



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
PUBLIC VERSION -
Dated: July 22, 2010

PLAINTIFFS' ANSWERING POST-TRIAL BRIEF

OF COUNSEL:

Stephen D. Alexander
Beth I.Z. Boland
J. Warren Rissier
Matthew J. Lawson
Karen J. Pazzani
BINGHAM MCCUTCHEN LLP
Suite 4400
355 South Grand Avenue
Los Angeles, CA 90071-3106

Dated: July 19, 2010

David C. McBride (#408)
Richard H. Morse (#531)
Melanie K. Sharp (#2501)
Martin S. Lessner (#3109)
Kristen Salvatore DePalma (#4908)
James L. Higgins (#5021)
Emily V. Burton (#5142)
James M. Yoch, Jr. (#5251)
Kathaleen McCormick (#4579)
Megan C. Haney (#5016)
Richard J. Thomas (#5073)
Nicholas J. Rohrer (#5381)
YOUNG CONAWAY STARGATT
& TAYLOR, LLP
The Brandywine Building
1000 West Street, 17th Floor
P. O. Box 391
Wilmington, DE 19899-0391
(302) 571-6600

Attorneys for Plaintiffs

TABLE OF CONTENTS

	<u>Page</u>
TABLE OF AUTHORITIES	iii
PRELIMINARY STATEMENT	1
ARGUMENT	4
I. COLLECTIVE STOCKHOLDER ACTION IN A PROXY CONTEST DOES NOT RESULT IN ATTRIBUTION UNDER THE TERMS OF THE RIGHTS PLAN	4
II. DEFENDANTS ATTEMPT TO USE THE RIGHTS PLAN FOR A PURPOSE NEVER BEFORE SANCTIONED AND NEVER APPROVED BY THE BOARD: TO BLOCK STOCKHOLDERS FROM ORGANIZING TO ELECT DIRECTORS OR REMOVE THE RIGHTS PLAN.....	6
III. DEFENDANTS' ADOPTION AND USE OF THE RIGHTS PLAN HAS NOT BEEN REASONABLE IN RESPONSE TO ANY COGNIZABLE THREAT	9
A. Defendants Have the Burden to Demonstrate the Reasonableness of the Rights Plan.....	9
B. Defendants' Use of the Rights Plan to Prevent Collective Stockholder Action in a Proxy Contest Is Not Reasonable in Relation to a Proper Corporate Objective.....	11
1. Defendants' Interpretation of the Beneficial Ownership Provision Materially Impairs the Conduct of a Proxy Contest.....	11
2. Attribution Rules Addressing a Proxy Contest for the Election of Directors Are Not Needed to Protect Against Changes of Control.....	15
C. A 20% Trigger Is Unreasonable When There is a Preexisting Insider Voting Group at 32-38%	18
1. Freezing Yucaipa at 20% Hinders Yucaipa and Advantages Leonard Riggio in a Proxy Contest	18
2. The 20% Trigger Is Not a Reasonable or Proportionate Means to Prevent Yucaipa From Acquiring Control	20
a. Yucaipa Cannot Acquire Control With Fewer Shares Than the Riggios	20
b. Yucaipa Is Not a Threat to Acquire Control.....	22
D. Defendants Are Not Entitled to Material Enhancement	26

IV. THE RIGHTS PLAN IS INVALID BECAUSE ITS ADOPTION WAS NOT ENTIRELY FAIR 29

V. THE RIGHTS PLAN WAS ADOPTED AND IMPOSED IN BAD FAITH, IS INVALID UNDER *BLASIUS*, AND SHOULD THEREFORE BE ENJOINED..... 30

