that Steel Partners is looking for?" PX 54 Mr Liemandt sought to explain away this query as meaning, "what is the amount that we can buy without hurting it," Liemandt Dep at 101, but Mr Price understood the question in a more natural sense: "I think he was asking for what percentage would we have to buy to trigger a change of control as per section 382" Price Dep at 151

Although Trilogy has hidden most of the subsequent evolution of its strategy behind the attorney-client privilege, it is no mere coincidence that,

REDACTED

The parties agreed to meet on December 17, 2008, in a private villa at the Bellagio in Las Vegas, Nevada Trilogy's chief spokesman at the meeting, Sean Fallon, could not recall ever advising Selectica that the agenda for the meeting would be broader than the alleged patent

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[14]

REDACTED

dispute *See* Fallon Dep at 180-83 In advance of the meeting, the parties exchanged drafts of, and ultimately executed, a confidentiality agreement providing that nothing discussed in the meeting would be admissible in evidence in any subsequent court proceedings Selectica and the Counterclaim Defendants do not intend to introduce evidence of the statements made during the December 17 meeting However, based solely on statements and conduct outside that meeting,

REDACTED

[15]

H. Trilogy Deliberately Triggers The NOL Pill.

After the December 17 meeting concluded, Liemandt, Price, Fallon and Jacops conferred *See* Jacops Dep at 146-47; Fallon Dep at 199-202; Price Dep at 169 Liemandt testified about that discussion.

> Sean [Fallon] said, "I committed" – "In order to see if there's a solution, I committed not to trigger the pill this afternoon" And he told me that And I told him, "I can't believe you'd fall on your sword for Selectica, but go ahead And you're in charge and you make the decision And then you can give them the time, whatever you committed to, and then just buy the shares later"

Liemandt Dep at 122 The following day, Trilogy purchased 30,000 Selectica shares *See* PX 104 Price, Liemandt and Fallon all testified to a conversation on December 18 or 19, in which Fallon told Liemandt that Trilogy had purchased more Selectica shares, but not enough to trigger the NOL Pill, and effectively gave Liemandt a "last clear chance" to back away from the brink *See* Fallon Dep at 205-07; Liemandt Dep at 123, Price Dep at 175-77 But Liemandt demurred and directed his subordinates to proceed

[15] Selectica's Board met by telephone on the evening of December 17, **REDACTED** *See* PX 90 at SEL17260

Trilogy purchased an additional 124,061 shares on the morning of December 19, thereby becoming an Acquiring Person under the NOL Pill *See* PX 104 Trilogy's witnesses gave different accounts of the reasons for Trilogy's decision Liemandt claimed that the sole reason for buying through the NOL Pill was his belief that the NOL Pill was illegal, and that the Selectica directors needed to be held to account for their decision to adopt it *See* Liemandt Dep at 124-26 Fallon testified more expansively:

> I think the general belief of that action [*i e*, triggering the NOL Pill] was that Selectica would continue its path of being not responsive to our advances and that acquiring additional shares would be important to increase our investment holding and trigger the pill, which would potentially bring some clarity and urgency to the discussions that we had been having with Selectica
>
> * * *
>
> Urgency, I think – you know, there's been a long history here It goes back years And then there was, again, a recent history of the last six months of us trying to make progress, making proposals on the company, and it again being responded to with no action, in our view
>
> And I think the urgency that acquiring more shares and potentially triggering the pill would be around setting a time frame that might help accelerate discussions or [*sic*] the direction of the business

Fallon Dep at 200-201 In short, Trilogy admits that it decided deliberately to trigger the NOL Pill in order to put immediate pressure on Selectica to resolve several disparate issues – the "three-legged stool," as Fallon referred to it, *see* Fallon Dep at 41-43 – to Trilogy's satisfaction The Court may well infer from the evidence that Trilogy had additional, ulterior motives in its unprecedented decision to trigger the rights plan, including attempting to sabotage the Needham process by creating uncertainty that would scare potential buyers away, potentially resulting in Trilogy being able to acquire Selectica at less than full value

I. December 19: Fallon Calls Zawatski, Announces That Trilogy Has Triggered The NOL Pill, And Conveys Trilogy's Demands.

Fallon telephoned Zawatski on Friday, December 19, and advised her that Trilogy had bought through the NOL Pill [16] Fallon Dep at 207-09 In a conversation later that day, Fallon set forth Trilogy's demands

REDACTED

J. Saturday, December 20: The Selectica Board Meets Promptly To Protect Stockholder Value.

On Saturday, December 20, the Selectica Board met to discuss Trilogy's demands and to consider an appropriate response to Trilogy's unprecedented decision to trigger the rights plan intentionally *See* PX 91

REDACTED

This action was filed on Sunday afternoon, December 21

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[16] The confidentiality agreement concerning the December 17, 2008 Las Vegas meeting does not by its terms cover subsequent discussions, including the December 19 telephone call Even if the Court takes the view that this and other telephone discussions were "compromise negotiations" within the meaning of D R E 408, the Court may nevertheless consider statements made in those discussions for purposes other than an attempt to establish liability or measure of damages Selectica is offering the statements made in these discussions to bolster its claim that the Board had a reasonable basis on which to perceive a threat to Selectica's NOLs from Trilogy – a threat that materialized when Trilogy resumed buying shares – and that the Board's actions in response to that threat were reasonable Trilogy claims the Board's response was a breach of fiduciary duty Trilogy cannot simultaneously claim that the Board acted without a reasonable basis and hide its own threatening conduct behind D R E 408

K. Monday, December 22: Trilogy Publicly Announces That It Has Triggered The NOL Pill, And The Board Seeks A Standstill.

The next morning, Monday, December 22, Trilogy filed an amended Schedule 13D announcing that it had bought through the NOL Pill *See* PX 104 That evening, at 4:00 p m Pacific time, the Board met again The Court will learn that Trilogy's action triggering the pill commenced a ten-business-day clock under the NOL Pill During that time, the Selectica Board retained the right to declare Trilogy's purchases "exempt," but only if the Board first determined that Trilogy was not a continuing threat to the Company's NOLs *See* PX 99 at §§ 1(n), 1(o), 3(a), 7(a) The Board also retained the right to exchange the rights (other than those belonging to Trilogy) for shares of common stock *See id* at § 24(a) However, if the Board did neither of those things within the ten-business-day period, the rights would "flip in" automatically; that is, the rights would become exercisable for $36 worth of newly-issued common stock at an exercise price of $18 per right *See id* at §§ 7(b), 11(a)(ii) Facing this choice,

REDACTED

The Board met again the following day, Tuesday, December 23, by telephone *See* PX 93 After consulting with counsel about the progress of the litigation, the Board considered the potential impact of its various options under the NOL Pill *See id* at SEL 17270-71 The Board decided to hold an in-person meeting the following Monday, December 29, with the Company's financial, legal and accounting advisors, to further evaluate the Company's options **REDACTED**

REDACTED

L. Wednesday, December 24: The Board Authorizes A Second Request For A Standstill.

During the afternoon of Christmas Eve, the Selectica Board met for the fifth time in the week since the Las Vegas meeting. *See* PX 94.

REDACTED

Zawatski placed a call to Fallon that day

M. Friday, December 26: Zawatski Calls Fallon To Request A Standstill.

Zawatski and Fallon spoke on the morning of Friday, December 26. *See* Fallon Dep. at 219; PX 112.

