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Case No. 5465-VCS

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

YUCAIPA AMERICAN ALLIANCE FUND II, L.P., a Delaware limited partnership, and YUCAIPA AMERICAN ALLIANCE (PARALLEL) FUND II, L.P., a Delaware limited partnership, Plaintiffs,	)	C.A. No. 5465-VCS
v.	)	
LEONARD RIGGIO, STEPHEN RIGGIO, GEORGE CAMPBELL JR., MICHAEL J. DEL GIUDICE, WILLIAM DILLARD, II, PATRICIA L. HIGGINS, IRENE R. MILLER, MARGARET T. MONACO, LAWRENCE S. ZILAVY, and BARNES & NOBLE, INC., a Delaware corporation, Defendants.	)	**REDACTED DOCUMENT** **Dated: JULY 11, 2010**

DEFENDANTS' ANSWERING PRE-TRIAL BRIEF

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PRELIMINARY STATEMENT

When a board of directors adopts a poison pill, the legal standard under Delaware law is clear. The Board must reasonably perceive a threat to corporate policy and effectiveness, and the measure must not be preclusive or coercive and must fall within the range of reasonableness. Furthermore, if a majority of the board is independent, the board's ability to satisfy its *Unocal* obligations is materially enhanced. Assuming the board has satisfied its obligations under *Unocal*, its decision to adopt a poison pill is protected by the business judgment rule.

Defendants satisfy *Unocal* here. Plaintiffs' arguments do not lead to a different result. As an initial matter, Plaintiffs assert that the Rights Plan was adopted by the Board for the purpose of frustrating Yucaipa's ability to prevail in a proxy contest. The record does not, and will not, sustain that assertion. Instead, the record is clear that the Rights Plan was adopted based on the advice of counsel because Yucaipa was voraciously buying shares in the marketplace and the Board wanted to ensure that Yucaipa did not acquire control without paying an appropriate premium to all stockholders. Importantly, nowhere in Plaintiffs' brief will the Court find an assertion that the Rights Plan is preclusive or coercive as those terms are defined by Delaware courts. Plaintiffs also do not seriously deny that the Board includes a majority of independent directors.

Plaintiffs argue that the Rights Plan does not fall within the range of reasonableness for two principal reasons. First, they argue that the Rights Plan is outside the range of reasonableness because it contains a grandfathering provision. But, the

record will show that the grandfathering provision was reasonable in this situation, as such clauses are in many situations. Second, Plaintiffs argue that the Rights Plan falls outside the range of reasonableness because agreements among stockholders to run joint slates and share proxy contest expenses would cause the plan to be triggered if the parties to such arrangements collectively own more than 20% of the Company's stock. Joint slates and expense sharing are very uncommon in the world of proxy contests, and are typically prohibited by poison pills. Plaintiffs may not like these provisions, but they cannot credibly argue that they are outside the range of reasonableness.

Finally, Plaintiffs argue that the correct legal standard for analyzing the Rights Plan is not *Unocal*, but rather *Blasius* or entire fairness. Here again, neither the record nor Delaware law will support Plaintiffs' argument.

As set forth in detail in Defendants' Opening Pre-Trial Brief, and as supplemented below, the Rights Plan at issue here is a garden-variety poison pill, and the Board acted exactly as it should have to protect the stockholders. Yucaipa has every opportunity to run and win a proxy contest (though it cannot go into that proxy contest having already locked up the votes).

ARGUMENT

Plaintiffs begin their brief with a quote from the deposition of Stephen Riggio (quoted portion on page 1 of Plaintiffs' brief in regular font below) that they trumpet as the "truth of what occurred here" – allegedly that the Rights Plan was adopted to stop Yucaipa from replacing Leonard Riggio on the Board. However, a review of

what Stephen Riggio actually said demonstrates that the Board adopted the Rights Plan in response to its reasonable fear that Yucaipa, acting alone or in concert with others, would seize control of the Company without paying an appropriate premium and fundamentally change the Company's business strategy:

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(S. Riggio Dep. at 161:2-162:15 (objections omitted).) Thus, as described by Stephen Riggio, the point of the Rights Plan was to guard against a possible acquisition of control without adequate payment to the other stockholders, not to entrench Leonard Riggio. (*See, e.g.*, L. Riggio Dep. at 199:18-201:3; Higgins Dep. at 242:11-25; Del Giudice Dep at 149:22-150:8 and 176:3-24; Zilavy Dep. at 185:14-19.)

Plaintiffs' legal arguments are likewise without merit.

First, the Beneficial Ownership provision that Plaintiffs claim is ambiguous clearly covers joint slates and sharing of proxy contest expenses. It cannot be the case that agreements to vote shares are covered by the Beneficial Ownership definition, but agreements to jointly nominate and advocate the election of a slate or to share the slate's expenses, which amount to the same thing, are not covered. (*See infra* Section I.)

Second, although Plaintiffs suggest that the Rights Plan was enacted for the purpose of preventing or impeding Yucaipa from mounting a proxy contest,[1] the record will show that the Board reasonably perceived Yucaipa's sudden and rapid accumulation of stock as a threat to the Company's stockholders, and the Board acted to prevent Yucaipa (either alone or by forming a group) from obtaining control of the Company without paying an adequate premium and to prevent an "arms race". The provisions of the Rights Plan, which are ordinary and consistent with Delaware law, fall within the range of reasonable responses to those perceived threats. (*See infra* Section II.)

Third, Plaintiffs ask the Court to impose the entire fairness standard of review upon the Board's decision making in adopting a poison pill. However, the adoption of the Rights Plan cannot fairly be described as an "interested" transaction, which was precisely the holding of this Court in, among other cases, *Unitrin*. (*See infra* Section III.)

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[1] In another context, Plaintiffs admit that the record shows that this was *not* the purpose of the Board and is *not* the effect of the Rights Plan. (Pls.' Op. Pre-Trial Br. at 28.)

Fourth, Plaintiffs' rote invocation of the *Blasius* standard fails. The evidence demonstrates that the Board's purpose in adopting the Rights Plan was *not* to interfere with or impede the stockholder franchise, but rather was to prevent the harm to stockholders that would have resulted from the acquisition of control by Yucaipa, either by itself or by forming a group. (*See infra* Section IV.)