CONCLUSION 30

TABLE OF AUTHORITIES

	<u>Page</u>
Cases	
<i>Chesapeake Corp. v. Shore</i> , 771 A.2d 293 (Del. Ch. 2000).....	5, 9
<i>Emerald P’rs v. Berlin</i> , 2003 Del. Ch. LEXIS 42 (Apr. 28, 2003).....	1
<i>Emerald P’rs v. Berlin</i> , 726 A.2d 1215 (Del. 1999).....	1
<i>In re IBP, Inc. S’holders Litig.</i> , 789 A.2d 14 (Del. Ch. 2001).....	1
<i>In re Tele-Commc’ns, Inc. S’holders Litig.</i> , 2005 Del. Ch. LEXIS 206 (Del. Ch. Dec. 21, 2005)	28
<i>Mills Acq. Co. v. MacMillan, Inc.</i> , 559 A.2d 1261 (Del. 1989).....	27
<i>MM Cos. v. Liquid Audio, Inc.</i> , 813 A.2d 1118 (Del. 2003).....	10
<i>Moran v. Household Int’l, Inc.</i> , 490 A.2d 1059 (Del. Ch. 1985), <i>aff’d</i> , 500 A.2d 1346 (Del. 1985).....	10
<i>Stahl v. Apple Bancorp, Inc.</i> , 1990 Del. Ch. LEXIS 121 (Aug. 9, 1990)	10
<i>Williams v. White Oak Builders, Inc.</i> , 2006 Del. Ch. LEXIS 112 (June 6, 2006).....	1
Rules	
17 C.F.R. § 240.14a-2(b)(2).....	13
Statutes	
8 Del. C. § 112	2
8 Del. C. § 113	2
8 Del. C. § 141(e).....	27
Other Authorities	
SEC Release Nos. 34-62495; IA-3052; IC-29340; File No. S7-14-10, July 14, 2010	2

PRELIMINARY STATEMENT

Defendants failed, in their Post-Trial Opening Brief, to engage the issues raised by their adoption and use of the Rights Plan. The first issue that Defendants completely ignore is the question of contract interpretation. Despite the fact that Plaintiffs raised this issue in their Opening and Answering Pre-Trial Briefs, Defendants do not even address the issue.¹ It will be unconscionable for Defendants to finally address this issue in their post-trial answering brief, when Plaintiffs will have no opportunity to respond.²

The second issue Defendants ignore is whether—if the contract language is construed to mean what Defendants say it means—Delaware law permits a Rights Plan to be used to prevent “groups” from being formed solely for the purpose of conducting a proxy contest to elect directors or to have revocable and nonbinding agreements as to how shares will be voted in that proxy contest.³ This issue was raised in Plaintiffs’ Opening Pre-Trial Brief⁴ and never directly addressed by Defendants. One can, however, deduce from Defendants’ briefs a remarkable proposition of law that Defendants ask this Court to adopt. As Plaintiffs understand, it is as follows:

¹ Pls.’ Pre-Trial OB at 25-34; Pls.’ Pre-Trial AB at 10-11.

² *See, e.g., Emerald P’rs v. Berlin*, 2003 Del. Ch. LEXIS 42, at *152 (Apr. 28, 2003) (“It is settled Delaware law that a party waives an argument by not including it in its brief.”). *See also Emerald P’rs v. Berlin*, 726 A.2d 1215, 1224 (Del. 1999) (“issues not briefed are deemed waived”); *Williams v. White Oak Builders, Inc.*, 2006 Del. Ch. LEXIS 112, at *32 n.95 (June 6, 2006) (finding that failure to address argument in opening post-trial brief results in waiver); *In re IBP, Inc. S’holders Litig.*, 789 A.2d 14, 62 (Del. Ch. 2001) (same).

³ As Yucaipa repeatedly has made clear, it is not seeking authorization to obtain binding or irrevocable commitments from other stockholders either allowing Yucaipa to vote other stockholders’ shares or binding stockholders as to how they will vote shares. All of Yucaipa’s actions are directed solely to a proxy contest for the solicitation of revocable proxies in accordance with the applicable rules and regulations governing such contests.

⁴ Pls.’ Pre-Trial OB at 47-48.

The directors of a Delaware corporation may unilaterally create a rights plan for the purpose of preventing stockholders from organizing into “groups” in excess of a particular size (as set in the sole discretion of the board) to conduct a proxy contest to elect directors other than those who adopted the rights plan—even when the incumbent board and other insiders have 36% of the outstanding voting stock of the company and the major issue in the proxy contest will be the incumbent board’s practice of approving every one of a multitude of self-dealing transactions—so long as there is a mathematical possibility that the stockholders might still be able to win the proxy contest.

This is the holding Defendants seek from this Court, and they tell the Court that it is the well-settled “balance” struck by Delaware courts over the past twenty years. It is not. It is contrary to the often articulated importance that Delaware courts place on protecting the stockholder franchise. At a time when the Delaware legislature, Congress, and the SEC are acting to facilitate the ability of stockholders to exercise their franchise,⁵ Defendants ask this Court to allow directors the unilateral power to block stockholders from forming groups to elect directors or vote down a rights plan. It is not surprising that Defendants do not expressly acknowledge the change in law they attempt to accomplish. What is stunning is that the Board never made the decision Defendants ask this Court to authorize.

