



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,

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.

C.A. No. 5465-VCS

REDACTED VERSION

Dated: July 2, 2010

DEFENDANTS' OPENING PRE-TRIAL BRIEF

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PRELIMINARY STATEMENT

On November 13, 2009, Barnes & Noble learned that Ronald Burkle had suddenly doubled his stake in the Company, buying nearly 8% of the Company in the four preceding days. With those purchases, Mr. Burkle then owned nearly 17% of the Company. Reasonably fearing a hostile attack, the Company consulted with legal advisors and investment bankers to analyze potential defensive measures. By the following Monday (November 16), the Company learned that Mr. Burkle had continued his rapid accumulation by purchasing an additional 375,000 shares, which took his holdings to almost 18% of the Company's shares.

After receiving explanatory materials in advance, and relying on the advice of its legal and financial advisors, the Board met on November 17 and adopted the Rights Plan at issue in this litigation. The record at trial will evidence a robust deliberative process at that meeting, during which the Board discussed the merits of adopting a poison pill and identified two threats to the Company's shareholders: (1) the risk that Mr. Burkle's funds (either acting alone or in concert with other investors) would acquire control of the Company without paying a control premium; and (2) the risk that, without a poison pill, Mr. Burkle and the Company's founder and Chairman, Leonard Riggio, could engage in an "arms race" to purchase the Company's stock, thereby causing that stock to become overly concentrated in the hands of a few investors to the detriment of the other shareholders. Importantly, the decision to adopt the Rights Plan was reached by a nine member Board that included six independent directors.

Following the adoption of the Rights Plan, Mr. Burkle engaged in an aggressive letter writing campaign with Leonard Riggio and the Board of Directors, stating that the Company had "declared war" by adopting a poison pill. At the same time, the Company learned that Aletheia Research and Management, Inc., a fund that had previously followed Mr. Burkle's lead by investing heavily in at least three other public companies in which Mr. Burkle had taken large positions (A&P, Wild Oats and Whole Foods), rapidly accumulated nearly 20% of the Company's stock. Continuing to reasonably fear Mr. Burkle's, and now Aletheia's, intentions with respect to the Company, the Board subsequently declined Mr. Burkle's demand that his funds be allowed to purchase up to 37% of the Company's outstanding stock.

Mr. Burkle's funds filed this lawsuit on May 5, arguing that without amendments to the Rights Plan that would allow those funds to purchase additional shares of the Company's stock and enter into voting agreements with other shareholders, a proxy contest that Mr. Burkle intended to mount would be extremely difficult, if not mathematically impossible, to win. However, the discovery record in this case has already refuted these allegations: Plaintiffs' own experts have conceded that a victory by Mr. Burkle's funds in a proxy contest is neither "mathematically impossible" nor "realistically unattainable". Taken together, those experts have concluded that

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Given those conclusions, Plaintiffs cannot satisfy the preclusiveness standard set forth in *Unocal* and applied in every subsequent Delaware case in which a defensive measure has been analyzed. As a result, Plaintiffs have invented an entirely new definition of preclusiveness, claiming that a defensive measure is preclusive, even where a dissident is likely to prevail in a proxy contest, if that dissident cannot be certain, *ex ante*, of its prospects for winning that contest. Put another way, Plaintiffs' argument is that the Rights Plan is preclusive *not* because it prevents them from winning a proxy contest, but instead because it allegedly prevents them from knowing, in advance and with certainty, that they will prevail. This argument lacks any factual basis. Moreover, there is simply no support for this argument under Delaware law, which has routinely upheld defensive measures where, as here, the dissident has at least a plausible chance of prevailing in a vote. In this case, Plaintiffs have far more than a plausible chance of prevailing in a vote.

Plaintiffs also take issue with the restrictions against group action set forth in the Rights Plan's definition of Beneficial Ownership – specifically, restrictions against the formation of joint slates and the sharing of proxy expenses. However, as set forth in detail below, the Rights Plan's definition of Beneficial Ownership is substantively *identical* to that in virtually every poison pill that has been upheld under Delaware law since *Moran*.¹ See, e.g., *Moran v. Household Int'l, Inc.*, 490 A.2d 1059 (Del. Ch.), *aff'd*,

¹ During discovery in this litigation, it became apparent that Plaintiffs were arguing that certain language contained in the Rights Plan's definition of Beneficial Ownership was

500 A.2d 1346 (Del. 1985), and *Stahl v. Apple Bancorp, Inc.*, 1990 WL 114222 (Del. Ch.).² Moreover, *Stahl* specifically considered, and rejected, precisely the same arguments that Plaintiffs make here concerning restrictions on joint slates and the sharing of proxy expenses.

In summary, Yucaipa seeks to relitigate well-settled jurisprudence regarding the effects of poison pills on proxy contests — in a case in which its own experts have already conceded that the pill in question has no preclusive effects. Plaintiffs' request to overturn those decisions should be denied. As demonstrated below, the Board's conduct with respect to the Rights Plan was reasonable in light of the threats posed by Yucaipa's actions and, therefore, satisfies the *Unocal* standard.

FACTUAL BACKGROUND

I. Barnes & Noble.

Barnes & Noble, Inc. ("Barnes & Noble" or the "Company") is the leading bookseller in the United States. Beginning with a single college bookstore in Manhattan in 1965, Leonard Riggio transformed a small personal business into a dynamic enterprise that engages in retail bookselling, college bookstore management, online retailing and book publishing. (Ex. 58 (Barnes & Noble History from Company website).) Mr.

novel, overbroad and prohibited conduct other than group action that is not ordinarily prohibited by a poison pill. Although (as discussed below), Defendants strongly disagree with each of those characterizations, the Board adopted a Second Amendment to the Rights Plan on June 23 eliminating the language that Plaintiffs claimed was a concern.

² A compendium of reported and unreported decisions is being filed simultaneously herewith.

Riggio's first bookstore, the Student Book Exchange, opened in Greenwich Village in 1965 and quickly developed a reputation for knowledgeable staff, wide selection and excellent service. (*Id.*) By the 1970s, that single bookstore had become a thriving business that included six other college bookstores. (*Id.*)

In 1971, Mr. Riggio acquired the Barnes & Noble trade name and flagship bookstore in New York City. The once-declining Fifth Avenue store soon became the nation's leading bookseller. (*Id.*) Since that time, Barnes & Noble has continued to employ innovative growth initiatives and marketing strategies that have helped it become one of the most recognized brands that now includes more than 750 retail locations and a significant internet retail business. (*Id.*)

From the 1970s until the mid-1980s, Mr. Riggio operated his bookselling business as a private company owned by him. Then, in 1986, Mr. Riggio formed the predecessor of the Company to carry on a trade book business, with Vendex International, N.V. ("Vendex"), a Dutch company, owning 50%, and Mr. Riggio the other 50%. The two operated as joint owners until the Company went public in 1993. At that time, as a result of the sale of shares to the public, Mr. Riggio's holdings in the Company were reduced to approximately 31.6%. (Ex. 1 (Schedule 13D filed 10/14/93).) Since then, his holdings of the Company's total shares outstanding have ranged between approximately 20% and 32%. Mr. Riggio has never increased his ownership beyond these levels, even during periods when there has been no limitation on the amount of stock one stockholder can acquire — such as the period beginning in 2008 following the

expiration of a poison pill adopted by the Company in 1998 (the "1998 Rights Plan"). In fact, it was Mr. Riggio's understanding that he could not, and would not, significantly increase his shareholdings without first consulting with, and obtaining the concurrence of, the Board. (*See* L. Riggio Dep. at 146:24-148:3.)

The Barnes & Noble Board currently is comprised of nine directors. Six of those directors, George Campbell Jr., Michael Del Giudice, William Dillard, II, Patricia Higgins, Irene Miller and Margaret Monaco, are independent. (Ex. 11 at 2-4 (2009 Proxy Statement); Ex. 47 at 5-10 (Indiv. Defs' Resp. and Obj. to Pls.' 3rd Set of Interrogs).) The remaining three directors are Leonard Riggio, his brother Stephen Riggio and Lawrence Zilavy. Mr. Del Giudice is the lead independent director.

II. Ronald Burkle and the Yucaipa Companies.

The Yucaipa Companies ("Yucaipa") are a group of investment funds based in Los Angeles that were founded and are controlled by Ronald M. Burkle. Two of these funds, Yucaipa American Alliance Funds II, L.P. ("YAAF II"), and Yucaipa American Alliance (Parallel) Fund II, L.P. ("YAAF Parallel", and together with YAAF II, "Plaintiffs"), are the entities through which Mr. Burkle and Yucaipa have invested in Barnes & Noble. (Ex. 13 at 9 (Yucaipa Schedule 13D/A, filed 11/13/09).) YAAF II and YAAF Parallel are also the entities through which this lawsuit has been brought. (Compl. at 1.) Yucaipa controls approximately \$9 billion in investments and, since its founding by Mr. Burkle in 1986, has completed some forty mergers and acquisitions worth \$30 billion. (Ex. 39 at 1-2 (*The Other Ron Burkle*, March 4, 2010).)

Mr. Burkle made his fortune in the grocery industry in the late 1980s and 1990s, buying and selling supermarket chains and financing his early acquisitions with the help of junk bonds. (*Id.* at 2.) He has also invested in retail, media, distribution and logistics. Mr. Burkle, through Yucaipa, is known for driving acquisitions and sales of companies and industry consolidation in his investments. As an analyst at BB&T Markets explained in an early 2009 news article, “[u]ltimately, what Yucaipa has done with other companies is acquire, merge and then sell. . . . Look at Wild Oats, where they acquired stock, put in management and sold the company.” (Ex. 9 at 1 (*Ron Burkle Goes Shopping at Whole Foods*, January 9, 2009).) In fact, in two of Yucaipa’s most recent high-profile investments, Pathmark and Wild Oats, each company agreed to be acquired by another company within two years of Yucaipa’s substantial investments. (*Id.*; Ex. 5 (*A&P to Buy Pathmark for 1.3 Billion*, Market Watch, March 5, 2007); Ex. 4 (*Whole Foods Agrees to Purchase Wild Oats Markets*, Bloomberg, February 22, 2007).)

Yucaipa’s initially friendly investments have often been followed by a strong assertion of control. A March 2010 article, for which Mr. Burkle gave his first interview in three years, reported that “Burkle expects to influence, if not control, the companies he invests in”, and a former advisor explained, “[w]hen Ron gets pushback, he pushes back harder”. (Ex. 39 at 1 (*The Other Ron Burkle*, March 4, 2010).) Thus, in October 2006, when Yucaipa held 17% of Wild Oats, an analyst reported that “It’s pretty clear that Burkle is calling the shots there now. . . . Yucaipa is getting their people in place.” (Ex. 2 (*Wild Oats Rises on Buyout Rumor*, October 21, 2006).)

This pattern has not gone unnoticed by shareholders of the companies in which Mr. Burkle has invested. For example, in late 2006, a 3.1% shareholder in Source Interlink Companies, in which Yucaipa had a 34% stake and a majority of the board at the time, filed a proposal for inclusion in the 2007 proxy protesting Yucaipa's assertion of control over the company without paying an appropriate premium:

It is an outrage that Ron Burkle and Yucaipa brazenly maneuvered to permanently eliminate the seats of several independent directors without shareholder approval, and in so doing, consolidate control of the board in Yucaipa and its allies. Mr. Burkle has now installed his own Yucaipa employee . . . as the new Chairman and has taken complete control over Source Interlink's affairs without paying a control premium for the Company.

(Ex. 3 at 1 (*Long-Time Shareholder Jon Leddecky Files Proxy Proposals and Challenges Yucaipa's Ron Burkle to 'Do What's Right for All Shareholders' at Source Interlink*, December 11, 2006).) This shareholder added that if Mr. Burkle wanted control of Source Interlink, then "Yucaipa should pay a fair and full price to Source's other shareholders and take over the business directly rather than through board maneuvers and late-night SEC filings". (*Id.* at 2.)

III. Yucaipa's Initial Investment in Barnes & Noble.

In late 2008, Mr. Burkle called Leonard Riggio to inform Mr. Riggio that he intended to begin purchasing shares in Barnes & Noble. (L. Riggio Dep. at 55:7-17, 56:8-20.)³ Prior to that time, Mr. Riggio had known Mr. Burkle as a result of an investment that Mr. Riggio had made in a company that was formed to acquire the Source

³ Transcripts of depositions referenced herein will be lodged with the Court.

Interlink Companies. (*Id.* at 68:21-23.) Along with many others, Mr. Riggio lost millions of dollars in that investment and was distressed about the lack of concern that Mr. Burkle had demonstrated for the interests of Mr. Riggio and other investors. (*Id.* at 117:8-23.)