I. The Definition of Beneficial Ownership in the Rights Plan is Standard and Unambiguous.

Plaintiffs' claim that there is ambiguity about the scope of the Rights Plan's Beneficial Ownership provisions, as they relate to joint slates and sharing of proxy contest expenses, has been manufactured for purposes of this lawsuit. Not once in the three letters that Yucaipa sent to the Company following the adoption of the Rights Plan was this issue raised. Instead, this issue was first raised in a letter to the Company sent simultaneously with the filing of the Complaint.

Shortly thereafter, the Company's counsel confirmed that Mr. Burkle would not trigger the Rights Plan by, among other things, "communicating his position regarding any candidates or other proposals to other stockholders fully and freely" or "soliciting and receiving revocable proxies in response to any public proxy solicitation", but that Yucaipa would trigger the Rights Plan if it were to "jointly share expenses of a proxy contest or propose a joint slate of directors". (Transmittal Aff. of Dawn M. Jones in Support of Defs.' Op. Pre-Trial Br. ("Jones Aff."), Ex. 45 (5/11/10 Ltr. from S. Goldstein to D. Robbins).)

A. <u>The Beneficial Ownership Provision is Standard.</u>

As set forth below, the "Beneficial Ownership" language in the Rights Plan is virtually identical to that found in nearly every poison pill that has ever been considered by Delaware courts. As amended, clause (c) of the Rights Plan's definition of Beneficial Ownership provides for the attribution of Beneficial Ownership of shares:

> which are beneficially owned, directly or indirectly, by any other Person (or an Affiliate or Associate thereof) with which such Person (or any such Person's Affiliates or Associates) has any agreement, arrangement or understanding (written or oral) for the purpose of acquiring, holding, voting (except pursuant to a revocable proxy as described in the proviso to clause (b)(ii) of this definition) or disposing of any voting securities of the Company.

(Jones Aff., Ex. 24.)

This language is almost exactly the same as that upheld in *Moran*, where any person was attributed with beneficial ownership of shares:

> which are beneficially owned, directly or indirectly, by any other Person with which such Person or any of such Person's Affiliates or Associates has *any agreement, arrangement or understanding for the purpose of acquiring, holding, voting or disposing of any securities of the Company.*

(Pittenger Aff. Ex. A at Section 1(c)(iii) (Rights Agreement dated August 14, 1984 between Household International Corporation and Harris Trust and Savings Bank) (emphasis added).)[2]

In *Stahl*, the Court similarly upheld a poison pill attributing ownership of shares:

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[2] The Transmittal Affidavit of Michael A. Pittenger in Support of Defendants' Answering Pre-Trial Brief ("Pittenger Aff.") is being filed contemporaneously herewith.

> which are beneficially owned, directly or indirectly, by any other Person with which such Person or any such Person's Affiliates or Associates has *any agreement, arrangement or understanding* (other than customary agreements with and between underwriters and selling group members with respect to a bona fide public offering of securities) *for the purpose of acquiring, holding, voting* (except to the extent contemplated by the proviso to Section 1(d)(ii)(B) hereof [exempting revocable proxies]) *or disposing of any securities of the Corporation.*

1990 WL 114222, at *3 (Pittenger Aff. Ex. B at Section 1(d)(iii) (Rights Agreement dated November 17, 1989 between Apple Bancorp, Inc. and American Stock Transfer and Trust Company) (emphasis added).) The poison pills in *Unitrin*, *Gaylord* and *Loventhal* also included substantively identical language.[3]

The foregoing are just a few examples of the many poison pills containing definitions of "Beneficial Ownership" substantively identical to that found in Barnes & Noble's Rights Plan. As noted in Defendants' Opening Pre-Trial Brief, the language in the Company's Rights Plan is also substantively identical to the definition of "Owner" found in Section 203 of the DGCL and the definition of beneficial ownership under Section 13 of the Exchange Act, the rules promulgated thereunder and the case law applying those provisions. (*See* Defs.' Op. Pre-Trial Br. at 54-55.) As a result, it is not at all surprising that Plaintiffs' own expert has conceded that, based on his 30-plus years of

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[3] *See* Pittenger Aff. Ex. C at Section 1.4.3 (Rights Agreement dated August 3, 1994 between Unitrin Corporation and First Chicago Trust Company of New York); Pittenger Aff. Ex. D at Section 1(d)(v) (Rights Agreement dated June 12, 1995 between Gaylord Container Corporation and Harris Trust and Savings Bank); Pittenger Aff. Ex. E at Section 1.3(iii) (Rights Agreement dated November 29, 1999 between Hilton Hotels Corporation and ChaseMellon Stockholder Services, LLC).

experience as a proxy solicitor, the definition of Beneficial Ownership in the Rights Plan is "standard" and not "unusual in any way". (Burch Dep. at 72:3-20.)

B. Rights Plan Restrictions on Voting Agreements Such as Joint Slates and Cost Sharing Have Been Approved By Delaware Courts.

According to Plaintiffs, a reading of the Rights Plan that would restrict joint slates and the sharing of expenses among stockholders who collectively own more than 20% of the Company's shares, but would not restrict the solicitation of revocable proxies, is "nonsensical". (Pls.' Op. Pre-Trial Br. at 33.) In fact, the distinction between the solicitation of revocable proxies on the one hand, and the formation of voting groups on the other, reflects a measured balance that has been reached by Delaware courts between the practical consideration that any effective rights plan will necessarily have some non-material impact on stockholder voting and the need to ensure that poison pills do not have the effect of disenfranchising stockholders.

The issue Plaintiffs now raise was first confronted by this Court in *Moran v. Household International, Inc.*, 490 A.2d 1059, 1079-80 (Del. Ch.) (noting that a "troublesome aspect of the Rights Plan is its potential restriction on proxy contests"), *aff'd*, 500 A.2d 1346 (Del. 1985). Then-Vice Chancellor Walsh noted that while the Household rights plan did "not directly affect the individual voting rights of any class of Household securities", it did have an impact on "block voting" in the sense of limiting the size of an insurgent's holdings, which could make success in a proxy contest less likely. *Id.* at 1079. However, Vice Chancellor Walsh also recognized that "[t]he proxy contest effect of the Household Rights Plan cannot be viewed in isolation" but was "part of the

overall design of the Plan" and that "[w]ithout this feature the Plan is of limited value". *Id.* at 1080. Thus, Vice Chancellor Walsh rejected the plaintiff's argument that a prohibition on cost sharing was unlawful. *Id.* On the other hand, the Court found that the rights plan did not (and could not) restrict the right to receive revocable proxies (just as the Company's Rights Plan does not do so). *Id.* at 1355. The Supreme Court affirmed, holding that "the effect upon proxy contests will be minimal" from a poison pill that included language regarding beneficial ownership that is functionally identical to that at issue in the present litigation. *Moran*, 500 A.2d at 1355.