REDACTED

REDACTED

N. Monday, December 29: The Board Meets To Consider Its Options.

The Board met in person at its outside counsel's offices in San Jose for several hours on Monday afternoon, December 29, with numerous advisors present by conference telephone *See* PX 95 The Board heard a presentation by its outside tax expert Brogan,

REDACTED

The Board also received a presentation from Needham

REDACTED

The Board then discussed a potential course of action

REDACTED

The first option was unappetizing for obvious reasons and likely would have defeated the point of adopting the NOL Pill in the first place The second option – allowing the rights to become exercisable – created substantial uncertainties for the Company If the rights became exercisable, any stockholder (except Trilogy and its affiliates) would have been able to purchase $36 worth of the Company's common stock for $18, or to sell those rights to other investors (again, except Trilogy and its affiliates) If all the rights (except those issued to Trilogy and its affiliates) were exercised, Trilogy's proportionate interest in the Company would have been diluted from nearly 7% down to less than 0 2% But given the low trading price of the stock, the Company lacked sufficient authorized shares to proceed in the event that any substantial number of holders exercised their rights Likewise, the Board had no way to be certain of the dilutive effect in advance, because it had no way to know who (if anyone) would exercise the rights Given that the common stock was then trading under $1 per share, many stockholders likely

would balk at the prospect of investing an additional $18 to acquire $36 worth of stock It was even possible that *none* of the rights would be exercised Finally, if some of the rights were exercised and some were not, it was possible that new greater-than-5% investors would emerge and that a "change of ownership" under Section 382 would occur as a result of the exercises

The remaining option – exchanging each right (other than those belonging to Trilogy and its affiliates, which were canceled automatically) for a newly-issued share of common stock – was a significantly more appealing prospect The effect of an exchange on the "change of ownership" calculation under Section 382 was small and predictable, and did not depend on investors' willingness to invest additional funds in a struggling company The exchange likely would be less dilutive to Trilogy than a flip-in The Board accordingly determined that an exchange of the rights for common stock would be a reasonable response to the threat posed by Trilogy, in light of the value of the NOLs to Selectica, Trilogy's accumulation of stock and refusal to agree to a standstill, and the ease with which one or more stockholders could thrust a Section 382 ownership change on the Company without the Board's approval *See id*

However, the Board recognized that it still had several days in which it retained the flexibility under the NOL Pill to declare Trilogy's purchases Exempt Transactions, before the rights would become exercisable and tradable separately from the common stock

REDACTED

The Board additionally adopted a resolution delegating to the Review Committee the Board's full power and authority to make decisions in connection with the emergence of an Acquiring Person under the NOL Pill *See id* at SEL 17284-85

O. The Board Tries A Third Time: Litigation Counsel To Litigation Counsel.

On the evening of December 29, Selectica's trial counsel emailed Trilogy's trial counsel at the Board's instruction *See* PX 70 Mr Varallo wrote (in part).

REDACTED

Id The following afternoon, Trilogy's counsel responded **REDACTED**

P. December 31: The Board Prepares The Ground For The Exchange.

On December 31, the Board met **REDACTED**

See PX 96 at SEL 17288-89 The Board then discussed its options with its legal advisors After discussion, the consensus that emerged at the Board was that the best option was to exchange the rights under the NOL Pill (other than rights issued to Trilogy and its affiliates) for shares of newly-issued common stock *See id* at SEL 17290

REDACTED

REDACTED

Q. January 2, 2009: The Review Committee Authorizes The Exchange And Declares A New Rights Dividend.

On Friday afternoon, January 2, 2009, the Board met briefly and adopted a resolution expressly confirming that its December 29 delegation of the Board's full power and authority to the Review Committee included (i) the power to effect an exchange of the rights under the NOL Pill; and (ii) the power to declare a new dividend of rights under an amended rights plan (the "Amended NOL Pill") The full Board then adjourned and the Review Committee – composed of Sems and Arnold – met with its inside and outside legal advisors and its financial advisors from Needham. *See* PX 97 at SEL 17293-94

The Review Committee discussed a presentation made by Needham **REDACTED**

See PX 97 at SEL 17296; PX 38

REDACTED

The Committee's outside Delaware counsel advised the Committee members **REDACTED**

See PX 97 at SEL 17302

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[17] **REDACTED**

After further discussion, the Committee decided that, in view of Trilogy's deliberate decision to become an "Acquiring Person" under the NOL Pill, its repeated refusal to agree to a standstill, and the relative ease with which a "change of ownership" under Section 382 could occur through market activity, it was appropriate to exchange the rights for new shares of common stock under the NOL Pill, and to declare a new rights dividend on substantially similar terms so as to maintain the protections for the NOLs that the NOL Pill had provided

The Committee then adopted resolutions determining (i) that Trilogy had become an "Acquiring Person" under the NOL Pill; (ii) that Trilogy could not be declared an "Exempt Person"; and (iii) that a "Flip-In Event" had occurred on December 19, 2008, the date on which Trilogy had bought through the NOL Pill *See id* at SEL 17304 The Committee next resolved to adopt the amendment to the NOL Pill previously discussed at the Board's December 31, 2008, meeting (the "Amended NOL Pill") *See id* at SEL 17305-06 Finally, the Committee adopted resolutions (i) authorizing an exchange of the outstanding rights, except for those issued to Trilogy and its affiliates, which were canceled automatically under the terms of the NOL Pill (the "Exchange"); and (ii) authorizing a dividend of one right per common share under the Amended NOL Pill *See id* at SEL 17306-08

R. Overview Of Expert Presentations.

Selectica and the individual counterclaim-defendants intend to proffer reports and testimony from four experts to assist the Court in understanding the evidence at issue in this case, and to determine facts put in issue by the parties *See* D R E 702

1. Professor Merle Erickson: Net Operating Loss Carry-Forwards Are A Valuable Corporate Asset.

Merle Erickson is a professor of accounting at the University of Chicago He will testify at trial regarding the value and limitations on the use of NOLs Specifically, Prof Erickson will

testify in depth as to the permissible uses of NOLs to generate positive cash flow and the effect of Section 382 on such uses In addition, Prof. Erickson will testify concerning the treatment of NOLs under generally accepted accounting principles ("GAAP"), and will opine that NOLs meet the definition of an "asset" under GAAP and are routinely reported on balance sheets as deferred tax assets Finally, Prof Erickson will testify that companies value NOLs and structure transactions so as to avoid imposition of limitations on their use under Section 382 *See* PX 130

2. Patricia Pellervo: The Chinn And Brogan Studies Were Reasonable Estimates.

Patricia Pellervo is a principal in the National Tax Services practice of PriceWaterhouseCoopers LLP ("PwC"), and in that capacity she has extensive experience in preparing analyses of possible "changes of ownership" under Section 382, similar to the studies prepared by Chinn and Brogan for Selectica Pellervo has reviewed both studies, including in particular the methodologies underlying their conclusions, and will testify regarding the reasonableness of those reports Specifically, Pellervo will testify as to the complexities of Section 382 and its application to a particular Company's equity profile, and as to the types of data used in compiling an "ownership change" analysis Pellervo's testimony will reflect that the methodologies used and conclusions reached in each of the Chinn and Brogan studies were reasonable in light of prevailing practice regarding such studies. *See* PX 123

Pellervo also has submitted a rebuttal report, and will testify at trial, in response to the expert report of Elliot Freier, proffered by Trilogy Freier contends in his report that the Brogan study was flawed due to a number of assumptions or methodologies that were, according to Freier, not supportable under the tax code or were otherwise inappropriate As Pellervo will explain, however, Freier's criticism centers largely on disagreements with certain of Brogan's assumptions concerning areas of tax law where there is no consensus among practitioners, and

the flaws that Freier purports to identify in Brogan's work do not render Brogan's opinion unreasonable or unreliable. In addition, Freier's work is irrelevant to the case. Finally, Pellervo will also rebut, among other things, certain conclusions reached in Freier's own Section 382 analysis. *See* PX 127.