On January 2, 2009, Yucaipa filed a Form 13D with the Securities and Exchange Commission (the "SEC") disclosing an 8.3% stake in Barnes & Noble, which it had accumulated through purchases made since November 24, 2008. (Ex. 6 at 9 (Yucaipa Schedule 13D, filed 1/2/09).) While stating that it held the shares "for investment purposes", Yucaipa also noted that it "intend[ed] to closely monitor the Company's performance and may modify [its] plans in the future". (*Id.*) Mr. Burkle and Mr. Riggio again spoke over the phone about Yucaipa's investment on January 5, 2009, and the Board was informed about Yucaipa's new status as a large shareholder at its January 6, 2009, meeting. (Ex. 7 (1/6/09 Minutes).)

Three days later, on January 9, 2009, Barnes & Noble received a Hart-Scott-Rodino ("HSR") notification from one of Yucaipa's investment entities, YAAF II, which expressed a "present good faith intention" to acquire up to \$126.2 million worth of Barnes & Noble stock. (Ex. 8 (1/9/09 HSR Notification).)

In late March 2009, Mr. Riggio met with Mr. Burkle in New York at Mr. Burkle's request. During this meeting, Mr. Burkle suggested that the Company pursue a transaction with Borders Group, Barnes & Noble's chief competitor, stating that Borders could be had "cheap" because its stock was selling at a low price. (L. Riggio Dep. at

59:6-60:22; 65:13-66:14.) Mr. Burkle acknowledged that he had spoken with William Ackman of Pershing Capital, Borders' largest shareholder. (*Id.* at 61:21-62:11.) Mr. Ackman had previously pushed for a merger between Barnes & Noble and Borders. (*Id.* at 46:12-23, 49:9-23.) At the time Mr. Ackman initially raised that idea, the Company's management and the Board conducted extensive studies regarding a potential transaction with Borders, and concluded that such a transaction was not in the Company's best interests. (*Id.* at 50:5-55:6.) When Mr. Burkle subsequently raised the possibility of such a transaction at their meeting, Mr. Riggio explained to Mr. Burkle that Barnes & Noble had already fully explored such a transaction but had determined it not to be in the Company's best interest, principally because, through a poor real estate strategy, Borders had accumulated more than \$4 billion in long-term leases for retail stores in undesirable locations. (*Id.* at 59:16-60:13.)

The next time Mr. Riggio heard from Mr. Burkle was on August 14, 2009, when Mr. Burkle sent a letter to Mr. Riggio, copied to the Board of Directors, expressing his dissatisfaction with the Company's acquisition of Barnes & Noble College Booksellers. (Ex. 12 (8/14/09 Ltr. from R. Burkle to L. Riggio).)

IV. Yucaipa Doubles Its Stake in Barnes & Noble.

With no warning, the Company learned on Friday, November 13, 2009, that Yucaipa had suddenly and rapidly doubled its stake in the Company. In a Schedule 13D/A filed late in the day, Yucaipa announced that it had increased its ownership from the previously disclosed level of just over 8% to just under 17%. (Ex. 13 at 9 (Yucaipa

Schedule 13D/A, filed 11/13/09.) As set forth in that Schedule 13D/A, the vast majority of the purchases accounting for that sudden jump had been made from November 10 through November 13.⁴ (*Id.*) In its filing, Yucaipa criticized the Company's management and corporate governance policies, and reserved its rights to pursue, among other things, a merger or sale of the Company. (*Id.* at 8.)

That same evening, Barnes & Noble received HSR notifications from YAAF II and YAAF Parallel, each of which disclosed an intent to purchase Company stock with a value between \$130.3 and \$651.7 million. (Ex. 14 at BKS00002750-2773 (Email from J. Daniels attaching 11/13/09 HSR notifications).) Based on the November

⁴ The following chart summarizes Yucaipa's purchases disclosed in the Form 13D/A filed on November 13:

Purchase Date	YAAF II	YAAF Parallel	Total	Aggregate
10/19/2009	180,854	119,146	300,000	300,000
10/26/2009	60,285	39,715	100,000	400,000
10/27/2009	45,213	29,787	75,000	475,000
11/9/2009	24,114	15,886	40,000	515,000
11/10/2009	1,021,825	673,175	1,695,000	2,210,000
11/11/2009	801,846	528,254	1,330,100	3,540,100
11/12/2009	315,228	207,672	522,900	4,063,000
11/13/2009	588,318	387,582	975,900	5,038,900

Notably, the Federal securities laws require the filing of an amended Schedule 13D "promptly" after a filer acquires an additional 1% of a company's stock. SEC Reg. §240.13d-2. As set forth in the above chart, Yucaipa crossed that 1% threshold on November 10, and yet waited until very late in the day on Friday, November 13, to file its amended Schedule 13D.

13, 2009, closing share price (\$20.05) and the number of shares outstanding as of October 31, 2009 (57,410,967 shares), either of the funds acting alone would have been able to seize majority control (56.6 %) by making purchases that placed their holdings at, or even near, the top end of the stated value range. Alternatively, purchases valued at just above the mid-point of the stated range by each fund would have made them, together, the Company's majority shareholder.

Jennifer Daniels, at that time Barnes & Noble's General Counsel, immediately consulted with Mr. Lombardi (the Company's CFO) and Mr. Milevoj (the Company's Director of Investor Relations) regarding the Yucaipa disclosure. Ms. Daniels also immediately contacted Scott Barshay of Cravath, Swaine & Moore LLP ("Cravath"). (Daniels Dep. at 154:4-156:6.) At that time, Mr. Barshay advised Ms. Daniels that the Company should consider implementing a poison pill to protect the interests of the Company's shareholders. (*Id.* at 169:11-20.) During the course of the following weekend, a team of attorneys at Cravath worked to analyze the situation and draft a shareholders rights plan. (*Id.* at 173:16-25.)

The following Monday, November 16, 2009, Ms. Daniels sent an email notifying the Board about Yucaipa's sudden and rapid accumulation of shares and provided the Board members with Yucaipa's November 13 Form 13D/A and HSR notification letters. (Ex. 14.) By the same email, Ms. Daniels suggested that the Board convene for a telephonic meeting the next day. (*Id.*)

V. Management Meets With Its Advisors on Monday, November 16, 2009.

That same Monday, representatives of the Company, including Ms. Daniels, Mr. Milevoj, Mr. Lombardi and Sheedeh Moayery, another in-house Barnes & Noble attorney, met with Mr. Barshay and Cravath attorney George Schoen to discuss the Company's response to Yucaipa's actions. (Ex. 15 at BKS00009519 (11/16/09 Moayery Notes).)⁵ Mr. Riggio did not attend this meeting. (*Id.*) Discussion at the meeting centered around the threat posed by Yucaipa and appropriate features of a shareholders rights plan that might be proposed to the Board in response to that threat. (*Id.* at BKS000009519-9522.) It was observed that Yucaipa "could be buying shares now" (*Id.* at BKS000009519), a suspicion that was confirmed when Yucaipa filed a Form 4 with the SEC later that day disclosing the purchase of almost 375,000 additional shares on Friday, November 13, and Monday, November 16. (*See* Ex. 16 at 8 (Yucaipa Schedule 13D/A, filed 11/17/09).) Those additional purchases increased Yucaipa's total stake to 17.8% of Barnes & Noble's common stock. (*Id.*)

During this meeting, the Company and its advisors also discussed the likelihood that

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(Ex. 15 at BKS00009520-21

(11/16/09 Moayery Notes).) Attendees at the meeting observed that "we don't know

⁵ In-house and outside counsel met separately for about 30 minutes prior to being joined by Mr. Milevoj and Mr. Lombardi. Ms. Moayery's notes indicate that the subjects of discussion in this "pre-meeting" were substantially similar to those discussed after the non-lawyers had joined. (Ex. 15 at BKS00009518 (11/16/09 Moayery Notes).)

what Burkle wants” and that

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(*Id.*

at BKS00009520.) The specific discussion of a potential rights plan during that meeting was largely oriented towards identifying “friendly features” for such a plan, with a view to avoiding criticism from proxy advisory firm ISS/RiskMetrics. (*Id.* at BKS00009519.) The Company’s advisors also noted that no matter what ISS’s recommendation was regarding a poison pill, “we have [a] fid[uciary] duty to do what is in [the shareholders’] best interest”. (*Id.* at BKS00009520.)

VI. The Board Meets on Tuesday, November 17, and Adopts the Rights Plan.

Before the Board meeting held on the afternoon of Tuesday, November 17, Board members received two “advance packets” consisting of PowerPoint slides for presentations by Cravath and Morgan Stanley, a proposed rights agreement drafted by Cravath with input from Ms. Daniels, a summary of the proposed rights agreement and proposed resolutions and a draft press release in case the Board elected to adopt a rights plan. (Exs. 17, 22.) After receipt of those packets, independent director (and Audit Committee Chair) Patricia Higgins telephoned Ms. Daniels to confirm that the Board members would have the opportunity to be advised of their own fiduciary obligations with respect to the proposed rights plan. (Daniels Dep. at 236:5-24; Ex. 18 (11/17/09 Email from J. Daniels).)

The November 17, 2009, Board meeting began with a discussion of the “recent rapid accumulation” of shares by Yucaipa—in particular, the fact that Yucaipa had increased its beneficial ownership to 16.8% as of Friday, November 13, and then

again to 17.8% as of Monday, November 16. (Ex. 19 at BKS00004278 (11/17/09 Minutes).) The Board understood that the purpose of the meeting was to consider a response to those actions, including whether the Board should adopt a shareholder rights plan. (*Id.*)

A. Cravath Reviews the Board's Fiduciary Duties, the Nature of Enhanced Review Under Unocal and the Purpose and Effects of a Rights Plan.

After a summary of events since Yucaipa's filings on the preceding Friday by Ms. Daniels and a preliminary discussion of Yucaipa and Mr. Burkle, Mr. Barshay made a presentation to the Board concerning the directors' fiduciary responsibilities with respect to the adoption of any defensive measures under Delaware law. First, Mr. Barshay described to the Board its duties of care and loyalty, explaining that the directors had to put aside their "own interests and look to the [shareholders]", "disclose [any] conflicts" and "[become] informed on [the] subject matter". (Ex. 21 at BKS00008625-26 (11/17/09 Moayery Notes); Ex. 20 at BKS00051977-78 (11/17/09 Daniels Notes).) Mr. Barshay then explained the "enhanced duty" applicable when "adopting a takeover defense" under the "Unocal/Unitrin standard". (Ex. 20 at BKS00051977-78 (11/17/09 Daniels Notes); Ex. 21 at BKS00008625-26 (11/17/09 Moayery Notes).) Specifically, Mr. Barshay advised that: (1) the Board must have a "reasonable ground" to believe that a "danger [to] corp[orate] policy and effectiveness" existed; and (2) any Board action can be neither coercive nor preclusive and must be reasonable in light of the threat posed.

(Ex. 20 at BKS00051977-78 (11/17/09 Daniels Notes); Ex. 21 at BKS00008625-26 (11/17/09 Moayery Notes).)

B. The Board Discusses the Threats Posed by Yucaipa's Rapid Accumulation of Company Stock.

Much of the Board's discussion at the meeting on Tuesday, November 17, revolved around the threat posed by Yucaipa's sudden accumulation of shares. (Ex. 20 (11/17/09 Daniels Notes).)

Members of the Board first discussed the threat that Yucaipa could seize control of the Company without the payment of a premium. (*Id.*; Ex. 21 (11/17/09 Moayery Notes).) The Board members discussed the fact that

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(Ex. 20 at BKS00051977 (11/17/09 Daniels Notes); Ex. 21 at BKS00008624-25 (11/17/09 Moayery Notes).) In addition, the Board members discussed a concern that, without paying a control premium for the Company, Yucaipa might nonetheless exert its influence to bring about an ill-advised transaction with Borders. Specifically, Mr. Riggio conveyed to the Board that Mr. Burkle had "told me he wants us to buy Borders", and suggested there was a danger that Burkle could accumulate enough shares to "force this to occur". (Ex. 20 at BKS00051977 (11/17/09 Daniels Notes); Ex. 21 at BKS00008626 (11/17/09 Moayery Notes).)

Led by lead independent director Michael Del Giudice, the Board also discussed the threat that, without a poison pill, Mr. Riggio and/or Yucaipa would accumulate additional shares. (Ex. 20 at BKS00051982 (11/17/09 Daniels Notes).) In

fact, during this meeting,

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C. The Board Debates the Proposed Rights Plan and Decides to Adopt It.

Mr. Barshay noted that in deciding whether to put a rights plan in place, the “central responsibility of the [Board is] to protect the [shareholders]”. (Ex. 21 at BKS00008626 (11/17/09 Moavery Notes.) As part of this discussion, Mr. Barshay explained to the Board that “we [Cravath] believe you have” reasonable grounds to conclude that there was a danger to corporate policy and effectiveness because “Burkle can come in [and] control [without] a pr[emium]” and that, in his view, the proposed rights plan would be neither preclusive nor coercive and would be reasonable given the threat of “creeping control”. (Ex. 21 at BKS00008625-26 (11/17/09 Moavery Notes).) Carmen Molinos of Morgan Stanley agreed that, based on Yucaipa’s “precipitous accumulation”, it was “prudent to put a pill in place”, especially since it is “a[n] ISS friendly pill and we are putting it up for a vote”. (Ex. 20 at BKS00051979 (11/17/09 Daniels Notes); Ex. 21 at BKS00008627 (11/17/09 Moavery Notes).)