Later, in *Stahl v. Apple Bancorp, Inc.*, 1990 WL 114222 (Del. Ch.), the Court considered arguments similar to those advanced by Yucaipa in the context of a substantively identical definition of beneficial ownership. *Id.* at *2-3. Like Yucaipa, the plaintiff in *Stahl* argued that it should be permitted to enter into joint slates and share costs as long as there was no formal and enforceable agreement, arrangement or understanding that would *bind* another stockholder to vote a certain way.[4] *Id.* at *3. There, the board argued that allowing such group conduct would undermine the purpose of the poison pill. The Court agreed, holding that the "[e]limination of this important

[4] The plaintiff in Stahl conceded that "[t]he formation of blocks of committed (*legally bound*) shares ... involves circumstances and considerations closely analogous to those arising from the existence of a large single stockholder, which considerations have been held to present threats justifying the rights that poison pill plans contemplate". *Stahl*, 1990 WL 114222, at *3 (emphasis added). Yucaipa has effectively made the same concession here. (*See* Pls.' Op. Pre-Trial Br. at 31 ("It is the ability to control the vote — either legally or as a practical matter — that implicates issues of 'control' that are the purpose of the Rights Plan.").)

provision of the Rights Plan would enable Mr. Stahl to accumulate even more votes through means other than the solicitation of revocable proxies".[5] *Id.* at *4. On the other hand, the Court in *Stahl*, as in *Moran* before it, concluded that a poison pill could not restrict a stockholder from soliciting and receiving revocable proxies.

The Board's concern here is the same as the concern of the board of Apple Bancorp in *Stahl* – that the ability of the Board to act in the best interests of all stockholders will be diminished, possibly significantly, if Yucaipa is able to establish a group of large stockholders acting as a block, for example, by entering into an agreement to nominate and advocate the election of a joint slate of directors or to share proxy contest costs. To be sure, the upcoming vote is for only three of the nine directors. But, it would be naïve to argue that once large stockholders form a block, they will not continue to work together to effect control of the Company – not only this year, but indefinitely, so long as they perceive value (which they have not paid for) in the existence of such a group. Such a block could ultimately dictate the conduct of the Company's

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[5] As in *Moran*, the *Stahl* court also found that restricting group conduct in the form of joint slates and cost sharing would have only an immaterial impact upon a proxy contest. Here, the expense of a proxy contest, while not trivial for most individuals, is immaterial for Yucaipa, whose Barnes & Noble investment is worth on the order of $200 million, and whose family of funds is worth over $9 billion. *See, e.g.*, *Moran*, 490 A.2d at 1080. Indeed, Burkle admitted Yucaipa could pay such expenses (Burkle Dep. at 124), and Plaintiffs' proxy solicitation expert has admitted that joint slates are relatively unimportant. (6/25/10 Burch Dep. at 79:18-80:17; *see also* Taxin Dep. at 132:9-20 (concurring that even where no rights plan is in place, institutional stockholders typically avoid group action in the proxy solicitation context, because they do not wish to be deemed part of a group under Section 13 of the Securities Exchange Act).)

business through, for example, a campaign of written consent solicitations concerning almost any aspect of Company policy that is not reserved to the Board as a matter of Delaware law.[6]

II. <u>The Rights Plan Is Reasonable In Relation To the Threat Posed by Yucaipa.</u>

In support of their ambiguity argument, Plaintiffs confirm that each member of the Board who has testified has explained that the Rights Plan was adopted not to impede a proxy contest, but instead to protect against the threat of Yucaipa obtaining control of the Company by acquiring stock or forming a group. (Pls.' Op. Pre-Trial Br. at 28; *see also* L. Riggio Dep. at 195:21-197:3; S. Riggio Dep. at 162:22-163:8; Del Giudice Dep. at 174:3-11; Higgins Dep. at 147:25-148:16; Zilavy Dep. at 228:6-24.) Yet when Plaintiffs argue that the Rights Plan is unreasonable, they argue the opposite, namely that the Rights Plan was adopted with the specific purposes of impairing a proxy contest in an effort to entrench Leonard Riggio. (Pls.' Op. Pre-Trial Br. at 66.)

As set forth in Defendants' Opening Pre-Trial Brief, the Rights Plan was adopted to protect against the threat that Mr. Burkle would acquire control (either acting

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[6] Plaintiffs cite *Chesapeake Corp. v. Shore*, 771 A.2d 293 (Del. Ch. 2000) for the proposition that a poison pill may only restrict legally-binding agreements to vote shares a certain way. (Pls.' Op. Pre-Trial Br. at 30, 32-33.) That was not the holding of *Chesapeake*. Rather, *Chesapeake* concerned an agreement that arguably created an indirect economic incentive for one party to favor a proposed merger. *Id.* at 350. This Court noted that it was "plausible" that another form of agreement could create such a significant incentive that it would be "economically irrational" for a stockholder to vote in any other way, resulting in an "agreement, arrangement or understanding" concerning voting (for purposes of the "Ownership" definition under Section 203). The Court held, however, that the actual agreement at issue there did not have such an effect.

alone or in concert with others) without paying an appropriate premium to all stockholders. (Defs.' Op. Pre-Trial Br. at 43-45.) Confirming the Board's fears, now Mr. Burkle demands the right to form groups with other Company stockholders, each of which could acquire up to 20% of the Company stock (and one of which already has nearly that amount). Were Mr. Burkle allowed to do so, he would have effective control of Barnes & Noble without having paid an appropriate price to all stockholders.