3. Professor John Coates: Stockholder Rights Plans Designed To Protect Ownership-Contingent Assets (Such As Net Operating Loss Carry-Forwards) Are Common And Reasonable.

John C. Coates IV is a professor of law and economics at Harvard Law School. He also is a former partner at Wachtell, Lipton, Rosen & Katz, where he specialized in mergers and acquisitions. Professor Coates has submitted an expert report, and will testify at trial, regarding customs and trends regarding shareholder rights plans designed to protect ownership-contingent assets, including NOLs. Specifically, Prof. Coates will testify regarding his findings that rights plans with approximately 4.99% triggers have been adopted at several dozen public companies, typically to protect ownership-contingent assets such as NOLs, and that such rights plans are now regarded as reasonable and customary under appropriate circumstances. *See* PX 128.

4. Peter Harkins: The NOL Pill, The Exchange And The Amended NOL Pill Did Not Preclude Potential Proxy Contests.

Peter Harkins is the President and CEO of D.F. King & Co., Inc., a leading proxy solicitation firm. Harkins is qualified by nearly 30 years' experience to opine as an expert on proxy contests. Based on that experience, Harkins will testify at trial that Selectica's NOL Pill did not, and the Amended NOL Pill does not, render the Company takeover-proof. Specifically, Harkins will identify a large number of proxy contests waged over the past three years at companies similar to Selectica according to various metrics, and testify that the insurgent succeeded in a substantial proportion of these proxy contests. Harkins also will testify based on

his experience that, given Selectica's ownership profile (before and after the Exchange) a proxy contest at Selectica would not be cost-prohibitive *See* PX 121

Harkins also has submitted a rebuttal report, and will testify at trial, in response to the expert report of Prof Allen Ferrell, proffered by Trilogy Harkins will testify that his experience has been that the broad academic themes relied on by Prof Ferrell are generally not useful indicators of the likely outcome in specific proxy contests, each of which is unique by nature Moreover, Harkins will testify that, in his experience, the most important determinants for a successful proxy contest are (i) the merits of the platform on which the insurgent's candidates run, and (ii) the company's shareholder profile *See* PX 122

* * *

When trial is over, the Court will have evidence of an extensive and good faith process designed to protect a potentially valuable corporate asset against the committed onslaught of a lowball bidder Whether the directors were right or wrong, and whether their expert advisors were or were not correct, makes absolutely no difference to the outcome of this case What matters is that the Board was more than reasonable in perceiving a threat to the Company – indeed, they were clearly correct in that regard Likewise, their actions were the definition of proportionality. they *three times* sought to avoid having to deploy the only weapon in their corporate arsenal capable of addressing the threat in a timely manner, and when met with Trilogy's stubborn and self-interested intransigence, utilized the least dilutive option available to them

After hearing all the evidence, the Court should conclude that judgment should be entered for the Plaintiff and Counterclaim Defendants, and against the Counterclaim Plaintiffs

ARGUMENT

I. THE EVIDENCE AT TRIAL WILL SUPPORT DECLARATORY JUDGMENT IN FAVOR OF SELECTICA AND JUDGMENT AGAINST TRILOGY.

A. Standard For Declaratory Relief.

Selectica seeks declaratory judgment that the Board's and the Review Committee's actions in (i) adopting the NOL Pill on November 16, (ii) authorizing the Exchange on January 2, and (iii) adopting the Amended NOL Pill and issuing a new rights dividend on January 2, were valid and proper "[T]he principal, salutary purpose of the declaratory judgment procedure is to provide a technique for early resolution of disputes where a party is suffering practical consequences from uncertainty arising from the assertion by another of a legal claim" *Schick Inc v Amalgamated Clothing & Textile Workers Union*, 533 A 2d 1235, 1241 (Del Ch 1987) There is no dispute that the Court may properly enter declaratory judgment as to the propriety of Selectica's actions The parties' interests are real and adverse, and the dispute is ripe *See Korn v New Castle County*, 2005 WL 2266590, at *5 (Del Ch Sept 13, 2005, revised Sept 27, 2005) Trilogy acknowledges that declaratory relief is appropriate by seeking declaratory and monetary relief as to the same facts

B. The Actions Of The Board And The Review Committee Were Valid Under Delaware Law.

As an initial matter, there can be no doubt that the Board and the Review Committee acted within their statutory authority in adopting the NOL Pill on November 16, authorizing the Exchange pursuant to the terms of the NOL Pill on January 2, and adopting the Amended NOL Pill and issuing a new rights dividend on January 2 The authority of a board of directors (or a committee of a board exercising power delegated by the board) to adopt a rights plan is well settled *See* 8 *Del C* §§ 141(a), 157; *Moran v Household Int'l, Inc* , 500 A 2d 1346, 1353, 1356 (Del 1985) (holding that defendant board validly adopted its rights plan pursuant to, *inter alia*,

inherent managerial authority under Section 141(a) and authority to issue rights under Section 157); *Leonard Loventhal Account v Hilton Hotels Corp*, 780 A 2d 245, 248 (Del 2001) ("It is settled Delaware law that a corporation chartered under the laws of this State may adopt shareholder rights plans ") (citing *Moran*, 500 A 2d 1346) It is equally well settled that the Delaware General Corporation Law (the "DGCL") does not limit the use of rights plans to the ordinary context of slowing a hostile takeover attempt in order to give the board of directors time to protect stockholder interests properly *See Hollinger Int'l, Inc v. Black*, 844 A 2d 1022, 1082-84 (Del Ch 2004) (rejecting claim that a rights plan triggered by sale of corporation's controlling stockholder was invalid under the DGCL, and holding that "the permissibility of the [rights plan] hinges on the equities"), *aff'd*, 872 A 2d 559, 567 & n 16 (Del 2005) There is no dispute that Selectica has complied with the relevant statutory formalities with respect to the NOL Pill and the Amended NOL Pill

Further, the DGCL reflects a clear policy determination that NOLs and other tax attributes are legitimate corporate assets, and indeed that such assets may be so important to corporations as to justify derogation from the ordinary public policy in favor of the free transferability of stock Section 202 of the DGCL expressly permits corporations to impose reasonable restrictions on transfer of shares, including restrictions "on the amount of the corporation's securities that may be owned by any person or group of persons " *See* 8 *Del C* § 202(a) The same section expressly provides that restrictions adopted for certain enumerated purposes "shall be conclusively presumed to be for a reasonable purpose " *See* 8 *Del C* § 202(d) Among the purposes "conclusively presumed" to be reasonable is "maintaining any federal tax advantage to the corporation or its stockholders, including without limitation maintaining or preserving net operating losses " *See* 8 *Del C* § 202(d)(1)(b) This statutory

presumption in favor of the reasonableness of transfer restrictions designed to preserve NOLs at the very least implies that the use of an independently permissible mechanism – such as a stockholder rights plan – to achieve the same end cannot be *per se* unlawful