Mr. Barshay also stated that Cravath's advice was that the Board "[f]reeze" existing shareholders, such as Mr. Riggio, whose ownership already exceeded the trigger, which was "typical[ly] how its [sic] done". (Ex. 21 at BKS00008626 (11/17/09 Moayery Notes); Ex. 20 at BKS00051979 (11/17/09 Daniels Notes).) In addition,

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(Ex. 20 at BKS00051982 (11/17/09 Daniels Notes); Ex. 21 at BKS00008628 (11/17/09 Moayery Notes).)

Following this robust deliberation, each independent director indicated his or her support for the concept of adopting a rights plan. (Ex. 20 at BKS00051983 (11/17/09 Daniels Notes); Ex. 21 at BKS00008629 (11/17/09 Moayery Notes).) Messrs. Schoen and Barshay then discussed the specific provisions of the proposed rights plan with the Board, including the "grandfathering provision". (Daniels Dep. at 180:25-181:10.) Finally, Ms. Molinos discussed Morgan Stanley's presentation regarding the plan and the exercise price. (Ex. 20 at BKS00051983 (11/17/09 Daniels Notes); Ex. 21 at BKS00008629-30 (11/17/09 Moayery Notes).) At the end of the meeting, which lasted approximately 1.5 hours, the Board unanimously voted to adopt the proposed shareholder rights plan (the "Rights Plan"). (Ex. 20 at BKS00051983 (11/17/09 Daniels Notes); Ex. 21 at BKS00008630 (11/17/09 Moayery Notes).)

VII. The Rights Plan.

In adopting the Rights Plan, the Board declared a dividend of one right per each share of common stock to purchase 1/1000th of a share of a new series of preferred stock. (Ex. 24 at Item 1.01 (Barnes & Noble, Inc. Form 8-K, filed 11/18/09 (Shareholder Rights Plan)).) In the event that any person or group (an “Acquiring Person”) acquires beneficial ownership of more than 20% of the Company’s common stock, these rights would become exercisable or, at the Board’s option, could be exchanged for common stock. (*Id.*)

As stated above, the Rights Plan includes a grandfather clause to take into account Leonard Riggio’s preexisting ownership stake. (*Id.*) However, unlike a prior rights plan adopted by the Company in 1998 (which allowed Mr. Riggio to acquire an additional 5% of the Company’s shares during the duration of that plan), the Rights Plan adopted in November 2009 effectively precludes Leonard Riggio or any of his Associates or Affiliates⁶ from acquiring any additional Company voting securities with only a few very limited exceptions (such as stock acquired by virtue of options or restricted shares granted pursuant to the Company’s employee benefit or compensation plans). (*Id.*) Along with Mr. Riggio and certain entities controlled by Mr. Riggio, the persons who

⁶ For purposes of the Rights Plan, “Beneficial Ownership” is defined in part by reference to regulations promulgated by the Securities Exchange Act of 1934. Specifically, any Barnes & Noble shareholder is deemed to have beneficial ownership of shares held not only by himself or herself, but also his or her “Affiliates” and “Associates” as those terms are defined under SEC Rule 13d-3.

cannot purchase additional shares of the Company's stock without triggering the Rights Plan include Mr. Riggio's wife, his brother Stephen Riggio, Stephen Riggio's wife Laura Riggio, Stephen Riggio's daughter Christina Riggio and any other person or entity acting in concert with any of those individuals. (*Id.*)

Of course, under the Rights Plan, the Board has the ability to permit Mr. Riggio and any of his Affiliates and Associates to acquire additional shares of the Company's voting securities, just as the Board could approve the purchase of shares by Mr. Burkle, Yucaipa or any other Company Shareholder in excess of the 20% cap. (*Id.*) Also, the rights can be redeemed or the Rights Plan can be modified by the Board. The Rights Plan expires three years after its effective date, and it has neither "slow hand" nor "dead hand" provisions that would limit in any way the right of a newly elected board to redeem the rights. (*Id.*)

Finally, in adopting the Rights Plan, the Board committed to submit it for shareholder approval no later than November 17, 2010 (*i.e.*, within one year of its adoption). (Ex. 23 (Barnes & Noble, Inc. Form 8-K, filed 11/18/09 (Press Release).) Although any Board decision concerning the redemption of the Rights Plan following that shareholder vote will need to be based upon the facts and circumstances then existing in the Board's exercise of its fiduciary duties, it was the Board's intention at the time it adopted the Rights Plan, and it remains its intention today, to redeem the rights in the event that the shareholders vote the Rights Plan down. (*See, e.g.*, Ex. 21 at

BKS00008630 (11/17/09 Moavery Notes); Ex. 45 (5/11/10 Ltr. from S. Goldstein to D. Robbins).)

VIII. Burkle Responds Aggressively to the Rights Plan.

Following the Board's adoption of the Rights Plan, Mr. Burkle engaged in an aggressive letter-writing campaign against the Company. On December 23, 2009, Mr. Burkle sent Mr. Riggio a letter criticizing various decisions made by the Company's management and Directors and claimed that the Company had "declared war" by adopting the rights plan. (Ex. 27 (12/23/09 Ltr. from R. Burkle to L. Riggio).) Mr. Burkle also accused the Company of not acting in the best interests of its shareholders. (*Id.*) Mr. Burkle, for the first time, also referred to a so-called "Best of Borders" strategy, without any explanation as to what that meant or how it could be executed. (*Id.*)

On January 6, 2010, Mr. Riggio responded that the "personal attacks" in Mr. Burkle's letter were "unfair and unwarranted". (Ex. 28 (1/6/10 Ltr. from L. Riggio to R. Burkle).) Mr. Riggio suggested that he or Mr. Burkle approach Ken Moelis, a mutual friend, to serve as an intermediary to sort through their "respective positions". (*Id.*) Shortly thereafter, Mr. Burkle sent another letter to each of the Company's Directors on January 28, 2010. (Ex. 30 (1/28/10 Ltr. from R. Burkle to Directors).) In addition to criticizing the Board's priorities and the Company's governance, Mr. Burkle demanded an exception to the Rights Plan to allow Yucaipa to acquire up to a 37% stake of the Company (a figure that he inaccurately described as equal to the stake held by Mr. Riggio and other "insiders"). (*Id.*) Mr. Burkle also purported to seek clarification regarding the

definition of “excluded shares” under the definition of “Acquiring Person”, insinuating that the Board had designed the Rights Plan to permit Mr. Riggio to accumulate effective majority control of the Company. (*Id.*)

During this time period, Yucaipa continued to purchase Company stock, increasing its total ownership to more than 18%. (Ex. 31 at 9 (Yucaipa Schedule 13D/A, filed 2/1/10).) The financial and business media took note of Mr. Burkle’s aggressive response to the Rights Plan, with many noting the possibility that Mr. Burkle was trying to seize control of the Company. (*See, e.g.*, Ex. 32 (Collection of Articles); *see also* Ex. 33 (reflecting communications between Company and its counsel concerning rumor of potential tender offer by Burkle).)

IX. Aletheia Increases Its Stake in Barnes & Noble to Just Below the Rights Plan Trigger.

At the same time that Yucaipa was sending aggressive letters to the Board and acquiring additional shares, another entity began making its own significant purchases of the Company’s stock. That entity, Aletheia Research and Management, Inc. (“Aletheia”), is an investment manager based in Santa Monica, California, just seven miles from Yucaipa’s headquarters in Los Angeles. As of the date the Rights Plan was adopted, Aletheia held a 6.37% stake in the Company, which had been acquired during the same time period that Yucaipa acquired its initial stake. Aletheia announced that stake in the Company by filing a Schedule 13G (which signals the purchase of stock for investment purposes only), rather than a Schedule 13D (which signals an intent to assert influence), in early 2009. (Ex. 10 (Aletheia Schedule 13G, filed 2/17/09).) Aletheia’s

next filing did not come until December 22, 2009, a little over a month after the adoption of the Rights Plan, when Aletheia switched to a Schedule 13D and announced that it had acquired a 10.82% stake in the Company. (Ex. 26 at 4 (Aletheia Schedule 13D, filed 12/22/09); *see also* Ex. 25 (reflecting communications between Company and its counsel concerning links between Yucaipa and Aletheia).) In that filing, Aletheia stated for the first time that it was explicitly reserving its “right to act in concert with any other shareholders of the Issuer, or other persons, for a common purpose should it determine to do so, and/or to recommend courses of action to management and the shareholders of the Issuer”. (*Id.*)

Aletheia did not stop at 10.82%. Instead, its stake in the Company grew to 13.12% by January 11, 2010 (Aletheia Schedule 13D filed 1/11/10) and 15.71% by January 28, 2010 (Aletheia Schedule 13D/A filed 1/28/10). On February 9, 2010, Aletheia reported a 17.44% stake in Barnes & Noble (Aletheia Schedule 13D/A, filed 2/9/10) — just shy of the 20% pill trigger and nearly as large as the 18.7% stake that Yucaipa had reported on February 1, 2010 (Yucaipa Schedule 13D/A, filed 2/1/10).

As Aletheia’s rapid series of purchases approached the 20% trigger, the Company became increasingly concerned about the possibility that Aletheia and Yucaipa would work together to circumvent the Rights Plan and obtain creeping control.⁷

⁷ The Aletheia funds’ first significant purchases of Barnes & Noble stock began, like Yucaipa’s, in late 2008. Aletheia’s subsequent filings disclose that its significant share purchases occurred in each instance within days or weeks of Yucaipa’s purchases. (*See* Ex. 48 at 28 (Harkins Report).)

Aletheia's express reservation of "the right to act in concert with any other shareholders" contributed to this concern. The Company's concerns were further heightened by the knowledge that Yucaipa and Aletheia had demonstrated a pattern of parallel investment in at least three other public companies: Wild Oats, Whole Foods and the A&P supermarket chain.⁸ At the same time, various press reports began to speculate that Yucaipa and Aletheia were working together. (*See, e.g.*, Ex. 29 ("Will it Take Two to Tango Past Barnes & Noble's Poison Pill" forwarded to Leonard and Stephen Riggio); Ex. 57 (additional articles).)

Discovery during this litigation has confirmed that the principals of Aletheia and Yucaipa (Peter Eichler and Ronald Burkle) have met to discuss, among other things, various investments on at least two occasions — once in August of 2009 and once in January of 2010 — and that Aletheia and its principals greatly respect and admire Mr. Burkle. (Burkle Dep. at 101:18-110:12; Eichler Dep. at 53:19-65:18.) Notably, throughout his deposition in this case, Mr. Eichler could not hide

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⁸ In June 2009, Mr. Burkle and Yucaipa filed a Schedule 13G/A disclosing a 4.5% stake in A&P's parent company. Subsequently, on August 12, 2009, Yucaipa disclosed an agreement to purchase convertible preferred shares of A&P that would give it, in one year's time, the right to receive 27.5% of A&P's common stock. The following month, Aletheia disclosed its own acquisition of a 25% stake in A&P. (*See* Ex. 48 at 30 (Harkins Report).)

Similarly, Aletheia obtained a 5.3% stake in Whole Foods Market in December 2008, just as Yucaipa was building the 7% stake it disclosed early the following month. (*See id.* at 29.) Both companies have also held significant stakes in Wild Oats Markets. (*See id.* at 30.)

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Thus, it is no surprise that Mr. Burkle conceded in his own deposition that Aletheia has demonstrated an affinity for following Yucaipa's investment strategies:

I know they have, or I have been told that they have bought shares in companies we have bought in the past. ... Although, frankly, we never known they were buying shares in companies we have bought in the past. They are a big fund and a big company. It is just an impression if somebody is following what you're doing, then they are at least have a positive impression of whether you make good decisions or not.

(Burkle Dep. at 56:25-57:10.) Mr. Burkle has also admitted that, in the event of a proxy contest, "I think [Aletheia] will give us a good listen. I believe they think that we are good investors." (*Id.* at 58:21-23.)

X. The Board Meets on February 16, 2010, and Considers Mr. Burkle's January 28 Letter.

As noted above, Mr. Burkle on January 28, 2010, had sent a letter to the Board requesting that the 20% cap be lifted in order for Yucaipa to take its stake to 37%. At a meeting held on February 16, 2010, the Board reviewed Yucaipa's January 28, 2010, letter and discussed Mr. Burkle's request to lift the cap for Yucaipa. (Ex. 35 at BKS00004286 (2/16/10 Minutes).) Specifically, Mr. Barshay of Cravath reviewed the

analysis that had been conducted when the Rights Plan was adopted, discussed the parallel increase in both Yucaipa's and Aletheia's ownership — Yucaipa held 18.7% of the Company at that time and Aletheia held 17.4% — and noted that the Rights Plan's 20% threshold and grandfathering provisions were “common and reasonable”. (*Id.*) The Board also discussed the fact that there was “ample evidence [that] Aletheia follows Yucaipa”. (Ex. 36 at BKS00051835 (2/16/10 Daniels Notes).)