Mr. Burkle's stated wishes and his actions have all the hallmarks of an attempt to acquire control of the Company without paying an appropriate premium, the protection against which has been upheld since at least as early as the Supreme Court's decision in *Cheff v. Mathes*, 199 A.2d 548 (Del. 1964). There, the Court held:

> [T]he evidence presented in the court below leads inevitably to the conclusion that the board of directors, based upon direct investigation, receipt of professional advice, and personal observations of the contradictory action of Maremont and his explanation of corporate purpose, believed, with justification, that there was a reasonable threat to the continued existence of Holland, or at least existence in its present form, by the plan of Maremont to continue building up his stock holdings. We find no evidence in the record sufficient to justify a contrary conclusion.

Id. at 556. (*See also* Defs.' Op. Pre-Trial Br. at 43-46.) These threats are similar to those that faced the board in the recent *Fertitta* litigation, where a complaint alleging that the board breached its fiduciary duties by *not* adopting a poison pill in response to indicia of a creeping takeover survived a motion to dismiss. *La. Mun. Police Employees' Ret. Sys. v. Fertitta*, 2009 WL 2263406 (Del. Ch.).

Mr. Burkle claims that the Board should "let the stockholders decide who should be elected". On this one point, he is right. The Board is letting the stockholders

decide who should be elected, and has never considered doing otherwise. The Rights Plan is neither coercive nor preclusive, and therefore the victor on any vote, including a vote on directors, will depend upon the merits of the respective platforms. As explained below and in Defendants' Opening Pre-Trial Brief, the Rights Plan falls within the range of reasonable responses to the threats posed by Mr. Burkle's actions.[7]

A. The Board's Decisions in Responding to the Threats Posed by Mr. Burkle's Actions are Entitled to Material Enhancement.

Under Delaware law, the existence of a majority of outside directors will "materially enhance" a board's ability to meet its burden under *Unocal*. (*See* Defs.' Op. Pre-Trial Brief at 40-43.) This material enhancement applies both to the Board's perception of a threat and to the analysis of whether the defensive measure under consideration falls within a "range of reasonableness". *Chesapeake*, 771 A.2d at 330

[7] In their "statement of facts", Plaintiffs mischaracterize nearly every aspect of the process by which the Board adopted and amended the Rights Plan; there is simply not enough room in this brief to describe all of their misstatements. Among other things, Plaintiffs claim that the Cravath presentation on November 17 took only "10 minutes", when in fact the testimony they cite refers to only one portion of Cravath's presentation. (Pls.' Op. Pre-Trial Br. at 10.) Notes of the meeting and testimony of witnesses who attended the meeting make clear that Cravath attorneys extensively advised the Board on its duties. The evidence also reflects that, in the course of adopting and amending the Rights Plan, the Board discussed, among other things:

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Defendants respectfully refer the Court to pages 4 through 35 of their Opening Pre-Trial Brief for an accurate discussion of the process by which the Board took the actions challenged in this lawsuit. (*See also* Barshay Dep. at 108:15-109:23,121:20-125:5, 129:8-130:19, 133:16-136:7, 136:16-138:24 (November 17, 2009 Board Meeting); *id.* at 225:5-227:13 (February 16, 2010 Board Meeting).)

n.86 (explaining that material enhancement "is relevant to both factors [of *Unocal*] because what a board does is as important as why a board claims it decided to do it" and noting that the "absence or presence of an outside majority might be a factor leading a court to conclude that particular defensive options were selected in good or bad faith").

Here, all decisions concerning the Rights Plan were unanimously approved by all six of the Independent Directors – a disinterested and fully-informed majority of the Board. (*See* Fact Sections VI, X and XIII of Defs.' Op. Pre-Trial Br.) Each of these Independent Directors, along with Mr. Riggio, has also verified that he or she does not have any relationships with the Riggios that would compromise their independence. (*See* Jones Aff. Ex. 47 at 5-10 (Indiv. Defs.' Resp. and Obj. to Pls.' 3rd Set of Interrogs.).) During his deposition, Michael Del Giudice, the Company's lead Independent Director, emphasized: "[W]e are an independent board. We have discussions, open discussions all the time." (Del Giudice Dep. at 252:8-9.) Indeed, even Mr. Burkle conceded at the March 29, 2010, meeting that at least five of the nine Directors are independent. (*See* Jones Aff. Ex. 42 (3/29/10 Daniels Notes (reflecting that Burkle considered the current Board to have four interested directors)).) This is not a Board dominated or controlled by Leonard Riggio under the relevant Delaware law. *See Selectica, Inc. v. Versata Enters., Inc.*, 2010 WL 703062, at *13 (Del. Ch.) (finding no evidence of control where large stockholder had "recommended" director to the board as a candidate); *In re Gaylord Container Corp. S'holders Litig.*, 753 A.2d 462, 465 n.3 (Del. Ch. 2000) ("the mere fact

that a controlling stockholder elects a director does not render that director non-independent").

B. Yucaipa's Argument that Grandfather Clauses are *Per Se* Unreasonable Must Fail.

As set forth in Defendants' Opening Pre-Trial Brief, numerous poison pills that included grandfather clauses have been upheld under the *Unocal* standard, and the use of such provisions is ubiquitous when a poison pill is adopted under circumstances in which a stockholder owns in excess of the triggering percentage. (Defs.' Op. Pre-Trial Br. at 61-63.) Yucaipa nonetheless claims that the Rights Plan is unreasonable because it includes just such a clause, arguing that it is "unfair" for Leonard Riggio to hold more shares of Barnes & Noble stock than Yucaipa does. (Pls.' Op. Pre-Trial Br. at 37-39.)

Although Yucaipa strains to limit its argument to the context of the upcoming stockholder vote, the implications of its claims are far more sweeping. According to Yucaipa, a trigger below the amount held by an individual or group of insiders is unnecessary to protect against a change of control because "no one could acquire control owning shares less than the shares grandfathered". (*Id.* at 40.) Thus, Yucaipa essentially asks this Court to declare, for the first time and contrary to the law of Delaware, that grandfather clauses (even those that prevent the grandfathered stockholder from acquiring additional shares) are *per se* unreasonable.