Finally, as the Supreme Court held in *Unocal*, Delaware's "corporate law is not static It must grow and develop in response to, indeed in anticipation of, evolving concepts and needs " *Unocal Corp v Mesa Petroleum Co* , 493 A 2d 946, 957 (Del 1985) For that reason, the Court historically has reviewed boards' decisions to adopt or deploy rights plans under the fact-specific reasonableness analysis set forth in *Unocal* and its progeny *See Moran*, 500 A 2d at 1356; *Hollinger*, 844 A 2d at 1084 ("The traditional test for examining whether a Rights Plan was permissibly adopted is that set forth in *Unocal* ") To Selectica's knowledge, this Court has never invalidated a rights plan solely on the basis of an impermissibly low trigger, and no statutory basis exists for imposing a minimum trigger level on rights plans [18] No *per se* rule prohibiting rights plans with triggers below a specified level exists in Delaware law, and the Court should decline Trilogy's expected invitation to impose one now

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[18] This Court's jurisprudence concerning the validity of termination fees in merger agreements provides a useful parallel in evaluating the validity of the 4 99% trigger threshold in the NOL Pill and Amended NOL Pill Despite much discussion among practitioners and academics concerning the maximum permissible size of a termination fee, the Court has steadfastly refused to adopt any bright-line rule approving or disapproving termination fees above or below a certain size or proportion of deal value *See, e g*, *Paramount Commc'ns Inc v QVC Network Inc* , 637 A 2d 34, 49 (Del 1994); *La Mun Police Employees' Ret Sys v Crawford*, 918 A 2d 1172, 1191 n 10 (Del Ch 2007) (emphasizing that the inquiry into the validity of termination fees is, "by its very nature fact intensive, [and] cannot be reduced to a mathematical equation"); *In re IXC Commc'ns, Inc v Cincinnati Bell, Inc* , 1999 WL 1009174, at *10 (Del Ch Oct 27, 1999) ("It is very difficult to say that any termination fee is so excessive *on its face* that it is unenforceable ") (emphasis in original); *In re Toys R Us, Inc S'holder Litig* , 877 A 2d 975, 1016 (Del Ch 2005) ("Th[e] reasonableness inquiry does not presume that all business circumstances are identical or that there is any naturally occurring rate of deal protection, the deficit or excess of which will be less than economically optimal ")

Trilogy's contention that the NOL Pill and Amended NOL Pill are *per se* illegal, *see* Counterclaim, ¶¶ 51, 97(a), therefore necessarily fails [19] Because Trilogy cannot identify any way in which the actions of the Board and the Review Committee have exceeded the directors' statutory authority, the Court should review those actions under *Unocal* and under the business judgment rule The evidence at trial will show that the Board and the Review Committee acted appropriately and consistently with their fiduciary duties Consequently, the Court should enter the declaratory relief that Selectica seeks

C. The Board's November 16, 2008 Decision To Adopt The NOL Pill Was An Appropriate Exercise Of Fiduciary Responsibility Under *Unocal*.

The board of directors is under a "fundamental duty and obligation to protect the corporate enterprise, which includes stockholders, from harm reasonably perceived, *irrespective of its source* " *Unocal*, 493 A 2d at 954 (emphasis added) The Board satisfies its burden under *Unocal* by making a two-part showing First, the "directors must show that they had reasonable grounds for believing that a danger to corporate policy and effectiveness existed " *Id* at 955 Where the challenged actions are taken by a majority of disinterested and independent directors, the board's showing of good faith and reasonable investigation is "materially enhanced " *Id*; *see also Polk v Good*, 507 A 2d 531, 537 (Del 1986) (presence of a majority of outside directors, coupled with a showing of reliance on advice by legal/financial advisors, "constitute a *prima facie* showing of good faith and reasonable investigation") Second, "the directors must show that the defensive mechanism was 'reasonable in relation to the threat posed '" *Moran*, 500 A 2d at 1345 (*quoting Unocal*, 493 A.2d at 955) To satisfy this second prong, the actions taken must not be draconian (*i e* not preclusive or coercive), and must be "within a range of

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[19] The statutory permissibility of the Exchange and the adoption of the Amended NOL Pill follow from the statutory permissibility of the NOL Pill

reasonableness." *Unitrin, Inc v Am Gen Corp*, 651 A 2d 1361, 1388-89 (Del 1995) The *Unocal* standard "is not intended to lead to a structured, mechanistic, mathematical exercise"; rather, it is a "flexible paradigm that jurists can apply to the myriad of 'fact scenarios' that confront corporate boards" *Unitrin*, 651 A 2d at 1373-74 Finally, it bears emphasis that the Court, in applying *Unocal* scrutiny, determines "whether the directors made a *reasonable* decision, not a *perfect* decision"[20] *Id* at 1385 (emphasis in original) If the actions of the Board were reasonable, they are "entitled to review under the traditional business judgment rule" *Id* at 1390

1. The Board Reasonably Identified A Threat To Corporate Policy And Effectiveness.

The evidence at trial will show that the Board, which consisted exclusively of independent and outside directors, undertook a reasonable investigation and reasonably identified a threat to corporate policy and effectiveness As an initial matter, the Board as of November 16 consisted entirely of independent, outside directors who were actively engaged in an effort to sell the Company or its assets None of the directors is an employee, and the Review Committee (*i e*, the committee that decided on January 2 to authorize the Exchange, to adopt the Amended NOL Pill and to issue a new rights dividend) consisted of the two directors who did

[20] Because the touchstone of the *Unocal* analysis is reasonableness, not perfection, a great portion of Trilogy's expert presentation is simply beside the point The directors' fiduciary duties required them to undertake a reasonable investigation and take reasonable action, not to insure the correctness of their advisors' conclusions nor to take some ideal course of action in response to that threat The evidence will show that the NOLs were and are in fact valuable to the Company and that the NOLs at present are not subject to a change-of-ownership limitation under Section 382 However, the Court need not determine what value the NOLs had or whether a change of ownership under Section 382 has occurred to resolve this case in Selectica's favor, because even if Trilogy's experts are right and the directors (and their expert advisors) were wrong about the value of the NOLs, the Board's investigation and actions were reasonable Because the directors carried out their fiduciary duties, their actions are entitled to judicial deference under the business judgment rule, even if the Court determines that the directors made a good faith (or even a negligent) mistake about the potential value of the NOLs to the Company

not serve as co-chairmen[21] None of the directors stood on both sides of any transaction or obtained a personal benefit not shared generally with all stockholders[22] Especially in light of the ongoing Needham process and the rights plan with a 15% trigger that had been in place since 2003, there is no basis for suspicion that the directors lowered the poison pill trigger (or took any of the subsequent actions at issue) for entrenchment purposes The Company and its directors will demonstrate a good faith investigation and determination of the need for the NOL Pill, and that showing will be "materially enhanced" by proof of the independence and disinterest of the directors

The trial record will show that the Board undertook a reasonable investigation and concluded that the Company's NOLs were a potentially valuable asset that merited protection Both the DGCL and generally accepted accounting principles recognize that tax attributes, including NOLs, may be valuable corporate assets *See* 8 *Del C* § 202(d)(1); PX 130 at 8-10 The NOLs took on added significance during the summer of 2008 **REDACTED**