Mr. Barshay reminded the Board that a defensive measure such as the Rights Plan could not preclude a shareholder from “being able to successfully run a proxy contest”. (*Id.*) Mr. Barshay then advised that “it was reasonable for the Board to perceive a threat to the Company and that the Shareholder Rights Agreement's 20% threshold is not preclusive and should not be waived as requested by Yucaipa”. (Ex. 35 at BKS00004286 (2/16/10 Minutes).) Following a discussion, the Board unanimously found that raising the trigger for Yucaipa would not be in the shareholders' best interests. (*Id.*) As Ms. Daniels's notes from the Board meeting indicate, the Board continued to view “Burkle and Yucaipa as a threat” based on Burkle's demand that he be permitted to increase Yucaipa's stake following the adoption of the Rights Plan. (Ex. 36 at BKS00051836 (2/16/10 Daniels Notes).) Despite Mr. Riggio's relatively large stake, Ms. Daniels's notes reflect that he was not perceived as an analogous threat, at least in part because he had “not gone out of his way to buy control” following the expiration of the 1998 Rights Plan. (*Id.*)

At this meeting, the Board also considered an amendment to the Rights Plan in response to Mr. Burkle's technical question about the circumstances under which "Excluded Persons" could acquire additional shares.⁹ (*Id.* at BKS00051837; Ex. 35 at BKS00004286 (2/16/10 Minutes).) At the meeting, Mr. Barshay advised the Board that while Cravath did not agree with Yucaipa's interpretation that of the Rights Plan in its January 28, 2010 letter, he recommended that the Board adopt an amendment to the Rights Plan to clarify an arguable technical ambiguity in the definition of "Acquiring Person". (*Id.*) As Mr. Riggio explained, the Board was given "a recommendation by our counsel and advisors to amend our shareholder rights agreement so that there would be no ambiguity with respect to I personally or together with my family having the rights to acquire additional shares of Barnes & Noble stock". (L. Riggio Dep. at 290:13-19.)¹⁰ This amendment was intended to foreclose any interpretation that the Rights Plan would permit a relative of Mr. Riggio to own more than the "grandfathered" share level.

The Board approved sending a letter to Mr. Burkle, dated February 17, 2010, declining Yucaipa's request to be allowed to acquire 37% of Barnes & Noble's outstanding shares without triggering the Rights Plan. (*Id.* at BKS00004289,

⁹ An "advance packet" circulated prior to the meeting contained a summary presentation explaining the confusion expressed by Mr. Burkle on this front and the effect of the proposed technical amendment. (Ex. 34 (Advance Packet for 2/16/10 Meeting).)

¹⁰ While Plaintiffs have consistently implied that this "Family Transfer" provision is a back-door route intended to allow "the Riggio family" to increase its control over the Company by allowing Riggio family members to collectively own approximately 50% of the Company shares, both this provision, and its iteration in the 1998 Rights Plan, were included simply for estate planning purposes.

BKS00004295; Ex. 37 (2/17/10 Ltr. from Board to R. Burkle).) The Board's letter also informed Yucaipa of the amendment to the definition of "Acquiring Person". (Ex. 37.)

XI. Independent Directors Higgins and Del Giudice Meet with Mr. Burkle, at His Request, on March 29, 2010.

On February 25, 2010, Mr. Burkle sent yet another letter criticizing the Board for rejecting Yucaipa's request to acquire up to 37% of the Company without triggering the Rights Plan. (Ex. 38 at BKS00004265-66 (2/25/10 Ltr. from R. Burkle to Board).) Mr. Burkle also insisted that an ambiguity remained in the Rights Plan's "family transfer" provisions, and once again demanded clarification. (See *Id.* at BKS00004265.) Mr. Burkle concluded his letter with a request to meet with the Company's independent directors to discuss the Company's corporate governance policies and practices and to reconsider Yucaipa's request that it be permitted to acquire additional shares without triggering the pill. (*Id.* at BKS00004266.)

At a meeting on March 8, 2010, the Directors discussed the February 25, 2010, letter from Mr. Burkle and agreed that a meeting "between Mr. Burkle and one or two non-management directors of the Board would be appropriate". (Ex. 40 at BKS00052054 (3/8/10 Minutes).) At another meeting nine days later, the Directors agreed that Mr. Del Giudice, as lead director, and either Ms. Higgins or Mr. Dillard, as Committee Chairs, would be appropriate Board representatives at such a meeting, and requested that Ms. Daniels contact counsel for Yucaipa and attempt to set a date. (Ex. 41 at BKS00010535 (3/17/10 Minutes).)

On March 29, 2010, Mr. Del Giudice and Ms. Higgins met with Mr. Burkle in New York City to discuss his concerns. Counsel for both Barnes & Noble and Yucaipa were also present. At this meeting, Mr. Burkle alleged that “the board was basically a pawn of Riggio and that Len was making wrong decisions”. (Del Giudice Dep. at 262:25-263:9.) Mr. Burkle also aired his views regarding the Company’s corporate governance and recommended that the Company add three or four additional independent directors to the Board, each of whom would be selected by Mr. Burkle. (*Id.* at 249:15-253:13, 262:19-265:6; Ex. 42 at BKS00050162 (3/29/10 Daniels Notes).) Mr. Burkle also stated (erroneously) that the current Board has four interested directors and only five independent directors. (*Id.*)

During this meeting, Mr. Burkle reiterated his request that the Rights Plan be canceled or amended to allow Yucaipa to acquire additional shares and yet again claimed to be unclear as to whether the Riggio family could acquire additional shares under the terms of the Rights Plan. (*Id.* at BKS00050163.) As Mr. Del Giudice recalls it, Mr. Burkle said he was “seeking to provide advice and input and make an impact on the company” and that he “want[s] some board seats” and “want[s] to be able to buy as much as Len”. (Del Giudice Dep. at 253:3-8.) Mr. Del Giudice and Ms. Higgins remained concerned about Mr. Burkle’s motivations following their meeting. As Mr. Del Giudice explained at his deposition:

I don’t know what his motivations are. He wants to keep buying shares, he wants to perhaps do other things with the company. He wants to take control of the company, he’s going to have to pay a premium. . . . I still

don't understand what his motivations are in wanting to keep purchasing shares of the company, and I certainly don't see what value [Burkle] adds to the shareholder[s].

(*Id.* at 254:8-255:8.) The meeting adjourned, and the Board did not have further communications with Mr. Burkle before Plaintiffs' initiation of this lawsuit.

XII. Yucaipa Sues on May 5, 2010, and Seeks Expedition on the Grounds That It Expects to Mount a Proxy Contest with Respect to the Barnes & Noble Annual Meeting Scheduled for September 2010.

On May 5, 2010, Yucaipa filed this lawsuit, alleging that the Board breached its fiduciary duties by adopting the Rights Plan and declining to amend it to Yucaipa's satisfaction. (*See* Compl. ¶¶ 79-128.)

Yucaipa sought expedited proceedings in this litigation on the basis of representations that it intended: (1) to run a proxy contest; and (2) to buy additional shares. Specifically, in both its Complaint and Motion for Expedited Proceedings, Plaintiffs represented that "Yucaipa expects to propose a slate of three directors to oppose management's slate at the next annual meeting of B&N stockholders which B&N has publicly stated will be held on or before September 30, 2010". (Compl. ¶ 4 (emphasis added); Mot. for Expedition ¶ 6 (emphasis added).) In so doing, Yucaipa grounded its purported need for expedition upon its intention to wage a proxy contest:

In order for Yucaipa to be able to wage a meaningful proxy contest . . . , Yucaipa needs relief from this Court to level the playing field without triggering the poison pill (1) in advance of the record date for the 2010 Meeting in order to buy additional shares and (2) well in advance of the advance notice by-law date in order to communicate, coordinate and reach agreements or understandings with other stockholders.

(Compl. ¶ 74; Mot. for Expedition ¶ 13.) In fact, in its May 13, 2010, letter to the Court, Yucaipa clearly stated that it had decided to conduct a proxy contest and explicitly acknowledged that seeking relief from this Court before deciding to wage a proxy contest would have been premature:

Plaintiffs did not make the decision to conduct a proxy contest until shortly before the filing of the Complaint and that decision was based upon the premise that the proxy contest could be conducted on an even playing field. Plaintiffs would have been imposing on both the Court and Defendants to litigate what would only have been a hypothetical issue until Plaintiffs determined to conduct the proxy contest.

(Ex. 46 at 4-5 (emphasis added) (5/13/10 Ltr. from D. McBride to V.C. Strine).) Similarly, in a Schedule 13D/A filed May 6, 2010, Yucaipa stated that it “currently expects to nominate three candidates for election to the Company’s nine-member classified Board of Directors at the Company’s 2010 Annual Stockholders Meeting, as an alternative to the Company’s three nominees.” (Ex. 44 at Item 4 (Yucaipa Schedule 13D/A filed 5/6/10).)

Yucaipa has now abandoned these prior representations. Faced with the opinions of *its own experts* that it *can* win a proxy contest, even with the Rights Plan in place, Plaintiffs’ new theory is that the Rights Plan is preclusive for purposes of *Unocal* and its progeny because it “precludes” Yucaipa from communicating with stockholders before launching a proxy contest, thereby making it “highly unlikely that a professional investor with fiduciary duties to clients like Yucaipa would invest the time and money to engage in a proxy contest” (Ex. 49 (Burch Report at 3).) Consistent with this new

theory, Mr. Burkle backed away from Yucaipa's stated intention to wage a proxy contest at his deposition, claiming, in a complete reversal from what Yucaipa has previously told the Court, that Yucaipa "ha[s]n't said we are going to have a proxy contest" and "ha[s]n't decided if we are going to have a proxy contest". (Burkle Dep. at 20:15-18.)¹¹

The same day that Yucaipa filed this lawsuit, its counsel also sent a letter to Jennifer Daniels, who had by that time left the Company for a new job, asking certain questions about the interpretation of the Rights Plan. (Ex. 43 (5/5/10 Ltr. from D. Robbins to J. Daniels).) The Company's counsel responded to those questions by letter dated May 11, 2010, confirming, among other things, that:

[P]ursuant to the definition of 'Beneficial Owner' in the Shareholder Rights Plan, your client (or any other shareholder) would not trigger the Shareholder Rights Plan by, among other things: (1) mounting a proxy contest by putting forth a slate of candidates for the upcoming Board election; (2) putting forth any proposals for shareholder consideration that he wishes; (3) communicating his position regarding any candidates or other proposals to other shareholders fully and freely; and (4) soliciting and receiving revocable proxies in response to any public proxy solicitation made generally to all of the Company's shareholders. Your client and his Affiliates and Associates would, however, trigger the Shareholder Rights Plan if: (1) they enter into any agreement, arrangement or understanding (written or oral) with any other shareholder for the purposes of acquiring, holding, voting (except pursuant to a revocable proxy as described above) or disposing of any voting security of the Company, or if they enter into any agreement, arrangement or understanding (written or oral) with any other shareholder to cooperate in obtaining, changing or influencing the control of the Company; and (2) the aggregate number of shares

¹¹ Mr. Burkle also stated at his deposition, contrary to Yucaipa's prior position before this Court, that he does not know whether Yucaipa would choose to acquire additional shares even if the Rights Plan's threshold were to be lifted. (Burkle Dep. at 153:3-153:7 (testifying that "[i]f it wasn't cheap we wouldn't acquire shares).)

Beneficially Owned by your client and such other shareholder and their Affiliates and Associates is 20% or more of the outstanding common stock. Thus, your client and his Affiliates and Associates would trigger the provisions of the Shareholder Rights Plan if they, along with any such shareholder, jointly share expenses of a proxy contest or propose a joint slate of directors.

(Ex. 45 (5/11/10 Ltr. from S. Goldstein to D. Robbins).)

XIII. The Board Amends the Rights Plan in Response to Yucaipa's Mischaracterization of Its Terms.

At his deposition on June 18, Mr. Burkle indicated – for the first time – that notwithstanding the clear responses in Ms. Goldstein's letter, Yucaipa nonetheless believed it was prevented by the language of the Rights Plan from engaging in any communications with other Barnes & Noble shareholders in advance of a proxy contest. (Burkle Dep. at 41:13-42:6.) (Notably, such an allegation is *not* included in Plaintiffs' complaint. *See, e.g.*, Compl. ¶ 55 (listing the claimed effects of the rights plan).) Mr. Burkle indicated that this belief was premised upon advice of counsel – presumably Yucaipa's counsel in this litigation. (Burkle Dep. at 44:7-45:19.)