In arguing that the Board's decisions were unreasonable, Yucaipa misstates the applicable legal standard. For example, Plaintiffs insist that it is "critical to analyze whether a 20% trigger that cements the Riggios' advantage is *necessary* to accomplish

any cognizable corporate purpose." (*Id.* at 39 (emphasis added).) Similarly, Plaintiffs complain that the Board did not "receive any advice from any advisor that preventing Yucaipa from acquiring such a percentage of stock was *necessary* to prevent a change of control." (*Id.* at 40 (emphasis added).) But whether an action was "necessary" is not the relevant legal analysis. In *Unitrin*, the Supreme Court rejected such a standard, finding that the "Court of Chancery applied an incorrect legal standard when it ruled that the Unitrin decision to authorize the repurchase program was disproportionate because it was 'unnecessary'". *Unitrin, Inc. v. Am. Gen. Corp.*, 651 A.2d 1361, 1385 (Del. 1995). The Supreme Court explained that the trial court's "determination that the Unitrin Board's adoption of the Repurchase Program was unnecessary constituted a substitution of [the Court's] business judgment for that of the Board, contrary to [the Supreme Court's] 'range of reasonableness' holding". *Id.* at 1386. As *Unitrin* makes clear, the standard is *not* whether something is "necessary", but instead whether it lies within a "range of reasonableness". *Id.* at 1387-88; *see also Mercier v. Inter-Tel (Del.), Inc.*, 929 A.2d 786, 810-11 (Del. Ch. 2007). (*See* Defs.' Op. Pre-Trial Br. at 46.)

Yucaipa's argument also mischaracterizes the threat to which the Board was responding. The Board was not trying to prevent any stockholder from accumulating more shares than Leonard Riggio. And the Board was not merely trying to prevent any single dissident from acquiring – alone – an absolute voting majority (an objective that would have been served equally well by implementing a rights plan with a 49% trigger). Rather, the Board sought to prevent the practical acquisition of control by a stockholder

or block of stockholders without payment of an appropriate control premium. (*See* Defs.' Op. Pre-Trial Br. at 43-46.)[8] Contrary to Yucaipa's unsupported assertions (*see* Pls.' Op. Pre-Trial Br. at 11-12), the Board specifically discussed the 20% trigger and the grandfather clause in both November and February, and each time they were provided with detailed advice from Cravath regarding those aspects of the Rights Plan. (Defs.' Op. Pre-Trial Br. at 17-18, 25-27; Barshay Dep. at 124:11-19, 127:17-128:7, 134:25-135:11.)[9]

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[8] Yucaipa has set forth a list of Company policies and objectives that do *not* exist, such as, for example, a "corporate policy against stockholders buying its shares" or "a corporate policy against stockholders nominating directors for election at an annual meeting." (Pls.' Op. Pre-Trial Br. at 44-45.) The Rights Plan did serve legitimate corporate policies that Plaintiffs do not bother to list – namely (1) restricting the ability of any stockholder from obtaining control of the Company without payment of a corresponding premium through a creeping acquisition of shares; and (2) preventing an "arms race" that would be detrimental to the interests of all stockholders. Defenses to such "creeping takeovers" – in many instances much more restrictive than a rights plan – have repeatedly been upheld. *See, e.g., Cheff v. Mathes*, 199 A.2d 548 (Del. 1964); *Stahl*, 1990 WL 114222. (*See also* Defs. Op. Pre-Trial Br. at 43-44.)

[9] Yucaipa appears to suggest that because the Board adopted the Rights Plan on November 17, rather than waiting a longer period of time, it must have done so for an improper purpose. This argument ignores the circumstances with which the Board was confronted. By delaying implementation of the Rights Plan, the Board would have run the very significant risk that it would have been too late to prevent Yucaipa from acquiring effective control of the Company. Indeed, Yucaipa filed a Schedule 13D/A on the very day of the Board meeting at which the Rights Plan was adopted, describing its acquisition of approximately 375,000 additional shares since its disclosure the previous Friday. (*See* Jones Aff. Ex. 13 (Schedule 13D/A filed 11/17/09); *see also* Jones Aff. Ex. 15 (Moayery 11/16 notes ("could be buying shares now")).) As the record demonstrates, the Board was fully advised about its duties, had the opportunity to review the proposed plan and discussed and debated it at length during the November 17 meeting. (Defs.' Op. Pre-Trial Br. at 14-18.) Rather than help Yucaipa's arguments, the fact that the Board acted swiftly in response to Yucaipa's buying frenzy demonstrates the seriousness with which the directors regarded the threat of a possible acquisition of control without payment of an adequate premium.

It is rare for a poison pill to have a triggering percentage higher than 20%. At any percentage meaningfully higher than 20%, Yucaipa could effectively dictate corporate policy if it had the cooperation – tacit or express – of even one other 20% large stockholder. For example, if Yucaipa held 30.1% of the Company's stock and Aletheia held 20%, Mr. Burkle and Peter Eichler could exert effective control over wide areas of Company policy, Board elections are only part of the picture here. Barnes & Noble's Certificate of Incorporation permits action by written consent on nearly any topic. It is by no means outside the realm of possibility that two or perhaps three large stockholders could together achieve the power to dictate corporate policy. If that is something Yucaipa wishes to achieve, the other stockholders of Barnes & Noble are entitled to receive a price for it – and the Board is *obligated* to negotiate on their behalf to maximize that price.

C. Yucaipa's Argument that the Board Unreasonably Favored Mr. Riggio Is Unavailing.

Yucaipa also argues that the adoption of the Rights Plan was unreasonable because it allegedly accords specific benefits to the Riggio family that are not available to other stockholders. This argument also fails. The Rights Plan significantly restricts rights Mr. Riggio and his family would otherwise enjoy, and it prevents him from acquiring additional shares (subject to limited exceptions such as pursuant to Company compensation plans).

First, Plaintiffs cite language in the Rights Plan providing that "grandfathered" stockholders may acquire additional shares only with the approval of the

Board. What this argument overlooks is Section 26 of the Rights Plan, which provides that "[a]t any time prior to the time any Person becomes an Acquiring Person ... the Company may, and the Rights Agent shall if the Company so directs, supplement or amend any provision of this Rights Agreement in any manner which the Company may deem necessary or desirable ... without the approval or any holder of the Rights". (Jones Aff. Ex. 24 at page 33.)[10] Thus, the reality is that – as with all poison pills – Board approval will allow *any* stockholder, not just an Excluded Person, to acquire additional shares before the Rights Plan has been triggered. Mr. Burkle's repeated requests that the Board allow him to acquire up to 37% of the Company's stock without triggering the Rights Plan demonstrates that he is well aware of the Board's power in this regard.[11]

Second, Plaintiffs argue that the adoption of the Rights Plan to protect against a possible creeping acquisition is unreasonable because the Board allowed the 1998 Rights Plan to lapse in 2008, and because the Board allegedly allowed Leonard Riggio to increase his own shareholdings without implementing a cap on his purchases.