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[21] For purposes of the "material enhancement" standard under *Unocal*, Mr Thanos and Ms. Zawatski do not lose their status as independent outside directors due to their service as co-chairs of the Board *See Aquila, Inc v Quanta Svcs, Inc*, 805 A 2d 196, 198 n 1, 206-07 (Del Ch 2002) (considering a non-executive chairman of the defendant corporation's board of directors to be independent when determining whether the "material enhancement" standard applied); *see also* Zawatski Dep at 20-21, Thanos Dep at 21-23 Similarly, they remain outside independent directors

REDACTED *See* Zawatski Dep at 237

238

Thanos Dep at 136-37 **REDACTED**

[22] The Court has, of course, long rejected the thesis that directors are "interested" in a decision to implement defensive measures solely as a result of their assumed desire to remain directors or to continue to receive ordinary director fees *See, e g, In re Limited, Inc S'holders Litig*, 2002 WL 537692, at *4 & n 27 (Del Ch Mar 27, 2002) The evidence makes clear that the directors' fees are not out of the ordinary, and there is no basis to believe that the directors' fees are material to any of the directors individually *See* Zawatski Dep at 17, 20-21, 24; Arnold Dep at 12, 15, 19-20; Sems Dep at 4; Thanos Dep at 15, 20 Moreover, this case arises in the context of the Board making great efforts to *sell* the Company

REDACTED

See Reilly Dep at 12-13. The directors relied on their expert advisors, Brogan and Reilly, **REDACTED**

The Board also acted reasonably in November when it determined that Trilogy's sudden emergence as a greater-than-5% stockholder constituted a threat to the value of the NOLs When Fallon called Zawatski on November 10 to announce that Trilogy had bought through the 5% threshold, he told her that Trilogy intended to continue buying, and that Trilogy was seeking to accelerate Selectica's sale process *See* PX 109 at SEL 17320; Fallon Dep at 144 The Board learned from Brogan that the purchases by Trilogy had increased the three-year rolling change of ownership among 5%-or-greater holders to nearly 40% The Board relied both on Brogan's expert advice and on its own business acumen to make the determination, clearly correct under the circumstances, that the Company stood exposed to a potential change of ownership under Section 382 through the actions of market participants As Brogan and Reilly advised, were such a change of ownership to occur, much of the value of the NOLs would be lost Moreover, as Brogan advised, and as Trilogy's purchases made very clear, such a change of ownership could happen very quickly and without advance notice to the Company [23]

The Board met for over two and a half hours on Sunday, November 16, to discuss the foregoing and other factors. The Board obtained the advice of its legal counsel as well as the advice of its investment banker Reilly and its NOL expert Brogan The Board expressly noted

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[23] Again, as noted above, at approximately the time of the November 16 meeting, Selectica became aware of another new greater-than-5% stockholder, Soundpost Partners Although Soundpost did not file its Schedule 13G until after the November 16 meeting, Soundpost's actions provide further confirmation of the Board's concern that even good faith, uncoordinated actions of market participants could push the Company toward an ownership change under Section 382

that, since Fallon had advised that Trilogy had crossed the 5% threshold, an additional 2 3% of the Company had changed hands *See* PX 89 Nothing stopped Trilogy or anyone else from buying additional shares over the 5% threshold and pushing the change-of-ownership calculation ever higher and the NOLs into ever greater danger The Board plainly had reasonable grounds to conclude that a threat to corporate policy and effectiveness existed as of November 16

2. Adoption Of The NOL Pill Was A Reasonable And Proportionate Response To The Threat Identified.

Having identified a threat to a potentially valuable corporate asset, the Board was duty-bound to act to forestall the threat *See Unocal*, 493 A 2d at 954 ("[W]e are satisfied that in the broad context of corporate governance, including issues of fundamental corporate change, a board of directors is not a passive instrumentality ") (footnote omitted) The evidence at trial will demonstrate that the Board undertook a reasonable consideration of its alternatives and chose a course of action that was non-draconian, reasonable and proportionate to the threat The Board's decision therefore is entitled to deference under the business judgment rule

As described above, after a lengthy meeting during which the Board received advice from its outside counsel, its investment banker and its NOL expert, the Board resolved to amend the Company's pre-existing shareholder rights plan in several respects, including (i) lowering the level of ownership at which a stockholder could become an Acquiring Person from 15% to 4 99%; (ii) "grandfathering" greater-than-5% stockholders as of November 17, 2008 and permitting such holders a 0 5% "cushion" for additional purchases; and (iii) allowing the Board to declare a purchase an "Exempt Transaction " *See* PX 99 at §§ 1(a), 1(o) These amendments clearly were designed to prevent further material increases in the "change of ownership" calculation under Section 382 Concurrently, the Board established the Review Committee,

consisting of Arnold and Sems, with a mandate to make periodic determinations about the ongoing need for a rights plan to protect the Company's NOLs PX 89 at 17243-44

The expected focus of Trilogy's fiduciary duty challenge to the NOL Pill is its purported preclusive effect *See* Counterclaim, ¶¶ 100, 123 The evidence at trial will show that the NOL Pill was not preclusive under *Unocal* A defensive measure is not preclusive merely because it inhibits potential takeover attempts or because it makes an insurgent's task more difficult *See, e g , Unitrin*, 651 A 2d at 1388-89 Defensive measures are *designed* to make takeovers more difficult, and, as the Court has previously noted, it would be "surprising if defensive measures did not have this effect" *In re Gaylord Container Corp S'holders Litig* , 753 A 2d 462, 482 (Del Ch 2000) Accordingly, the Court does not deem a defensive measure preclusive under *Unocal* unless that measure renders an insurgent's takeover effort "mathematically impossible or realistically unattainable" *Unitrin*, 651 A 2d at 1388-89, *see also Carmody v Toll Bros , Inc* , 723 A 2d 1180, 1195 (Del Ch 1998) (same) Crucially, the Court does not evaluate the preclusiveness of rights plans in a factual vacuum Rather, as the Court in *Gaylord Container* expressly held:

> While it is true that a poison pill absolutely precludes a hostile acquisition so long as the pill remains in place, the mere adoption of a garden-variety pill is not in itself preclusive under Delaware law That is because in the event of a concrete battle for corporate control, the board's decision to keep the pill in place in the face of an actual acquisition offer will be scrutinized again under *Unocal*

753 A 2d at 481 (footnote omitted); *see also Barkan v Amsted Indus , Inc* , 567 A 2d 1279, 1287 (Del 1989) That is, the mere adoption (or amendment) of a rights plan is non-preclusive as a matter of law, because the Court will review a board's decision to maintain (or to refuse to redeem) a pill in response to a concrete acquisition proposal separately from the same board's decision to adopt the pill in the first place Trilogy has not made, before or after November 16,

any concrete acquisition proposal with which a pill (of any triggering threshold) would interfere Because the Board has not decided to maintain the NOL Pill in the face of an acquisition proposal with which that pill would interfere, there is no basis on which to find the NOL Pill preclusive [24]

Further, the evidence at trial will make clear that the Board's decision to adopt the NOL Pill did not preclude potential takeovers as a practical matter Selectica had publicly announced its retention of Needham and its willingness to consider value-maximizing transactions Trilogy's rhetoric notwithstanding, the record reveals no basis to believe that the Board, despite its stated interest in selling, really intended to use the NOL Pill as a means to fend off *bona fide* acquisition proposals and remain in control