This position was repeated in two expert reports served on Yucaipa's behalf the next day, Saturday June 19. For example, Plaintiffs' expert Daniel Burch opined that “the Barnes & Noble Rights Plan, if upheld by this Court, will effectively prevent Yucaipa's ability to engage in pre-filing communications with other shareholders, who will in turn likely refuse to communicate with Yucaipa”. (Ex. 49 at 9 (Burch Report).) Similarly, Yucaipa's other expert, Gregory Taxin, opined that the Rights Plan would “in my view . . . have a significant chilling effect on conversations, meetings, interactions

and even the giving of revocable proxies between shareholders in the context of a proxy fight.” (Ex. 50 at 10 (Taxin Report).)

These two experts pointed to the same provision of the Rights Plan as the foundation for their purported concern on this front, namely subclause (ii) of clause (c) of the Rights Plan’s definition of Beneficial Ownership, which provided for attribution of Beneficial Ownership as between persons who reach “an agreement, arrangement or understanding (written or oral) ... to cooperate in obtaining, changing or influencing the control of the Company”. (Ex. 50 at 8; Ex. 49 at 8.) Both Messrs. Burch and Taxin also expressed the view that the language of the Rights Plan was “highly unusual” (Ex. 49 at 8 (Burch Report)) and “quite uncommon” (Ex. 50 at 9 (Taxin Report)).¹²

Although Defendants were unpersuaded by Plaintiffs’ or their experts’ protestations about the Rights Plan’s purported chilling effect, the Company’s counsel recommended that the Rights Plan be amended to remove any possible ambiguity. (Ex.

¹² In this regard, Messrs. Taxin and Burch were wrong. At least six other public companies have adopted plans with identical (or nearly identical) language. (See Ex. 61.) Note that for the Court’s convenience and to avoid a needlessly voluminous submission, Defendants have prepared a summary schedule showing the relevant language in each of these rights plans, as well as of two other groups of rights plans referred to elsewhere in this Memorandum. If the Court prefers, Defendants would be happy to lodge the complete text of any or all of these plans.

Defendants have also identified more than thirty plans that have been adopted or amended since 2006 that are even broader, each of which generally attributes beneficial ownership of securities among “any group of persons who, by formal or informal agreement or arrangement, have embarked on a common purpose or act” – or words to similar effect. (See Ex. 60; see also *infra* at Argument § I.B.2, describing and identifying “wolfpack” pills triggered by “acting in concert” or “consciously parallel”.)

52 (6/23/10 Ltr. from S. Goldstein to S. Alexander).) The Board met on Wednesday, June 23, and unanimously approved a second amendment to the Rights Plan (the "June 23 Amendment"), which simply deleted the language identified by Plaintiffs' experts as objectionable. (*Id.*) The Board's decision to amend the Rights Plan reflected the fact that the Board never intended for the "agreement to cooperate to influence control" language of subclause (ii) of clause (c) to apply to a potential or actual proxy fight.

Later the same day, counsel for Barnes & Noble sent counsel for Yucaipa a letter describing the June 23 Amendment. The letter explained that:

[T]he Board earlier this afternoon adopted a Second Amendment to the Rights Agreement that removes subclause (ii) of clause (c) of the definition of Beneficial Ownership. Thus the 'cooperation' language cited by your experts, which also apparently formed the basis for the legal advice provided to Mr. Burkle that he described during his deposition, has been removed.

(*Id.*) As explained in further detail below (*see* Section I.B.1.a)), the attribution provisions of the definition of Beneficial Ownership in the Rights Plan are now entirely consistent with, among other things, the provisions of rights plans that have been upheld by this Court and the Supreme Court since 1985 and the terms of Section 203 of the General Corporation Law of the State of Delaware. Thus, Plaintiffs' expert has admitted that the Rights Plan now contains a completely "standard" definition of "Beneficial Owner". (6/25/10 Burch Dep. Tr. at 72:14-20.)

ARGUMENT

A board's exercise of its fiduciary responsibility to adopt a defensive measure will be protected by the business judgment rule so long as: 1) the board had "reasonable grounds for believing that a danger to corporate policy and effectiveness existed" at the time of adoption; and 2) the board's "defensive response was reasonable in relation to the threat posed". *Unitrin, Inc. v. Am. Gen. Corp.*, 651 A.2d 1361, 1373 (Del. 1995) (citing and summarizing *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 955 (Del. 1985)); see also *Hollinger Int'l, Inc. v. Black*, 844 A.2d 1022, 1084 (Del. Ch. 2004), judgment entered, 2004 WL 5322715 (Del. Ch.) (Strine, V.C.) ("The traditional test for examining whether a Rights Plan was permissibly adopted is that set forth in *Unocal*."). As this Court has recently explained, the *Unocal* standard requires that directors whose defensive actions are challenged "identify a legitimate corporate objective served by [their] decision" and "show that their actions were reasonable in relation to their legitimate objective and did not preclude the shareholders from exercising their right to vote or coerce them into voting a particular way." *Mercier v. Inter-Tel (Del.), Inc.*, 929 A.2d 786, 810-11 (Del. Ch. 2007) (Strine, V.C.).

As set forth below, the evidence at trial will establish that the Board's actions with respect to the Rights Plan satisfy the heightened *Unocal* standard. (See Section I, *infra*.) The relevant Delaware law, as well as the evidence adduced at trial, also will establish that the *Blasius* standard is inapplicable and, even if applicable, is satisfied. (See Section II, *infra*.)

I. THE BOARD'S ACTIONS WITH RESPECT TO THE RIGHTS PLAN WERE AN APPROPRIATE EXERCISE OF FIDUCIARY DUTIES UNDER UNOCAL.

Although Yucaipa has gone to great lengths to portray the Rights Plan at issue here as unique in the alleged limitations it imposes upon shareholders, the simple fact is that the Rights Plan is no different from those that have been universally upheld by Delaware courts since *Moran*. Defendants respectfully submit that the terms of the Rights Plan, and the Board's actions in adopting that Rights Plan, easily satisfy the standard articulated in *Unocal* and its progeny.

First, the evidence will show that the Board adopted the Rights Plan in good faith and after reasonable investigation in response to the threats posed by the sudden and rapid accumulation of Company stock by Yucaipa. That rapid accumulation presented two threats to the Company's shareholders. The first was the threat that Yucaipa, acting alone or in concert with others, could obtain control of the Company without paying a control premium. That threat, which goes to the core of the corporate objectives that may be served by adopting a poison pill, was exacerbated by the Board's reasonable concern that Mr. Burkle would use a position of control to force the Company to enter into an ill-advised transaction with Borders. The second was the threat that Mr. Burkle and Mr. Riggio could engage in an unfettered arms-race absent a poison pill, which would unreasonably concentrate the ownership of the Company's common stock in the hands of two investors to the detriment of the Company's other shareholders. The evidence will also show that by February 2010, when Yucaipa demanded consent to

purchase up to 37% of the shares of the Company, these threats were even more serious in light of Aletheia's suspicious buying activity. (See Section I.A., *infra*.)

Second, the evidence will show that the Rights Plan was a reasonable response to these reasonably perceived threats. The terms of the Rights Plan, which are wholly unremarkable, neither preclude the possibility of a successful proxy fight by Yucaipa (or any other minority shareholder), nor do they coerce shareholders to accept or endorse any proposal by the Board. The evidence will also show that the Rights Plan, which is significantly more conservative in many respects than other poison pills that have been approved by Delaware courts, was a proportionate response to the serious threats posed by Yucaipa's actions. (See Section I.B., *infra*)

A. The Board's Actions With Respect to the Rights Plan Satisfy the First Prong of Unocal.

To sustain its burden under *Unocal*, the Board must first establish that it had reasonable grounds for believing that a danger to corporate policy and effectiveness existed. *See, e.g., Unocal*, 493 A.2d at 954-55; *see also Inter-Tel*, 929 A.2d at 810 (explaining that Board must establish that it enacted defensive measure for a "legitimate corporate objective"). A Board satisfies this burden by showing "good faith and reasonable investigation". *Unocal*, 493 A.2d at 955.

1. The Board Engaged in a Rational Deliberative Process With Respect to the Rights Plan, Including Reliance on Outside Expert Advisors.

As an initial matter, the Board “engaged in a rational deliberative process to define the threat it faced”. *In re Gaylord Container Corp. S’holders Litig.*, 753 A.2d 462, 479 (Del. Ch. 2000) (Strine, V.C.). This process included robust Board discussions of the threat posed by Yucaipa and the receipt of legal advice from an outside law firm. *Id.*

As discussed in detail above, the Company’s management reacted to the concerning news that Yucaipa had, in roughly four days, doubled its stake in the Company by immediately engaging outside legal advisors. (See Factual Background §IV.) These advisors developed a proposed response to the threats posed by Yucaipa’s actions and discussed that proposal in detail with management. (See Factual Background §V.); see also *Gaylord*, 753 A.2d at 467 (describing CEO’s and CFO’s pre-board-meeting receipt of an “eighteen-page memorandum reviewing ‘various mechanisms public companies employ to protect stockholders from raiders’”). The Company’s General Counsel also promptly advised the Board of the situation and provided advance materials describing a proposal that the Board adopt a rights plan. (See Factual Background §§V-VI.)

During the meeting on November 17, the Board discussed the threats posed by Yucaipa’s sudden and rapid accumulation of shares, including a discussion about the lack of any viable alternatives and the terms of the proposed rights plan. (See Factual

Background §VI.) The Board also discussed the interplay between the proposed rights plan and Mr. Riggio's existing approximately 30% stake in the Company. (See Factual Background § VI.) Similarly, in February 2010, when it decided not to accede to Mr. Burkle's demand that he be allowed to purchase up to 37% of the Company and amended the definition of "Excluded Persons", the Board, acted on the advice of outside counsel following thorough deliberation. (See Factual Background §X.) This process "supports the conclusion that the Board acted in an informed manner". *Gaylord*, 753 A.2d at 479.

The evidence demonstrating the Board's reliance on advice from both Cravath and Morgan Stanley also establishes the applicability of Section 141(e) of the DGCL. See, e.g., *Selectica, Inc. v. Versata Enters., Inc.*, 2010 WL 703062, at *17 (Del. Ch.) (applying §141(e) to Board's actions in adopting poison pill); *Gaylord*, 753 A.2d at 479-80 (approving board process which included "detailed legal advice" from a distinguished outside law firm"). As a result, Yucaipa's challenge to the Board's decisions concerning the Rights Plan will necessarily fail because no evidence will support a conclusion that the Board's reliance on its expert advisors was unreasonable. *Selectica*, 2010 WL 703062, at *17-18.

2. The Board's Determinations Are Entitled to Material Enhancement.

Under Delaware law, "the presence of a majority of outside independent directors will materially enhance" a showing of reasonableness under *Unocal's* first prong. *Unitrin*, 651 A.2d at 1375 (citing *Unocal*, 493 A.2d at 955); see also *Selectica*, 2010 WL 703062, at *14 ("Where decisions are made by outside independent directors . .

, the concern that the board's decisions are tainted by self-serving motives is mitigated, and there naturally follows a greater presumption of good faith and reasonable investigation.”). The Board's actions challenged in this case are entitled to material enhancement because six of the nine directors who made those decisions were independent.¹³ In fact, because “the presence of a majority of outside directors [is] coupled with a showing of reliance on advice by legal and financial advisors”, there is a “*prima facie* showing of good faith and reasonable investigation”. *Selectica*. 2010 WL 703062, at *12 (citations omitted).

To determine whether a director qualifies as an “outside director”, Delaware courts utilize a “bright-line rule” that considers whether that director is “a non-employee and non-management director” who “receiv[es] no income other than usual directors' fees”. *Id.* at *13 (quoting *Unitrin*, 651 A.2d at 1375; *Moran*, 490 A.2d at 1074-75). All six of the Independent Directors qualify as outsiders because they are not

¹³ Barnes & Noble's 2009 proxy lists the six Independent Directors:

Based on information supplied to it by the Directors, the Board of Directors has affirmatively determined that each of George Campbell Jr., Michael J. Del Giudice, William Dillard, II, Patricia L. Higgins, Irene R. Miller and Margaret T. Monaco are ‘independent’ under the listing standards of the New York Stock Exchange (the ‘NYSE’), and have made such determination based on the fact that none of such persons have had, or currently have, any relationship with the Company or its affiliates or any executive officer of the Company or his or her affiliates, that would currently impair their independence, including, without limitation, any such commercial, industrial, banking, consulting, legal, accounting, charitable or familial relationship. (Ex. 11 at 4.)

employed by the Company and do not receive additional income from the Company other than their directors' fees. *See Selectica*, 2010 WL 703062, at *14.¹⁴

Delaware courts also sometimes apply a more subjective "actual person" standard to determine director independence, engaging in a contextual analysis "based upon individualized facts about the specific directors" that takes into consideration the "circumstances" and "situation at issue". *Id.* at *13 (citations omitted).¹⁵ As the record will show, each of the Independent Directors was sufficiently independent such that their decisions regarding the Rights Plan were based "on the corporate merits of the subject before the board rather than extraneous considerations or influences". *See Id.* (internal citation omitted). None of these Independent Directors is "beholden" to Mr. Riggio nor is any of them so "under [Mr. Riggio's] influence that their discretion would be sterilized", *Rales v. Blasband*, 634 A.2d 927, 936 (Del. 1993); none "has any financial or personal interests in conflict with [Barnes & Noble's] public stockholders"; and none

¹⁴ Directors Campbell, Dillard, Del Giudice, Higgins and Monaco have never been employed by the Company. (*See Ex. 47 (Indiv. Defs.' Resp. and Objs. to Pls.' 3d Set of Interrogs. at 7-9).*) While Ms. Miller was employed by the Company from January 1991 to June 1997 (*see Id.* at 8-9), she has not been employed at any point during the relevant time period and thus also qualifies as an outsider. *See Gaylord*, 753 A.2d at 465 (none of the disinterested and independent directors "was a member of Gaylord's management at any relevant time").