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[10] *See also* Barshay Dep. at 185:5-15 ("[T]he ability of the board to approve anybody buying more than their percentage under the pill is exactly the same . . . it's an amendment to the pill versus an approval under the pill. . . . [T]here really is absolutely no distinction between what the board would have to do if Mr. Riggio requested the right to buy more shares or if anybody else requested the right to buy above the pill.").

[11] Yucaipa also has taken issue with the so-called "family transfer" provision of the Rights Plan, claiming that this provision somehow provides Mr. Riggio with a special advantage. However, as explained in Defendants' Opening Pre-Trial Brief, that provision, which was included for estate planning purposes, does not provide Mr. Riggio with any rights with respect to his shares that are not also available to Mr. Burkle (or any other Company stockholder). (Defs.' Op. Pre-Trial Br. at 27.)

However, the Board allowed the 1998 Rights Plan to lapse because it did not perceive a threat to the Company that warranted its extension. That does not mean, as Plaintiffs assert, that no subsequent threat could justify the implementation of a new poison pill. Similarly, Yucaipa's argument about Mr. Riggio's acquisitions ignores history. At one time, when he began his bookstore business, Mr. Riggio was the sole owner. Once the Company went public, his shareholdings were reduced to roughly 30%, and have hovered between approximately 20% and approximately 30% ever since (including between the expiration of the 1998 Rights Plan and the adoption of the Rights Plan at issue here, *when he did not purchase any additional shares*). Importantly, since the time Barnes & Noble became a public company, Mr. Riggio has never acted jointly with any other stockholder to exert control over Barnes & Noble.

As Mr. Riggio has explained, he believes that he is constrained from purchasing any shares materially above his current holdings without consultation with, and approval of, the Board. Moreover, he, unlike Mr. Burkle, is a director of the Company and therefore owes the Company's stockholders a fiduciary duty to act in their best interests. In light of these circumstances, Mr. Riggio was reasonably perceived *not* to be a threat to the Company or its stockholders. That does not change the fact that Mr. Burkle, with his sudden and rapid accumulation of shares, and without any fiduciary obligations to other Company stockholders, was reasonably perceived as a threat.

Third, Yucaipa argues that the grandfather clause was unreasonable because, rather than grandfathering Mr. Riggio's holdings, the Board should have

"sterilized" his vote above 20%. However, putting aside the fact that the Board did not view Mr. Riggio as a threat to corporate policy or effectiveness, the Board does not have the power to sterilize Mr. Riggio's shares. Section 212(a) of the DGCL provides that "[u]nless otherwise provided in the certificate of incorporation and subject to the provisions of § 213 of this title, each stockholder shall be entitled to 1 vote for each share of capital stock held by such stockholder". The Company's Certificate of Incorporation does not provide for anything other than one vote per share of common stock. (Pittenger Aff., Ex. F (Barnes & Noble Certificate of Incorporation).)

Moreover, "sterilizing" Mr. Riggio's shareholdings would undoubtedly have worked a deprivation of a valuable property right in violation of Delaware law. *See, e.g.*, *State of Wis. Inv. Bd. v. Peerless Sys. Corp.*, 2000 WL 1805376, at *7 (Del. Ch.) ("The right to vote one's shares is a fundamental aspect of stock ownership governed and protected by 8 *Del[.] C.* § 151(a)."); *Arnold v. Soc'y for Sav. Bancorp, Inc.*, 678 A.2d 533, 536 (Del. 1996) ("Conversion is an act of dominion wrongfully exerted over the property of another, in denial of his right, or inconsistent with it. A stockholder's shares are converted by any act of control or dominion ... without the stockholder's authority or consent, and in disregard, violation, or denial of his rights as a stockholder of the company.") (internal quotations, citations and alterations omitted).

D. The Board is Not "Using the Rights Plan to Prevent Collective Stockholder Action In a Proxy Contest".

Plaintiffs also contend that the Board is deliberately using the Rights Plan to frustrate their prospects of success in a proxy contest. The evidence at trial will show that this is false.

Plaintiffs make three arguments on this front: 1) that the phrase "agreement, arrangement or understanding" is so vague as to have an "*in terrorem*" effect (Pls.' Op. Pre-Trial Br. at 46-47; *see also id.* at 25-26); 2) that because the Rights Plan has a peripheral impact on stockholder voting agreements, that impact must have been the Board's overriding purpose (*id.* at 47-49); and 3) that the Rights Plan would be equally effective if it were amended to permit entirely unrestricted joint conduct and agreements with respect to voting (*id.* at 50-52).

The first of these arguments is merely a recapitulation of the "ambiguity" argument with which Plaintiffs begin their brief, and which is discussed at length above. It is false that the Beneficial Ownership definition under the Rights Plan is anything other than standard and conventional (*see supra* at Section I), and it is incorrect that Defendants have "provide[d] no guidance as to what conduct might trigger the Rights Plan" (*see* Defs.' Op. Pre-Trial Br. at 52-54).

Plaintiffs' second argument is equally without merit. The Board adopted the Rights Plan to protect the stockholders from the possibility that Yucaipa could obtain control of the Company without paying an appropriate premium – either through a "creeping" acquisition of stock or the formation of control groups with third persons. (*Id.*

at 16-17.) Plaintiffs would prefer to buy the votes necessary to win an election before the record date, or to lock up those votes before a proxy contest begins. They therefore have become convinced – or so they say – that any obstacles to those ends imposed by the Rights Plan must be the intended consequence of Defendants' actions. They are wrong. The obstacles they identify are immaterial and are the necessary by-product of a standard rights plan, with standard and legitimate aims, adhering to a balance of policies analyzed at length and approved by the Delaware courts over the last twenty years. *Moran*, 490 A.2d at 1079-80; *Moran*, 500 A.2d at 1355; *Stahl*, 1990 WL 114222, at *4-5.[12]

Plaintiffs' third argument – that the Rights Plan's restrictions upon "agreements, arrangements or understandings" with respect to voting are unnecessary – is

[12] Plaintiffs do identify one case – decided in 1988 and never cited for this purpose – which observed, in dicta, that where a Board had lowered a rights plan's triggering threshold to one percentage-point below the combined holdings of two outside stockholders on the eve of an anticipated proxy fight, the amendment did impair plaintiffs' ability to mount a proxy contest and that defendants had "not established that they were unaware of the probable effect of their actions". *See Henley Gp., Inc. v. Santa Fe S. Pac. Corp.*, 1988 WL 23945, at *11 n.22 (Del. Ch.). Even in those circumstances, however, the Court did not conclude that the amendment to the trigger threshold was made for the purpose of interfering with the stockholder franchise. Needless to say, the facts of this case are far different.