Moreover, even if a prospective bidder chose to make a hostile acquisition offer, the NOL Pill did not pose an insurmountable obstacle to a proxy contest to replace the Board As noted above, Selectica's proxy solicitation expert will testify that, notwithstanding the 4 99% threshold, the NOL Pill does not preclude an insurgent's success in a potential proxy contest [25]

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[24] For purposes of the preclusion analysis at the stage of adoption (as distinct from the stage of deployment), there is no meaningful distinction between the NOL Pill and the "garden variety" rights plans that the Court has upheld in *Gaylord Container*, *Moran* and numerous other cases in the past 25 years The NOL Pill functions in exactly the same way as a pill with a 15% or higher triggering threshold would, and "absolutely precludes a hostile acquisition so long as the pill remains in place," *see Gaylord Container*, 753 A 2d at 481, no more and no less than would a pill with a higher threshold That the NOL Pill may make a hypothetical proxy contest marginally more difficult for some prospective insurgents is of no consequence, especially in light of (i) Selectica's announced willingness to sell the Company or its businesses; and (ii) the provision in the NOL Pill expressly permitting the Board to exempt stockholders or purchases from the 4 99% limit

[25] *See generally* PX 121, PX 122 Among other items of data, Mr Harkins identified, during the years 2006-08, eight proxy contests that took place at public companies with a market capitalization under $50 million and that were mounted by an insurgent holding less than 5% of the target company's outstanding shares PX 121 at 5 In those eight contests, the insurgent prevailed in six Notably, even the artificially restricted data set proffered by Professor Ferrell includes one example of a proxy contest won by an insurgent holding approximately 1% of the target company's stock *See* Ferrell Report at 20; Ferrell Dep at 62

This intuitively obvious conclusion – that a pill that forces a prospective insurgent to start with less than 5% of a target company's stock makes success in a proxy contest more difficult at the margin, but not impossible – conclusively negates any claim that the NOL Pill was preclusive under *Unocal* due solely to its 4 99% trigger [26]

Nor was the NOL Pill preclusive when considered in conjunction with the Company's classified board or other pre-existing defensive measures It is certainly true that the charter provision classifying the Board inhibits an acquirer from taking control of the Board through fewer than two proxy contests, but the staggered board would have that effect even if Selectica had a 15% trigger pill or no pill at all Moreover, the DGCL expressly authorizes classified board provisions, *see* 8 *Del C* § 141(d), and the Court has recognized that a staggered board can operate only to delay, not to preclude, a takeover via proxy contest *See, e g*, *Toll Bros*, 723 A 2d at 1186-87 The combination of a poison pill and a classified board undoubtedly makes such a takeover more difficult at the margin, but there is no evidence that the two provisions in combination render a takeover impossible [27] Similarly, the NOL Pill and the classified board do

[26] *Cf Unitrin*, 651 A 2d at 1383 ("The key variable in a proxy contest would be the merit of [the insurgent's] issues, not the size of its stockholdings ") (*citing Moran*, 500 A 2d at 1355)

[27] Trilogy's attack in its pleadings on various other corporate governance features that may be considered "defensive" necessarily fails for lack of proof In addition to the NOL Pill and the staggered board, Trilogy mentions that Selectica's charter or bylaws prohibit stockholder action by written consent, prohibit stockholders from calling special meetings, grant the directors "blank check preferred" power, and impose advance notice requirements on nominations of director candidates and proposals for business to be transacted at an annual meeting *See* Counterclaim, ¶ 88 All of these provisions are permissible, all have been in place at Selectica for many years, and none were imposed by the current directors Indeed, Trilogy bought its shares in October 2008 with constructive (if not actual) knowledge of all of these provisions Moreover, the Court has recognized that there is no naturally-occurring rate or combination of defensive measures, and that parties attacking corporate defenses must make a specific showing that the defensive measures in combination operate in a preclusive, coercive or unreasonable manner *See Crawford*, 918 A 2d at 1181 n 10; *see also Gaylord Container*, 753 A 2d at 480 n 64 Moreover, Trilogy itself managed to overcome a nearly-identical set of defenses when it acquired Versata, Inc (now a part of the Trilogy organization) through a negotiated merger agreement and friendly tender offer in late 2005 *See* PX 26 - PX 35 inclusive

not, separately or together, preclude a potential acquirer from making a tender offer conditioned upon redemption of the rights or an exemption by the Board In addition, Harkins will testify at trial that a proxy contest at this Company would not be prohibitively expensive given the stockholder profile; indeed, the cost likely would be modest The Company's combination of defensive devices, whether including or excluding the NOL Pill, is not preclusive under *Unocal*

Finally, the evidence at trial will show that the NOL Pill was within a range of reasonable responses to the threat to the Company's NOLs posed by Trilogy's acquisitions "The *ratio decidendi* for the 'range of reasonableness' standard is a need of the board of directors for latitude in discharging its fiduciary duties to the corporation and its shareholders when defending against perceived threats " *Unitrin*, 651 A 2d at 1388 Indeed, "if a board reasonably perceives that a threat is on the horizon, it has broad authority to respond with a panoply of individual or combined defensive precautions " *Id* at 1388 n 38. Implicit in this deferential standard is "[t]he concomitant requirement . for judicial restraint " *Id* at 1388, *see also Paramount Commc'ns, Inc v Time, Inc*, 1989 WL 79880, at *29 (Del Ch July 14, 1989) (when analyzing the reasonableness of defensive measures under *Unocal*, "it is prudent to keep in mind that the innovative and constructive rule of *Unocal* must be cautiously applied lest the important benefits of the business judgment rule (including designation of authority to make business and financial decisions to agencies, *i e*, boards of directors, with substantive expertise) be eroded or lost by slow degrees "), *aff'd*, 571 A 2d 1140 (Del 1990)

As described above, the Company had accumulated substantial NOLs over many years, and the Board had monitored the NOLs for some time During the summer of 2008, the Board hired an investment banker and embarked on a process designed to identify a potential value-maximizing transaction As of November 16, the Board had numerous reasons for believing

both that the NOLs potentially constituted a significant part of the Company's overall value and that a Section 382 change of ownership would materially impair that value without creating any new value for the Company The Board met with its counsel, the investment banker running the strategic process, and an expert on NOLs The Board was advised

REDACTED

The Board had very few options for preventing a change of ownership under Section 382 The Board lacked the power to impose transfer restrictions unilaterally on non-consenting stockholders *See* 8 *Del C* § 202(b) Even if a charter amendment could have prevented a change of ownership, the necessary stockholder approval would have taken months, during which time the NOLs would have had no protection A rights plan likely was the Board's only viable option for preventing market trading from causing a Section 382 change of ownership

The Board considered a number of possible permutations of the pill before settling on the terms of the NOL Pill For example, the Board considered whether or not to allow current greater-than-5% holders a "cushion," *i e* , to allow such holders to buy a small number of additional shares without triggering the rights, and decided on a 0 5% cushion Despite the urgency, the Board delayed the effectiveness of the NOL Pill until the close of business on the day the NOL Pill was announced The Board carved out express exemption authority and created a committee expressly charged with reviewing periodically the continuing need for a pill with a 4 99% trigger *Cf Stahl v Apple Bancorp, Inc* , 1990 WL 114222, at *7 (Del Ch Aug 9, 1990) (noting that a board "has a continuing duty to assess the impact of its stock rights plan

upon the corporation and its stockholders and, to the extent it has legal power to do so, amend the plan or redeem the rights, when and if its fiduciary duty to the corporation dictates.")