¹⁵ The tension between the "seemingly bright-line rule" for determining whether a director is an "outside director" for the purposes of the "material enhancement" aspect of *Unocal* and the "subjective 'actual person' standard" for the question of director independence was acknowledged by the Court of Chancery in *Selectica*. *See* 2010 WL 703062, at *13. The proper standard for "material enhancement" has since been presented to the Delaware Supreme Court as part of the *Selectica* appeal. The outcome of this issue will not have any effect here since the Board satisfies both tests.

receives director compensation in an amount that would jeopardize his or her independence, *Gaylord*, 753 A.2d at 465. See also *Selectica*, 2010 WL 703062, at *14 (compensation was not “sufficiently material” to the directors “to preclude their independence”).

3. **The Board Acted For a Legitimate Corporate Purpose.**

In the face of Yucaipa’s rapid purchases of Barnes & Noble stock without any accompanying tender offer, the Board’s primary objective in this case was a traditional and well-recognized one – to prevent the risk of a corporate takeover at an inappropriately low price through an acquisition strategy that denied the Board a meaningful opportunity to bargain on its shareholders’ behalf.

This corporate objective – securing a control premium before a controlling stake may be acquired – goes to the heart of a Board’s fiduciary duties to a company’s shareholders and is well-recognized under Delaware law. See *Unocal*, 493 A.2d at 954 (holding that a board possesses “a fundamental duty and obligation to protect the corporate enterprise, which includes the stockholders, from harm reasonably perceived, irrespective of its source”); *Gaylord*, 753 A.2d at 481 (explaining that a “pill gives the target board leverage to negotiate with a would-be acquirer” as well as “the breathing room to explore alternatives”); *Stahl*, 1990 WL 114222, at *1 (upholding poison pill enacted by board “mindful of the threats posed by a creeping acquisition of a control block”); *NACCO Indus., Inc. v. Applicia Inc.*, __ A.2d __, 2009 WL 4981577, at *26 (Del.

Ch.) (describing adoption of poison pill as “an action that [a company] logically would have taken in response to the threat of a creeping takeover”).

In fact, in a recent case, *Louisiana Municipal Police Employees' Retirement System v. Fertitta*, 2009 WL 2263406 (Del. Ch.), the Court denied a motion to dismiss an action alleging breach of fiduciary duty premised upon, among other things, a board's failure to implement a poison pill in the face of what the Court called an “obvious intention to engage in a creeping takeover”. *Id.* at *7, and *8 n.34. Although the defendants in that case protested that no court had previously found an affirmative *per se* duty to enact a poison pill or any other specific defensive measure, the Court explained:

To say that there is no *per se* duty to employ a poison pill to block a 46% stockholder from engaging in a creeping takeover does not refute the conclusion that the board's failure to employ a pill, together with other suspect conduct, supports a reasonable inference at the motion to dismiss stage that the board breached its duty of loyalty in permitting the creeping takeover.

Id. at *8 n.34. Here, Yucaipa's rapid accumulation of shares was, at a minimum, consistent with the actions of one seeking to acquire control of the company without making any premium offer at all.

As the evidence will establish, the Company and the Board acted in response to this threat in November 2009. The testimony of each of the directors who has already been deposed, as well as notes of the November meeting taken by two separate attorneys for the Company, confirm that the Board discussed the threat of a creeping takeover. (See Factual Background § VI.) Mr. Barshay will testify that he advised the Board in November that a rights plan was necessary to prevent a possible

acquisition of control by Yucaipa without payment of a control premium. The evidence will also establish that the Board was particularly concerned about Yucaipa gaining control of the Company without paying a premium and then forcing an ill-advised transaction upon the Company. (*Id.*)

In addition, and significantly given Yucaipa's subsequent demand that it be allowed to purchase up to 37% of the Company, the Board actively considered the additional threat to the best interests of the shareholders that would have been presented by allowing Yucaipa and/or Mr. Riggio to continue to purchase additional shares unfettered, thereby resulting in an "arms race" and significantly concentrating ownership of the Company between Yucaipa and Leonard Riggio. (*See Factual Background § VI.B-C.*) This concern, on its own, presented a threat to the interest of the remaining shareholders of the Company. It is one thing to purchase stock from a Company knowing that the founder and Chairman has roughly 30% of the outstanding shares and the remaining 70% is held by a mix of directors, officers, employees, unaffiliated institutions and public investors. It is quite another to learn that a majority of the Company has been consolidated in the hands of two individuals (and, with the subsequent purchases by Aletheia, 80% or more in the hands of three investors).

The evidence will also establish that the Board's decision in February 2010 not to amend the Rights Plan to allow Mr. Burkle to purchase up to 37% of the Company was driven by the same concerns that Mr. Burkle would seize control without paying a premium and that ownership would become excessively concentrated in two

shareholders. By February, Yucaipa had increased its holdings in the Company to 18.7% and Aletheia had dramatically increased its own holdings, purchasing a total of 17.44% of the Company, facts that reasonably led the Board to conclude that two entities that the Board (as well as members of the financial press) feared would or could work together had already accumulated nearly 37% of the Company. (See Factual Background §§ VII-X.)

B. The Board's Actions With Respect to the Rights Plan Also Satisfy the Second Prong of Unocal.

The second prong of the *Unocal* analysis requires a demonstration that the Board's response to a reasonably perceived threat was itself reasonable in relation to that threat. *Moran*, 500 A.2d at 1356 (quoting *Unocal*, 493 A.2d at 955). "The key inquiry under this prong of *Unocal* is whether the defensive measures are 'draconian,' in the sense of being preclusive or coercive."¹⁶ See *Gaylord*, 753 A.2d at 480; see also *Inter-Tel*, 929 A.2d at 810-11. If a defensive measure is neither preclusive nor coercive, the Court must then determine whether the Board's actions fall within the range of reasonableness by determining whether the response was "limited and corresponded in degree or magnitude to the degree or magnitude of the threat". *Unitrin*, 651 A.2d at 1389.

¹⁶ A defensive measure may also be considered "draconian" if it is coercive in the sense of "cramming down" a management-sponsored alternative on shareholders. *Unitrin*, 651 A.2d at 1387; *Selectica*, 2010 WL 703062, at *20. Because no particular management-sponsored alternative is on the table, and no allegations of coerciveness have been raised (nor could be raised), this issue is not presented in this case.

1. **The Rights Plan Is Not Preclusive.**

A poison pill or other defensive measure is “preclusive” for purposes of Unocal only if it renders a proxy contest by an outside shareholder “mathematically impossible or realistically unattainable”. *Unitrin*, 651 A.2d at 1388-89. Here, Plaintiffs’ own proxy expert has flatly denied that a Yucaipa victory in a proxy contest is “mathematically impossible or realistically unattainable”. (6/25/10 Burch Dep. at 143:19-144:21.) As a result, Plaintiffs have now invented an entirely new (and unsupported) theory that a poison pill can be “preclusive” *not* because it prevents a dissident from winning a proxy contest, but rather because it allegedly diminishes the ability of the dissident to know, in advance and with certainty, that it will prevail. In support of this argument, Plaintiffs have claimed that the “Beneficial Ownership” definition in the Rights Plan improperly precludes certain pre-proxy communications with other shareholders and improperly precludes them from entering into voting agreements. However, as set forth below, there is absolutely no prohibition on mere communications, and the limitations on group conduct about which Plaintiffs complain are precisely the same limitations that have been upheld by Delaware courts time and time again. And, because the Rights Plan does not render a proxy contest “mathematically impossible or realistically unattainable”, the grandfather provision necessarily is not preclusive under *Unocal*.

(a) The Parties Agree That Yucaipa May Win a Potential Proxy Contest.

As set forth at length in the expert reports submitted on Yucaipa's behalf, and confirmed by Defendants' expert, the Rights Plan does not preclude Yucaipa from prevailing in a proxy contest.

Plaintiffs' first expert, Gregory Taxin, opines at some length that the

(Ex. 50 at 6 (Taxin Report).) He also

opines

REDACTED

REDACTED

(*Id.* at 7.)¹⁷ In this scenario that Mr. Taxin believes is "likely", he concedes that

(*Id.*) Mr. Taxin ultimately concludes that

REDACTED

REDACTED

(*Id.*)

¹⁷ Mr. Taxin's view

REDACTED

(Ex. 55, at

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Plaintiffs' other expert, Daniel Burch, has similarly concluded that it is "mathematically possible" for Yucaipa to prevail in the proxy contest. - (6/25/10 Burch Dep. at 143:19-144:21.)

REDACTED

(Ex. 49 at 13 (Burch Report); Ex. 53 at 4 (Burch Rebuttal Report).) For example, Mr. Burch projects that

REDACTED

(Ex. 49 at 13,

Scenario 1.) Perhaps even more telling, Mr. Burch concludes that

REDACTED

(Ex. 53 at 4 (Burch Rebuttal Report); Ex. 50 at 7 (Taxin Report).)

Defendants' expert Peter C. Harkins agrees with both of Plaintiffs' experts that the Rights Plan in no way precludes a successful proxy contest by Yucaipa. Specifically, Mr. Harkins has concluded and will testify that "there are many plausible scenarios for Yucaipa to elect directors at the next annual meeting", and that "I believe that Yucaipa's election of directors in opposition to the Board is both mathematically possible and realistically attainable." (Ex. 48 at 5 (Harkins Report); *see also* Ex. 54

(Harkins Rebuttal Report).) Based upon his experience and upon an analysis of the timing of Aletheia's investments in four companies (including Barnes & Noble) in which Yucaipa also holds significant stakes, Mr. Harkins also concludes that "it is reasonable to assume that Aletheia and/or its clients may be predisposed to vote as recommended by Yucaipa". (Ex. 48 at 28.) Nevertheless, like Mr. Burch, he has also modeled voting scenarios in which Aletheia does not vote as a block at all.

REDACTED

Thus, the parties agree that the outcome of a potential proxy contest is far from a foregone conclusion, and that the ultimate results will depend upon the merits of the platforms presented:

- It is, of course, hard to predict how a fight at the Company might ultimately be decided by shareholders in the absence of knowing who the Board and dissidents would offer as Board candidates." (Ex. 50 at 5 (Taxin Report));
- In a contested election of directors at B&N, as is usually the case, much would depend on the platform of Yucaipa's nominees versus the platform of the Board's nominees for election as directors and the relative appeal of those platforms to the Company's shareholders and their proxy voting advisors." (Ex. 48 at 5 (Harkins Report).)

Mr. Burkle himself has conceded that other shareholders may be open to hearing Yucaipa's platform:

Q. As you sit here today you have no reason to think they wouldn't consider your position were there to be a proxy contest?

A. I think anybody would consider anybody's position.

Q. So the answer to that is no, I have no reason to believe they wouldn't consider my positions?

A. I don't have any reason to believe that they don't have an open mind about what they would do. (Burkle Dep. at 34:13-23.)

(See also Burkle Dep. at 58:21-23 (acknowledging with respect to Aletheia that "I think they will give us a good listen. I believe they think that we are good investors.")) Delaware law is clear that in these circumstances, where the "[t]he key variable in a proxy contest would be the merit of [a dissident shareholder's] issues, not the size of its stockholdings", a rights plan is not preclusive. *Unitrin*, 651 A.2d 1361, 1383 (citing *Moran*, 500 A.2d at 1355).

(b) Plaintiffs' Position that the Definition of Beneficial Ownership Precludes Shareholders From Mounting a Proxy Contest is Unavailing.