Plaintiffs also incorrectly cite *MM Cos. Inc. v. Liquid Audio, Inc.*, 813 A.2d 1118, 1129 (Del. 2003) for the proposition that "[a]ny impact a pill has on voting is a misallocation of power between the board and its stockholders, requiring compelling justification". (Pls.' Op. Pre-Trial Br. at 48.) *Liquid Audio* actually says "[t]he 'compelling justification' standard set forth in *Blasius* is applied independently or within the *Unocal* standard only where 'the primary purpose of the board's action is to interfere with or impede exercise of the stockholder franchise and the stockholders are not given a full and fair opportunity to vote' effectively." *Id.* at 1130; *see also Inter-Tel*, 929 A.2d at 809-813.

also incorrect. As noted above, Plaintiffs' "necessary" standard is not the standard under *Unocal* and *Unitrin*. Moreover, and putting aside the fact that such restrictions were found to be appropriate in *Moran* and have been included in every rights plan of which Defendants are aware since *Moran*, they are plainly necessary to achieve the legitimate purpose of the Rights Plan. As already explained herein, and as the Court succinctly explained in *Stahl*, "[t]he formation of blocks of committed . . . shares . . . involves circumstances and considerations closely analogous to those arising from the existence of a large single stockholder, which considerations have been held to present threats justifying the rights that poison pill plans contemplate". *Stahl*, 1990 WL 114222, at *3.

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At various points in their Opening Pre-Trial Brief, Plaintiffs suggest that the Rights Plan is not in the "range of reasonableness" because Yucaipa has never previously participated in a hostile bid. This argument is entirely disconnected from reality and has no foundation in Delaware law. Although a track record of hostile acquisitions might indeed heighten a board's apprehension, the idea that the Board should have disregarded Yucaipa's abrupt and voracious acquisition of Company stock in November 2009, merely because Yucaipa had not previously undertaken a hostile takeover, is absurd.[13] If the Board had stood idly by while Yucaipa acquired a majority

[13] To put a slightly finer point on it: Yucaipa has also never mounted a proxy contest, but it is plainly considering doing so now.

of the Company's shares, the directors would today be facing a lawsuit not because it adopted a poison pill but because it had failed to adopt a one.

III. <u>The Rights Plan Is Not Subject To Review For "Entire Fairness".</u>

Since the Supreme Court's decision in *Moran*, Delaware courts have consistently held that the decision to adopt and maintain a stockholder rights plan is properly evaluated under the *Unocal* standard for defensive measures, not the entire fairness standard:

> In choosing *Unocal* as the framework for reviewing the board's conduct, I reject plaintiffs' arguments that the entire fairness or *Revlon* standards apply to this case. The members of the board may have a personal interest in retaining the poison pill and continuing the repurchase program, *but the intermediate standard of judicial scrutiny under Unocal was designed to deal with this potential conflict.*

In re Unitrin, Inc. S'holders Litig., Nos. 13656, 13699; 1994 WL 698483, at *4 (Del. Ch.) (emphasis added), *rev'd on other grounds*, 651 A.2d 1361 (Del. 1995);[14] *see also City Capital Assocs. Ltd. P'ship v. Interco Inc.*, 551 A.2d 787, 790 (Del. Ch. 1988) (noting that "the Supreme Court in *Moran* has directed us specifically to its decision in *Unocal* . . . as supplying the appropriate legal framework for evaluation of the [board's decision not to redeem its rights plan]"), *criticized on other grounds*, *Paramount Commc'ns, Inc. v. Time Inc.*, 571 A.2d 1140, 1152-53 (Del. 1989). The Board's interest in employing and retaining this Rights Plan as a defensive measure intended to protect

[14] Though reversing on other grounds, the Delaware Supreme Court agreed that the Court of Chancery "properly concluded the facts before it required an application of *Unocal* and its progeny". *Unitrin*, 651 A.2d at 1372.

the Company from a creeping acquisition of control "does not rise to the level of a self-dealing transaction that requires the board to demonstrate entire fairness". *See In re Unitrin*, 1994 WL 698483, at *4.

In an attempt to circumvent *Unitrin*, Plaintiffs implausibly label the Rights Plan "an economic transaction between the Company and its controlling stockholders". (Pls.' Op. Pre-Trial Br. at 54.) However, Plaintiffs concede, as they must, that "[t]he declaration of a dividend is typically not subject to entire fairness scrutiny because *the dividend treats all stockholders the same*". (*Id.* at 55 (emphasis added).) Yucaipa nevertheless argues that this particular dividend is unique because it "treated the Riggios differently" from other stockholders. (*See id.*)[15]

The Rights Plan does not constitute a self-dealing transaction simply because some of its terms account for the circumstances that existed at the time it was adopted, including Leonard Riggio's then-current stock ownership. As discussed above, the specific provisions that Yucaipa claims provide Mr. Riggio with the ability to acquire additional shares without any limitations do anything but that. (*See supra* Section II.B.)

[15] The case law Plaintiffs cite for this proposition is inapposite. The first two cases deal with the selective payment of dividends, which is not analogous to the situation here, where the dividend (in the form of the exercise right) was issued to all stockholders on an equal basis consistent with the amount of stock owned. *See Burton v. Exxon Corp.*, 583 F. Supp. 405, 416 (S.D.N.Y. 1984); *In re Primedia Inc. Derivative Litig.*, 910 A.2d 248, 260-61 (Del. Ch. 2006). The third case cited by Plaintiffs is not analogous to the rights plan dividend context because it involves a merger, the context in which the entire fairness test of "fair dealing" and "fair price" was developed and can be logically applied – as well as allegations that the defendant had siphoned off a portion of the merger consideration for his own use. *In re John Q. Hammons Hotels Inc. S'holder Litig.*, 2009 WL 3165613, at *9-14 (Del. Ch.).