All of the foregoing factors bespeak an action proportional to the identified threat. The NOL Pill did not punish past actions or immediately dilute any stockholder's interest. The NOL Pill did not force any current stockholders to divest. The intended effect of the NOL Pill was to give the Board breathing room to complete the Needham process. The Board did only what it had to do to allow the Company to continue on the course the Board had previously charted. *See Paramount Commc'ns, Inc. v. Time, Inc.*, 571 A.2d 1140, 1150 (Del. 1989); *Unitrin*, 651 A.2d at 1361 ("range of reasonableness" analysis should take into account whether the response "was limited and corresponded in degree or magnitude to the degree or magnitude of the threat")

The purported rarity of NOL pills among all US-listed corporations does not detract from the reasonableness of the Board's response. The parties' respective experts agree that dozens of companies have adopted pills with thresholds in the vicinity of 5% for the avowed purpose of protecting NOLs. *See* Ferrell Report at 5-7; PX 128 at 10-11 & Ex. D. That a given defensive measure or combination of defensive measures is relatively unusual among some arbitrarily large set of corporations does not make that measure or combination of measures unreasonable.[28] *See Gaylord Container*, 753 A.2d at 480 n.64. The evidence at trial will show that Trilogy's contentions that the NOL Pill renders potential proxy contests prohibitively expensive,[29] or that

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[28] As Prof. Coates will testify at trial, pills designed to protect NOLs are customary and reasonable in certain circumstances. That most publicly-traded corporations do not face such circumstances does not imply that NOL pills are unreasonable or unusual for the corporations that do face such circumstances. *See* PX 128; *see also* PX 129 (identifying circumstances under which Risk Metrics will recommend in favor of a poison pill designed to protect NOLs).

[29] As Harkins will testify at trial, the concentration of Selectica's stock would allow an insurgent to solicit the support of the holders of a majority of the Company's outstanding shares in a minimal number of communications. *See* PX 121, PX 122; *compare Unitrin*, 651 A.2d at 1383 n.33 (finding significant to a company's susceptibility to a proxy contest "the fact that the relatively concentrated

the NOL Pill is improperly discriminatory against Trilogy,[30] lack factual and legal foundation For all of these reasons, and those to be adduced at trial, the NOL Pill was a non-draconian and reasonable response to a threat that the Board identified in good faith and after appropriate and careful investigation The Board's decision to adopt the NOL Pill is therefore entitled to protection under the business judgment rule *See Unitrin*, 651 A 2d at 1390

D. The Review Committee's January 2, 2009 Decisions To Authorize The Exchange, To Adopt The Amended NOL Pill And To Declare A New Rights Dividend Were Appropriate Exercises Of Fiduciary Duty Under *Unocal*

The Court also should enter judgment in favor of Selectica and its Board as to the Review Committee's actions on January 2, 2009 As described above, material factual developments had occurred between November 16 and January 2 **REDACTED**

See PX 24 Within two days after the Las Vegas meeting, Trilogy had deliberately bought a sufficient number of shares to become an Acquiring Person Trilogy then announced to the world that it had done so and that it intended to continue to buy shares **REDACTED**

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percentage of stockholdings would facilitate a bidder's ability to communicate the merits of its position") Trilogy's contention that a proxy contest would be excessively expensive depends entirely on the expected testimony of Prof Ferrell – who concedes he has no personal experience with proxy contests, Ferrell Dep at 12 – which is not reliable on this point In any event, Trilogy's complaint about the potential cost of a proxy contest (which Trilogy is not waging) is belied by Trilogy's conscious decision to trigger the NOL Pill, a more economically costly decision than running a proxy contest would be, even accepting Prof Ferrell's uninformed and inflated estimate of the cost of a proxy contest

[30] The NOL Pill treats all stockholders, including Trilogy, identically, unless and until those stockholders elect to trigger the pill Every rights plan, regardless of trigger level, "discriminates" in the sense that it treats the acquiring person differently than other stockholders, and that is a perfectly permissible feature *See, e g*, *Hollinger*, 844 A 2d at 1083 More generally, directors responding to threats to corporate policy and effectiveness are entitled to treat the source of the threat differently from other stockholders *See, e g*, *Unocal*, 493 A 2d at 957 (upholding discriminatory self-tender)

There can be no doubt that the Board and the Review Committee acted reasonably in identifying a threat from Trilogy's actions following November 16. The Board met eight times between November 16 and January 2; six of those meetings occurred after Trilogy deliberately became an Acquiring Person on December 19. After Trilogy triggered the NOL Pill and

REDACTED Trilogy

refused three separate requests for a standstill, in a clear effort to force the Board's hand. At the December 29 meeting, the full Board received updated presentations from Brogan and Reilly, as well as outside counsel. *See* PX 95. The evidence will leave no doubt that the Board acted with more than due care in considering its options.[31]

The threat that the Board and the Review Committee faced in late December and early January was obvious and imminent. The NOL Pill was a valid and binding contract between the Company and the rights agent, and Trilogy's actions triggered rights and obligations under the NOL Pill. If the Board chose to do nothing, the rights would detach, trade separately from the common stock, and become exercisable for $36 in new Selectica common stock at an exercise price of $18. As discussed above, that was an unappetizing prospect for a number of reasons, among them the unpredictability of the stockholders' response to such an event.[32] Alternatively,

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[31] It should also be noted that the decisions to authorize the Exchange and the Amended NOL Pill were, in the final analysis, the Review Committee's decisions, pursuant to a delegation of the full power and authority of the Board made on December 29 and reiterated and reconfirmed on January 2. *See* PX 95 at SEL 17285-85; PX 97 at SEL 17295. The two Review Committee members are both unquestionably disinterested and independent directors. The Review Committee's showing of proper identification of a threat, to which the Exchange, the Amended NOL Pill and the new rights responded, is "materially enhanced" under *Unocal*.

[32] As noted above, it was possible that the stockholders would exercise so many rights that the Company would be unable to issue a sufficient number of common shares consistent with the authorization in its charter, and would be forced to issue debt or preferred equity to cover the shortfall. Alternatively, it was possible that no one would invest $18 to obtain $36 worth of a stock trading under a dollar, and that Trilogy's tactical conduct would have no consequences. Finally, it was possible that some stockholders (or investors who bought rights from stockholders) would exercise and others would not,

the Board could back down and grant Trilogy an exemption, but given Trilogy's repeated refusal to agree to a standstill and its avowed desire to put pressure on the Company, such a choice would have encouraged Trilogy (and potentially others) to continue buying Both of these options appeared likely to result in a substantial blow to the value of the NOLs

The remaining option under the NOL Pill, the Exchange, plainly was the most reasonable and most proportionate response to the threat posed by Trilogy's deliberate decision to become an Acquiring Person and its repeated refusal to agree to a standstill [33] The Exchange imposed a relatively small but noticeable economic penalty on Trilogy for its tactical conduct, making good on the deterrent effect that the NOL Pill was intended to have in the first place The Exchange neatly avoided the uncertainty of stockholder response entailed in the flip-in and had a predictable *de minimis* effect on the change-of-ownership calculation under Section 382, diminishing Trilogy's ownership by approximately half and increasing all other stockholders' interests marginally The Exchange was proportionate to the threat and is entitled to protection under the business judgment rule