Yucaipa and its experts agree that the Rights Plan does not render a proxy contest "mathematically impossible" or "realistically unattainable". Thus, it cannot be preclusive under *Unocal*. Nonetheless, they argue that the Rights Plan should be modified because it allegedly precludes Yucaipa from estimating the likely support from other shareholders in the event that it decides to mount a proxy contest. (See, e.g., Ex. 49 at 7 (Burch Report); Ex. 50 at 10 (Taxin Report).) Putting aside the change of course this argument represents for Plaintiffs (who sought expedited proceedings from this Court in May on the basis of their then-recent "decision" to mount a proxy contest) and the fact that the alleged uncertainty as to the likely outcome of a proxy contest confirms that victory in such a contest by Yucaipa is neither "mathematically impossible" nor "realistically unattainable", the premise of this argument is simply wrong.

To begin, the Company clearly stated through its counsel in a letter dated May 11, 2010, that Yucaipa would *not* trigger the pill by, among other things, engaging in conversations with other shareholders. (Ex. 45.) Ms. Goldstein stated in her letter that:

[P]ursuant to the definition of “Beneficial Owner” in the Shareholder Rights Plan, your client (or any other shareholder) would not trigger the Shareholder Rights Plan by, among other things: (1) mounting a proxy contest by putting forth a slate of candidates for the upcoming Board election; (2) putting forth any proposals for shareholder consideration that he wishes; (3) *communicating his position regarding any candidates or other proposals to other shareholders fully and freely*; and (4) soliciting and receiving revocable proxies in response to any public proxy solicitation made generally to all of the Company’s shareholders. (*Id.*)

Notwithstanding the explanation provided in Ms. Goldstein’s May 11 letter, Yucaipa nonetheless submitted reports in which its experts concluded that certain language found at Section (c) of the “Beneficial Ownership” definition in the Rights Plan was unusual, difficult to understand or threatens to attribute mutual Beneficial Ownership to shareholders who merely communicate with one another in advance of a potential proxy contest about issues or candidates likely to be at issue in such a contest. (*See, e.g., Ex. 49 at 7 (Burch Report); Ex. 50 at 10 (Taxin Report).*) According to Messrs. Taxin and Burch, that language “might well deter a dissident shareholder from even launching a proxy fight”. (*See, e.g., Ex. 49 at 8-9; Ex. 50 at 10.*)

The language that Messrs. Taxin and Burch focused upon is the second subclause of clause (c) of the definition of Beneficial Ownership:

[W]hich are beneficially owned, either 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 (i) 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 or (ii) *any agreement, arrangement or understanding (written or oral) to cooperate in obtaining, changing or influencing control of the Company.*

(Ex. 24 at Ex. 4.1 at 3 (Form 8-K, filed 11/18/09 (Rights Plan)) (emphasis added).)

Plaintiffs' experts purport to believe that the final clause of the foregoing paragraph is so unusual and indefinite that institutional shareholders would be unwilling even to tell Yucaipa their views about Company management, lest they be deemed to beneficially own Yucaipa's shares and thereby trigger the pill. (*See, e.g.*, Ex. 49 at 8-9; Ex. 50 at 10.)

No fair reading of that provision, coupled with the representations made by the Company in Ms. Goldstein's May 11 Letter, could support an interpretation that restricts Yucaipa's ability to communicate with other shareholders or to learn such shareholders' intentions, expectations, goals or priorities with respect to any shareholder vote. It is difficult to credit the notion that Plaintiffs or their peers would truly be confused about whether, for example, telephone discussions about a shareholder's views about management are permitted. However, to remove any purported uncertainty on this point and because the Board never intended that the "agree to cooperate to influence control" language would in any way limit or affect communications in connection with a proxy fight or potential proxy fight, the Board adopted an amendment to the Rights Plan on June 23, 2010, that deleted the "cooperation" clause. (*See Factual Background § XIII.*)

As amended, clause (c) of the definition of Beneficial Ownership — the only clause of that definition with which Plaintiffs have taken issue — reads as follows:

[W]hich 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.

(Ex. 51 (Form 8-K, filed 6/23/10, Ex. 4.1 at 1).) This definition of Beneficial Ownership is no different than the language that has been incorporated into countless rights plan upheld by this Court since *Moran* — as Plaintiffs' expert Mr. Burch admits. (6/25/10 Burch Dep. at 72:3-20 (“Q. And so if you read the current poison pill, is the definition of beneficial owner unusual in any way? A. Not that I'm aware of. Q. It's a standard definition, correct? A. I believe it is, yes.”).)

For example, in *Stahl*, 1990 WL 114222 (Del. Ch.), the Court upheld a definition of beneficial ownership that included shares:

[W]hich are beneficially owned, directly or indirectly, by any other person with which such person or any such person's affiliates has any agreement, arrangement or understanding . . . for the purpose of acquiring, holding, voting or disposing of any securities of the [Company]. *Id.* at *3.

That clause is, in all meaningful respects, identical to the clause challenged by Yucaipa here.

The language in the Company's Rights Plan is also substantively identical to the provisions of DGCL § 203, specifically subclause (iii) of the definition of

“Owner”, which provides that someone is the owner of stock if that person “individually or with or through any of its affiliates or associates”:

(iii) [h]as any agreement, arrangement or understanding for the purpose of acquiring, holding, voting (except voting pursuant to a revocable proxy or consent ...), or disposing of such stock with any other person that beneficially owns, or whose affiliates or associates beneficially own, directly or indirectly, such stock.

8 *Del. C.* § 203(c)(9)(iii). The language of the Rights Plan is also identical in scope to the definition of beneficial ownership under Section 13 of the Exchange Act, the rules promulgated thereunder and the case law applying those provisions. Rule 13d-5 provides:

When two or more persons agree to act together for the purpose of acquiring, holding, voting or disposing of equity securities of an issuer, the group formed thereby shall be deemed to have acquired beneficial ownership, for purposes of Sections 13(d) and(g) of the Act, as of the date of such agreement, of all equity securities of that issuer beneficially owned by any such persons.

Thus, even assuming there were any legal validity to Yucaipa’s argument that a Rights Plan could be deemed preclusive because of its alleged effect in deterring pre-proxy contest communications (which, to Defendants’ knowledge, has never even been suggested by a Delaware court), it cannot plausibly be argued that the terms of the Rights Plan chill any discussions that would otherwise occur subject to the limitations imposed by, among other things, Section 13 of the Exchange Act and the rules promulgated thereunder.

(c) Plaintiffs' Argument that Prohibitions on Joint Slates and Sharing Expenses Deter a Proxy Contest Is Without Merit.

Plaintiffs also argue that the limitations upon group conduct contained in the Rights Plan might somehow deter Yucaipa from deciding to mount a proxy contest. However, a challenge to exactly those limitations was considered and rejected by this Court twenty-five years ago in *Moran*, 490 A.2d 1059 (Del. Ch.), *aff'd*, 500 A.2d 1346 (Del. 1985). Plaintiffs in *Moran* argued that “the Rights Plan impose[d] a critical inhibition on proxy contests” by, among other things, “limiting the size of an insurgent group”. 490 A.2d at 1080. The Court responded, in essence, that although the Rights Plan did impose certain burdens on the conduct of proxy contests, such incremental difficulty could not “be viewed in isolation”, but rather was “part of the overall design of the Plan” and noted that “[w]ithout this feature the Plan is of limited value”. *Id.* In affirming the Court of Chancery’s decision in *Moran*, the Supreme Court held that a rights plan’s limitation on concerted action does not “fundamentally restrict[] proxy contests” because it does not interfere with the voting power of individual shares. *Moran*, 500 A.2d at 1357; *see also Selectica*, 2010 WL 703062, at *20. Precisely the same logic applies here.

The *Moran* plaintiffs, like Yucaipa, also complained explicitly about the financial burden imposed by the poison pill’s prohibition on cost-sharing between dissident groups. The Court of Chancery opinion aptly characterized this argument as “somewhat strained”, since a group holding 19% of the issuer’s shares would have a very

substantial investment to protect. 490 A.2d at 1080. In this case, Yucaipa's investment in Barnes & Noble is worth approximately \$200 million, and Mr. Burkle himself is worth an estimated \$3.5 billion; *Moran's* holding in this regard applies here with at least equal force.

This Court explained again in *Stahl*, 1990 WL 114222, that a poison pill's limited restriction upon an individual's ability to form a group does not materially interfere with the shareholder's voting power because it "does not directly infringe upon [plaintiff's] ability to present a slate and to communicate with shareholders; nor does it impair the shareholders' ability to vote for [plaintiffs'] slate at the meeting". *Id.* at *4. The plaintiff in *Stahl* challenged a poison pill to the extent it imputed beneficial ownership of Bancorp's stock:

[S]olely by reason of any agreement, arrangement or understanding with such other person for:

a) the formation of and membership on a committee for the purpose of promoting or opposing any stockholder resolution or for nominating or electing a slate of nominees to the Board of Directors of [Bancorp] and/or service on such a slate of nominees and/or agreement to a slate of director nominees;

... and/or

c) the sharing of expenses and the indemnification against expenses and liabilities by any such other person with respect to expenses incurred or conduct occurring during the time such other person is a nominee or a member of such committee.

Id. at *2. In upholding the company's poison pill, Chancellor Allen recognized that the "thrust of the Supreme Court's reasoning in *Moran* was simply that the restrictions

imposed by the stock rights plan on a proxy contest were immaterial to conducting a proxy fight effectively”. *Id.* at *6. Chancellor Allen also explained that the voting arrangements or understandings at issue in that case (and thus, the ones at issue here) were “immaterial in the sense that a shareholder may put forth a slate of candidates and communicate her position to others, and others may vote for that slate without restriction”. *Id.*

As the similarities between the *Stahl* and Barnes & Noble rights plans demonstrate, Yucaipa has been reduced, like the plaintiff in *Leonard Loventhal Account v. Hilton Hotels Corp.*, to “challeng[ing] ... fundamental aspects of the Rights Plan ... which have existed since the earliest days of the poison pill.” 2000 WL 1528909, at *1 (Del. Ch.). Plaintiffs’ objections to the joint-slate and cost-sharing effect of the Barnes & Noble Rights Plan should likewise be rejected on grounds of *stare decisis*. *Id.* at *4. And, of course, as described above, even Plaintiffs’ experts agree that Yucaipa could very well prevail in a proxy contest, notwithstanding the existence of the Rights Plan.

(d) The Grandfather Provision in the Rights Plan Also Does Not Preclude Victory by a Dissident Such As Yucaipa.

Plaintiffs also point to the grandfather clause as a sign of entrenchment and a symbol of Mr. Riggio’s purported control over the Company, now arguing that the presence of this so-called “insider block” also discourages Yucaipa from mounting a proxy contest.

Once again, Yucaipa’s argument ignores the fact set forth above that neither of its experts has opined that the Rights Plan, including this clause, actually

precludes a victory by a dissident slate in the contest itself. Instead, they have reached the opposite conclusion. Each of the experts in this case has performed his analysis on the express understanding that the Rights Plan, including the grandfather clause, will remain in place. Perhaps under different facts, with a larger “inside” shareholder and/or a different shareholder makeup, it is possible that the arithmetic analysis prescribed by *Unitrin* and its progeny would have yielded a different result. But that is not the case here. The *Unitrin* analysis is a robust and flexible tool that fully and appropriately accounts for the presence of a large, management-aligned shareholder in cases like this – and they are many – where an insider’s stake is capped by a grandfather clause.

* * * * *

At the outset of this case, Plaintiffs claimed:

In order for Yucaipa to be able to wage a meaningful proxy contest . . . , Yucaipa needs relief from this Court to level the playing field without triggering the poison pill (1) in advance of the record date for the 2010 Meeting in order to buy additional shares and (2) well in advance of the advance notice by law date in order to communicate, coordinate and reach agreements or understandings with other stockholders.

(Compl. ¶ 74; Mot. for Expedition ¶ 13.) Fact discovery and the conclusions of Plaintiffs’ own experts have now confirmed that this allegation is false. On this record, it is undisputed that Yucaipa *can* wage a meaningful proxy contest whether it gets relief from the Court or not. As a result, Plaintiffs have changed course, arguing not that the Rights Plan precludes them from prevailing in a proxy contest, but instead that a rights plan is preclusive where a dissident cannot predict with certainty that it has a 50% chance of prevailing in such contest before it is mounted. That is not the law in Delaware.

To be sure, the presence of the Rights Plan may make it somewhat more difficult for Yucaipa to mount a successful proxy contest. However, “it is not enough that a defensive measure would make proxy contests more difficult – even considerably more difficult. To find a measure preclusive (and avoid the reasonableness inquiry altogether), the measure must render a successful proxy contest a near impossibility or else utterly moot, given the specific facts at hand”. *Selectica*, 2010 WL 703062 at *21. Indeed, as the Supreme Court in *Unitrin* expressly noted, “[t]his Court’s choice of the term draconian in *Unocal* was a recognition that the law affords boards of directors substantial latitude in defending the perimeter of the corporate bastion against perceived threats.” 651 A.2d at 1388 n.38. The evidence will show (and, indeed, already has shown) that there simply is no basis for a finding of preclusiveness in this case where Plaintiffs’ own experts concede that,

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If Yucaipa cannot prevail, it will be because the other shareholders do not find its platform persuasive, not because of the Rights Plan.