That leaves only the grandfather clause. The presence of that clause does not render the Rights Plan a "self-dealing" transaction. Were there any merit to this theory, any case involving a poison pill that grandfathered-in stockholders at their ownership level before the adoption of the pill would have been subject to entire fairness review. *See, e.g.*, *In re infoUSA, Inc. S'holders Litig.*, 953 A.2d 963, 1001-02 (Del. Ch. 2007) (applying business judgment rule to board's exemption of a 41% stockholder from a poison pill).[16]

Moreover, Plaintiffs' assertion that Leonard and Stephen Riggio act together as controlling stockholders of the Company is unfounded. (*See* Pls.' Op. Pre-Trial Br. at 58.) Together, Leonard and Stephen Riggio own a 28.91% stake in the Company (Jones Aff. Ex. 48 at 13 (Harkins Report)), which does not amount to effective control. While Plaintiffs refer to some cases suggesting "that substantial minority interests ranging from 20% to 40% often provide the holder with working control", other more recent precedent cited by Plaintiffs involve a stockholder stake that is significantly closer to 40%. (*See* Pls.' Opening Pre-Trial Br. at 57-58, 58 n.232 (citing cases that reflect stakes of 35.9%, 39%, 40%, 39.2% and 37%).) Indeed, it is difficult to square Plaintiffs' assertion that the Riggios are controlling stockholders with the conclusions of Plaintiffs' own experts, who have concluded Yucaipa is likely to succeed in a proxy contest in some of the most likely scenarios. And, as discussed above (*see supra* Section

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[16] *See also Selectica, Inc. v. Versata Enters., Inc.*, 2010 WL 703062 (Del. Ch.) (*Unocal* was applied and pill was upheld where those stockholders with stakes greater than 4.99% were grandfathered in when poison pill trigger was lowered from 15% to 4.99%).

II.A) and in Defendants' Opening Pre-Trial Brief, all decisions concerning the Rights Plan were unanimously approved by all six Independent Directors.

In any event, even if this Court were to adopt Plaintiffs' novel invocation of entire fairness in the poison pill context, the Board has satisfied this test. The Board relied upon the advice of its counsel and bankers and engaged in a robust deliberative process. (*See* Defs.' Op. Pre-Trial Br. at Fact Sections VI, X and XIII.) The Rights Plan does not cement any alleged control of the Company by the Riggios, nor does it preclude stockholders from waging a proxy contest. (*See id.* at Section I(B); *supra* § II.)

IV. <u>The Blasius Standard Does Not Apply and Has Been Met In Any Event</u>

In arguing that *Blasius* applies to the Board's actions, Plaintiffs mistakenly rely on the Delaware Supreme Court's finding in *Liquid Audio*. (*See* Pls.' Op. Pre-Trial Br. at 66-67.) But, as that decision made clear, "[t]he 'compelling justification' standard set forth in *Blasius* is applied independently or within the *Unocal* standard *only where* 'the primary purpose of the board's action is to interfere with or impede exercise of the stockholder franchise and the stockholders are not given a full and fair opportunity to vote' effectively." *Liquid Audio*, 813 A.2d at 1130 (emphasis added).

The record is clear that the Rights Plan was *not* adopted for the purpose of interfering with or impeding the exercise of the stockholder franchise, let alone for the "primary purpose" of doing so.[17] Instead, when faced with Yucaipa's rapid acquisition of

[17] Plaintiffs' reliance on *WNH Invs., LLC v. Batzel*, 1995 Del. Ch. LEXIS 47, at *17-18 (Del. Ch.), in connection with its discussion of the Board's intent is misplaced. *WNH*

stock (and subsequently, with Aletheia's parallel acquisition), the Board acted with the legitimate purpose of protecting stockholders from the threat of a creeping takeover without the payment of any control premium and to prevent an "arms race". (*See* Defs.' Op. Pre-Trial Br. at 16-17, 43-46.) In no way can it be said that the Rights Plan was adopted for the "primary purpose of disenfranchising stockholders" such that *Blasius* would apply. *Inter-Tel*, 929 A.2d at 818; *see also Hollinger Int'l, Inc. v. Black*, 844 A.2d 1022 (Del. Ch. 2004) (Strine, V.C.) (*Blasius* review did not apply where rights plan had no "novel or material" effect on voting rights and did not prevent the election of a new board).

Even if *Blasius* did apply (which it does not), the Board is able to demonstrate a "compelling justification" for its actions since the Directors acted in "good faith" with the legitimate corporate objective of preventing either a creeping takeover or "arms race" and employed "means" that were properly "fit" to that objective. *See Inter-Tel*, 929 A.2d at 819; *see also Hollinger*, 844 A.2d at 1089 (even if *Blasius* did apply, a sufficiently compelling justification existed for "any incidental burden" the rights plan had on stockholder voting rights). As discussed in Defendants' Opening Pre-Trial Brief (at Argument Section I.B) and *supra* in Section II.A, the "compelling justification" standard under *Blasius* is satisfied because the Board's actions were reasonable in

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Investment did not involve a poison pill, nor did it apply *Blasius*. Instead, *WNH Investment* simply considered whether *Blasius* modified the rule articulated in *Canadian Southern Oils, Ltd. v. Manabi Exploration Co.*, 96 A.2d 810 (Del. Ch. 1953) that a dilutive issuance of stock for the primary purpose of maintaining control should be set aside as a breach of fiduciary duty. *See WHN Invs.*, 1995 Del. Ch. LEXIS 47, at *20-23.

relation to the Board's good faith intent to protect both stockholders and corporate policy from the threat of an acquisition of control without payment of an adequate premium.

CONCLUSION

For the foregoing reasons, and based on the evidence that will be adduced at trial on this matter, Defendants respectfully request that the Court enter judgment in favor of Defendants and against Plaintiffs on all counts of the Complaint and deny Plaintiffs' requests for relief.

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