For similar reasons, the Court should uphold the Review Committee's decision to adopt the Amended NOL Pill and issue a new rights dividend under the business judgment rule The threat to the NOLs that justified adoption of the original NOL Pill in November continued to exist in early January; if anything, Trilogy's tactical decision to obtrude its own interests on those of the Company and all the stockholders magnified the threat The Board believed, **REDACTED**

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with the result that the stockholders' proportionate ownership of the Company could shift, perhaps substantially and perhaps causing a change of ownership under Section 382 by itself That the Board could not be confident that allowing the rights to become exercisable would preserve the NOLs weighed against choosing such a course of conduct

[33] It is evident that the Exchange was not a preclusive or coercive defensive measure under *Unocal* The Exchange did not foist any buyout proposal on the stockholders, nor did it preclude future proxy contests, tender offers, or other proposals

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See PX 95 at SEL 17277 A pill to protect the Company's NOLs was clearly an appropriate response[34] The Exchange, however, resulted in the previously-issued rights ceasing to be outstanding, with the result that no pill at all (let alone one tailored to protect the Company's NOLs) would have been in place absent further Board or Review Committee action A new rights dividend clearly was a necessary corollary of the decision to authorize the Exchange, and that decision of the Review Committee should be upheld under *Unocal* and the business judgment rule[35]

II. APPROPRIATE FORMS OF RELIEF.

As set forth above, Selectica is entitled to judgment on all counts of the Amended Complaint and on all counterclaims The Court should declare that the NOL Pill and Amended NOL Pill were valid, that the rights issued under each were (and in the case of the rights issued under the Amended NOL Pill, are) valid and binding, that the shares issued in connection with the Exchange were validly issued, and that the Board has fulfilled its fiduciary obligations in connection with the foregoing matters Selectica reserves the right to seek an award of attorneys' fees and costs as an element of damages based on Trilogy's intentional decision to trigger the

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[34] The Amended NOL Pill differs from the original NOL Pill in several ways that make manifest the Review Committee's further effort to tailor the pill to the Company's situation *See* PX 101 The Amended NOL Pill is set to expire in three years, a customary feature of NOL pill plans that derives ultimately from the three year rolling time frame of the change-of-ownership calculation under Section 382 In light of the compact time frame and the reasonable expectations about the movement of the Company's common stock price over that period, the Review Committee set the exercise price under the Amended NOL Pill significantly lower than it had been under the 2003 plan and the NOL Pill

[35] Because Selectica will establish its entitlement to declaratory relief, it follows that Trilogy is not entitled to relief on its first three counterclaims, which mirror Selectica's claims As noted in the Pretrial Order, Trilogy has amended its pleadings to dispose of its fourth and fifth counterclaims, relating to alleged breach of the duty of disclosure and alleged tortious interference with prospective business relations, as well as its request for punitive damages As Trilogy has waived these claims, Selectica will not address them herein, but reserves the right to address them in subsequent papers should Trilogy seek to reassert such claims

NOL Pill and refusal to agree to a standstill *See Arbitrium (Cayman Islands) Handels AG v Johnston*, 705 A 2d 225, 231 (Del Ch 1997)

Trilogy seeks a wide variety of forms of relief, and a number of them must be deemed barred by various equitable doctrines To the extent Trilogy continues to seek injunctive relief preventing the Exchange or rescission of the Exchange, that request obviously has become impractical and is barred by laches Trilogy failed to seek temporary or preliminary relief from the Exchange for several weeks following the Exchange, before the shares were actually issued pursuant to the Exchange, and the shares were actually issued nearly three months ago

To the extent Trilogy seeks a damage award, that request fails for a number of reasons As an initial matter, Trilogy's conscious decision to trigger the NOL Pill and to spurn multiple requests for a standstill agreement constitutes unclean hands, acquiescence and waiver of any potential damage award Trilogy, which owned no shares at the beginning of October 2008 and then acquired over 6% of the Company in a matter of weeks, knew about the NOL Pill,

REDACTED

Trilogy acted irrationally as a stockholder in order to hold all other stockholders' interests hostage to its own interests as a creditor and an intellectual property licensor Trilogy could have challenged the validity of the NOL Pill without triggering it, or could have agreed to a standstill; instead, Trilogy forced the Company to incur the regulatory and legal costs and distractions associated with the Exchange With respect to any claim that Trilogy has suffered economic harm arising from the Exchange, Trilogy has unclean hands, and its knowing decision to trigger the NOL Pill constitutes acquiescence in the contractual consequences of the pill and waiver of any claim for monetary relief Even if the Court determines after trial that Trilogy is entitled to relief and that Trilogy's

own conduct does not bar such relief, the record will reveal no basis for a damage award. *Compare Frontier Oil Corp. v. Holly Corp.*, 2005 WL 1039027, at * 39 & n 241 (Del. Ch. Apr. 29, 2005) (awarding only nominal damages where prevailing party failed to present proof quantifying damages). Trilogy has not identified a damages expert or submitted any quantification of damages.[36]

Even if a non-speculative basis exists for awarding damages against the Company, and even if such relief is not barred, damages cannot be awarded against the individual directors. To the extent Trilogy's claims sound exclusively in the duty of care, Selectica's certificate of incorporation (which contains an exculpatory provision permitted by 8 *Del. C.* § 102(b)(7)) precludes a damage award against the individual directors. *See* PX 131. Moreover, the record will show that the directors relied in good faith on experts selected with reasonable care in determining (i) that the NOLs were a potentially valuable corporate asset, (ii) that the NOLs were threatened by Trilogy's conduct and other investors' potential conduct, and (iii) that the NOL Pill, the Exchange and the Amended NOL Pill were appropriate and proportional responses to the threat. The directors therefore are fully protected from liability. *See* 8 *Del. C.* § 141(e).

CONCLUSION

The evidence will show that Trilogy, with full knowledge of the consequences of its actions, deliberately triggered Selectica's shareholder rights plan in a misguided effort to coerce

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[36] Trilogy has proffered a purported *rebuttal* expert who claims to have performed an event study and determined that Selectica's stock suffered an "abnormal return" in an aggregate amount of approximately $8.5 million between November 17 (the day the NOL Pill was announced) and January 5 (the day the Exchange was announced). This is insufficient as a quantification of damages for a number of reasons, including (i) the event study makes no effort to exclude the effects of firm-specific news (such as Trilogy's decision to trigger the pill); (ii) the event study includes the results of the January 5 trading session, during which trading in Selectica's stock was halted after it became apparent that the market did not adequately understand the effect of the Exchange; (iii) the event study's reliability is questionable overall due to the thin trading in the stock; (iv) even if the event study has any reliability, it quantifies purported damages to the Company, not to Trilogy individually.

the Board to pay Trilogy substantial sums The Board did not back down, and did exercise its fiduciary duty and judgment For the foregoing reasons and those to be presented at trial and in such post-trial written and oral submissions as the Court may allow, judgment should be entered in favor of Selectica and its directors and against Trilogy.

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Dated. April 22, 2009

EFiled: Apr 22 2009 6:53PM EDT
Transaction ID 24827480
Case No. 4241-VCN

CERTIFICATE OF SERVICE

I hereby certify that on April 22, 2009, a true and correct copy of the foregoing was caused to be served by electronic-filing on the following counsel of record:

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