2. The Board’s Adoption of the Rights Plan Falls Within the Range of Reasonableness.

Because the Rights Plan is neither preclusive nor coercive, the Board’s actions satisfy the second prong of *Unocal* unless the terms of the Rights Plan are nonetheless unreasonable in relation to the threats identified by the Board. This proportionality test is “inherently qualitative”. *Selectica*, 2010 WL 703062, at *22. In assessing whether a Board’s response to a reasonably perceived threat itself falls within a range of reasonableness, the Court “should be deciding whether the directors made a

reasonable decision, not a perfect decision. If a board selected one of several reasonable alternatives, a court should not second guess that choice even though it might have decided otherwise or subsequent events may have cast doubt on the board's determination. Thus, courts will not substitute their business judgment for that of the directors, but will determine if the directors' decision was, on balance, within a range of reasonableness"). *Paramount Commc'ns v. QVC Network Inc.*, 637 A.2d 34, 45-46 (Del. 1994); *Inter-Tel*, 929 A.2d at 814. The evidence will show that the Board's acts in adopting the Rights Plan plainly fall within this range of reasonableness.

First, as stated above, the Board was presented in November with the sudden and rapid accumulation of stock by Yucaipa. Reasonably fearing a change of control without the payment of a premium to the other shareholders, the Board, after reasonable investigation and in reliance upon expert advisors, implemented a garden-variety rights plan with a 20% trigger (a threshold that is at the very high end of the rights plans that have typically been adopted by Delaware corporations). At that time, Leonard Riggio, who had once owned 100% of the Company and subsequently had reduced his holdings when the Company went public, beneficially owned approximately 30% of the Company, so he had to be grandfathered.

That was a perfectly reasonable decision; grandfather clauses in poison pills are ubiquitous. Between February 1 and August 10, 2009, alone, Corporate Control Alert counted twelve US-incorporated companies that adopted or amended pills with "grandfathered person" provisions. (Ex. 56 (Rights Plan Chart, 26 Corp. Control Alert

19 at 20-25.) In the same time period, eight of the twelve Canada-incorporated companies that adopted or amended poison pills included such language. (*Id.* at 25.) This does not count amendments to exclude specific persons from acquiring shares above a pill's threshold, for example as part of a negotiated transaction. As Mr. Barshay correctly informed the Board on November 17, 2009, a grandfather clause is simply "how it's done" when a board seeks to limit unbridled accumulation of a company's shares in a situation where one or more large shareholders already exist. (Ex. 21 at BKS00008626 (11/17/09 Moayery Notes).)¹⁸

There are also ample Delaware cases that have approved poison pills that included grandfather clauses. The case most directly on point is *In re: infoUSA, Inc. S'holders Litig.*, 953 A.2d 963 (Del. Ch. 2007), which concerned a company with a 41% insider shareholder. The board of directors implemented a poison pill but exempted the insider from it completely. *Id.* at 1001-02. A series of letter agreements between the insider and the company prohibited the insider from acquiring any additional shares, creating the same practical effect that a grandfather clause would have had if it had been directly written into the poison pill. On a motion to dismiss, the Court dismissed

¹⁸ Plaintiffs are simply mistaken in assuming that a grandfather clause in a poison pill is necessarily an index of entrenched board support for an insider. Indeed, challenges to poison pills are not infrequently brought by the very persons "grandfathered in" under such clauses. *See, e.g., Stahl*, 1990 WL 114222, at *1 (describing implementation of poison pill with 15% trigger with grandfather clause applicable to plaintiff, who held a 30.3% stake at the time of adoption).

plaintiff's claim that the board had breached its fiduciary duties in approving this arrangement.

Other Delaware cases have similarly treated grandfather clauses as the typical and inoffensive features they are. Most recently, in *Selectica*, 2010 WL 703062, at *7, this Court upheld a pill with a 5% trigger that grandfathered in all shareholders above that threshold. And, in *Loventhal*, the Court noted that plaintiffs did not even challenge the grandfathering provision in a pill. 2000 WL 1528909, at *1.

Moreover, in adopting the grandfather clause, the Board could have allowed Mr. Riggio to buy additional shares without triggering the Rights Plan, as permitted by the 1998 Rights Plan (which allowed subsequent purchases of up to 5% of the Company's stock). Indeed, such "cushions" are common features of rights plans with grandfather clauses, occurring at least as far back as the rights plan approved by this Court in *Stahl* in 1990.¹⁹ No such cushion was included in this Rights Plan, despite the fact that Mr. Riggio specifically expressed a desire to purchase additional shares both before and during the November 17 meeting, a request that the Board refused. (See Factual Background §VI.B.)

¹⁹ More recent examples include rights plans adopted by Evergreen Energy (15% trigger, 2% cushion); Icagen (15% trigger, 2% cushion); Innospec (15% trigger, 0.5% cushion); Penwest Pharmaceuticals (15% trigger, two "grandfathered persons" at 20% and 21% respectively, specific cushions for each grandfathered person); Ford (5% trigger, 0.5% cushion); Centreline Holding Company (5% trigger, 0.25% cushion); First Mid-Illinois Bancshares, Inc. (15% trigger, grandfathered investor group at 40.1%, 1% cushion). (See Ex. 62.)

Second, with respect to the definition of “Beneficial Ownership”, the Board’s intent at the time it adopted the Rights Plan, as confirmed by the June 23 Amendment in response to the blatant misinterpretations of the Rights Plan espoused by Yucaipa and its experts, was to adopt a “garden variety” rights plan. Inherently, the adoption of such a rights plan included certain limitations upon the formation of groups by the Company’s shareholders, including the prohibitions on forming joint slates and sharing expenses upheld in *Stahl*. As explained in *Moran*, a poison pill that did not include limitations upon concerted action would be of “limited value” given the ease with which the 20% threshold could be circumvented. *Moran*, 490 A.2d at 1080. As in *Moran*, the Board was advised that the Rights Plan could not be preclusive and was advised of the impact that the provisions of the Rights Plan would have upon group action. (See Factual Background § VI.A-B.) The Board reasonably determined that such limitations were necessary to protect the best interests of the shareholders, a principle that is well-settled under the law of this state. See, e.g., *Moran*, 490 A.2d 1059 (Del. Ch.), *aff’d*, 500 A.2d 1346 (Del. 1985); *Stahl*, 1990 WL 114222, at *1.

Here again, the Board did not adopt the most restrictive provisions that it might otherwise have adopted. During the past 5 years, boards and commentators have become increasingly aware of the threat of the “wolf packs”, *i.e.*, the threat of coordinated action by large holders of its stock.²⁰ “Wolfpack” behavior can extend beyond efforts to

²⁰ See, e.g., David J. Berger & Kenneth M. Murray, As the Market Turns: Corporate Governance Litigation in an Age of Stockholder Activism, 5 N.Y.U. J. L. & Bus. 207,

pressure an existing board to alter corporate policy, or even to replace individual directors. Such conduct can be designed to put a target company in play or lay the groundwork for an acquisition.²¹

As a result of this growing phenomenon, many companies have begun incorporating broad language into Rights Plans that precludes even “conscious parallelism”. For example, Georgia Gulf Corporation adopted (in April of this year) a pill which may be triggered where a shareholder has:

[K]nowingly acted ... (whether or not pursuant to an express agreement, arrangement or understanding) *in concert with, or towards a common goal or otherwise in parallel* with [another] Person in relation to acquiring, holding or disposing of any securities of the Company, (ii) each such Person is aware of the other Person’s conduct in relation to the Company’s securities, and (iii) the conduct of each such Person in relation to the

210-211 (Spring 2009) (“Hedge funds have ... developed very sophisticated techniques to pressure boards and to maximize and magnify their influence. For example, it has become common for several hedge funds to invest in a company after one hedge fund takes a public position advocating change. . . . This has led to the so-called ‘wolfpack’ effect, whereby a significant number of a company’s shares are sold by the company’s existing investors to other hedge funds who have views more sympathetic to the activist investor than to the incumbent board, and also, may have a shorter investment horizon than either the incumbent board or the company’s more traditional shareholders.”)

²¹. As one former practitioner has explained: “[S]ome hedge funds may cross the hazily marked line between hedge fund and private equity fund, and actually intend to put the target together with other portfolio companies in order to flip both out as a larger, more valuable entity. So the hedge fund starts by looking for a target that will yield a fast return. Another factor that attracts hedge fund attacks is an existing base of disgruntled institutional shareholders, who, while they won’t start the attack themselves, are happy to tag along (and perhaps even instigate) the attacks. A corporation’s shareholder profile that holds the opportunity for a ‘wolf pack’ approach increases the potential threat level of the jawboning investor described above.” David P. Porter, *Institutional Investors and Their Role in Corporate Governance: Reflections by a “Recovering” Corporate Governance Lawyer*, 59 Case W. Res. L. Rev. 627, 674 (Spring 2009).

Company's securities constitutes at least a portion of the basis for the conduct of the other Person in relation to the Company's securities. (Ex. 59.)

The evidence adduced at trial will show that Morgan Stanley suggested that the Company include such language in the Rights Plan as it was being drafted but, based on advice of counsel from Cravath, the draft that was presented to the Board did not include any such language.

Third, the remaining provisions of the Rights Plan are conventional and conservative. As noted above, the Rights Plan was expressly designed to be "ISS-friendly", and incorporates conservative features advocated by shareholders rights advocates. For example, the Rights Plan's 20% trigger is higher than at least 75% of rights plans currently in place and most of the pills that have been approved by the Delaware courts. (Ex. 48, Harkins Report at 34.) Moreover, the Rights Plan's 3-year term is shorter than average, and the Board's commitment to put the Rights Plan to a shareholder vote within 12 months – a practice recommended by RiskMetrics – is conservative.

C. The Board's Adoption and Amendment of the Rights Plan Is Protected By the Business Judgment Rule.

Because the Board's conduct with respect to the adoption and amendment of the Rights Plan satisfies the *Unocal* review, its actions are entitled to the protection of the traditional business judgment rule. *Unocal*, 493 A.2d at 958. Under the business judgment rule, the Board is presumed to have acted on an informed basis, in good faith and in the honest belief that its actions were taken in the best interests of the corporation.

Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984). In order to rebut this presumption, Plaintiffs have the burden of demonstrating “by a preponderance of the evidence that the directors’ decisions were *primarily* based on (1) perpetuating themselves in office, or (2) some other breach of fiduciary duty such as fraud, overreaching, lack of good faith, or (3) being uninformed”. *Unitrin*, 651 A.2d at 1390 (quoting *Unocal*, 493 A.2d at 958). As this court has noted, “[i]t is not at all apparent how a plaintiff could meet this burden [necessary to rebut the business judgment rule] in a circumstance where the board met its burden under *Unocal*.” *Gaylord*, 753 A.2d at 475-76 (citation omitted).

As demonstrated above in Sections I.A-B, Defendants have acted reasonably and proportionately in adopting and amending the Rights Plan. Plaintiffs are unable to produce any evidence to satisfy the standards set forth under Delaware law for either gross negligence or bad faith. See *In re Walt Disney Co. Deriv. Litig.*, 906 A.2d 27, 67 (Del. 2006) (finding that a director acts in bad faith when he “intentionally fails to act in the face of a known duty to act, demonstrating a conscious disregard for his duties”); *McPadden v. Sidhu*, 964 A.2d 1262, 1274 (Del. Ch. 2008) (“Delaware’s current understanding of gross negligence is conduct that constitutes reckless indifference or actions that are without the bounds of reason.”). Accordingly, Plaintiffs will not sustain their burden of rebutting the protection of the business judgment rule.

II. THE BLASIUS STANDARD DOES NOT APPLY TO THE BOARD’S ACTIONS WITH RESPECT TO THE RIGHTS PLAN.

The heightened “compelling justification” standard articulated in *Blasius* only applies to actions taken for the “primary purpose of thwarting the exercise of a

shareholder vote". *Blasius Indus., Inc. v. Atlas Corp.*, 564 A.2d 651, 660 (Del. Ch. 1988). Because the rights plan does not have the effect of "precluding or coercing stockholder choice" (*see supra* Section I.B), it cannot be said to have been adopted for the "primary purpose of disenfranchising stockholders" such that *Blasius* would apply. *See Inter-Tel*, 929 A.2d at 818; *see also Hollinger*, 844 A.2d at 1089 (*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* were found to apply, the Board will be able to demonstrate a "compelling justification" for its actions. Where, as here, directors act "for the purpose of preserving what the directors believe in good faith" to be in the best interest of the corporation, "they act for a compelling reason in the corporate context" and it becomes "a question about the fit between the means they employ, not the end they are seeking to achieve". *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 *supra* in Section I.B, the Board's actions were reasonable in relation to its legitimate corporate objective such that the "compelling justification" standard under *Blasius* is satisfied.

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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