The final issue that Defendants largely but not entirely ignore is the justification for the 20% trigger—either as a limit to the number of shares that may be purchased or as a limit

⁵ The Delaware General Assembly recently amended the DGCL to expressly authorize “proxy access” and “expense reimbursement” bylaws. 8 *Del. C.* §§ 112, 113. Congress last week passed the Restoring American Financial Stability Act of 2010 containing provisions to facilitate stockholder influence on executive compensation and authorize SEC action on “proxy access.” S. 3217, 111th Cong. (2010) (awaiting President’s signature) (Section 951 “Say on Pay” and Section 971 authorizing Proxy Access), *available at* <http://www.opencongress.org/bill/111-s3217/show>. The SEC recently issued a “Concept Release on the U.S. Proxy System,” in part to promote the accuracy and integrity of the system “which is the principle means by which shareholders can exercise their voting rights.” SEC Release Nos. 34-62495; IA-3052; IC-29340; File No. S7-14-10, July 14, 2010, at 6.

on the size of groups that may form to conduct a proxy contest or elect directors. Defendants still expend most of their effort addressing a decision that is not in issue: whether they were justified to adopt *any* rights plan. As the Court noted, the critical issue is the reasonableness of the trigger level for both the limit on shares that may be purchased and the limit on the size of groups that may be formed to conduct proxy contests or elect directors.⁶ Besides Barshay's self-serving testimony that *he* considered the issue and concluded 20% was reasonable,⁷ the only empirical support for selecting 20% is that it is typical and tolerated, if not approved, by RiskMetrics. However, this is not the typical case for which RiskMetrics approves such a level and it is not a typical circumstance.

Defendants assert that the 20% level was selected because of concern about a "group" being formed that would acquire control of the Company. Presumably, Defendants are concerned that two stockholders—each with a percentage equal to the trigger level—would combine to form a group. But this argument misses the point. The 20% level defines how large that "group" might be. The issue is whether it is reasonable that the size of that group be limited to 20% when a preexisting insider group already has 36% of the outstanding shares (*not* including options and restricted stock). If, as is implicit in Defendants' argument, they were concerned with two stockholders forming a group in excess of 30-35%, the trigger level should be at 30-35%, not 20%.

⁶ See Tr. 1085:16-1087:4 (Court).

⁷ Barshay Dep. 52:12-23.

ARGUMENT

I. COLLECTIVE STOCKHOLDER ACTION IN A PROXY CONTEST DOES NOT RESULT IN ATTRIBUTION UNDER THE TERMS OF THE RIGHTS PLAN

The threshold issue is whether the language of the Rights Plan actually precludes the formation of “groups”—or, stated differently, whether the Rights are “triggered”—under the circumstances identified by Defendants, namely, by agreements respecting the conduct of a proxy contest for the election of directors (such as a joint slate or sharing of expenses), or by revocable, nonbinding “agreement[s], arrangement[s] or understanding[s]” as to whether a stockholder will ultimately vote its shares or give a revocable proxy in connection with a proxy contest conducted pursuant to the applicable rules and regulations.

In their Opening and Answering Pre-Trial Briefs and in their Opening Post-Trial Brief, Plaintiffs demonstrated that the relevant language of the definition of Beneficial Ownership is ambiguous. The language must be construed against the Company in order to preserve stockholder rights, and reasonably may be interpreted not to preclude the formation of “groups”—or cause the Rights to be triggered—by the conduct Defendants contend would do so here. Defendants have never responded to this argument, and they ought not be permitted to do so for the first time in their post-trial answering brief.⁸

Essentially, there are two issues of contract construction: first, what is the scope of the phrase “agreement[s], arrangement[s] or understanding[s] . . . for the purpose of . . . voting” shares? Second, what is the scope of the exemption for the solicitation of revocable proxies? Plaintiffs have demonstrated that agreements pertaining to the conduct of a proxy contest

⁸ See *supra* note 2.

(such as joint slates and cost sharing) are not agreements for the purpose of voting.⁹ Plaintiffs also have demonstrated that nonbinding and revocable “agreement[s], arrangement[s] or understanding[s]” concerning how a stockholder will vote or whether a stockholder will grant a revocable proxy in such a proxy solicitation are not “agreement[s], arrangement[s] or understanding[s]” as this phrase was interpreted in *Chesapeake Corp. v. Shore*,¹⁰ where this Court held that a contract was *not* such an agreement if it did not contain a legal commitment to vote shares for a merger or economically compel such a vote.¹¹

However, if the clause is broad enough to capture such agreements, the exemption for the solicitation of revocable proxies must be broad enough to exempt such agreements when they are part of a proxy solicitation of revocable proxies pursuant to the rules and regulations under the Exchange Act. Such agreements are all part of the process by which revocable proxies are solicited.

Defendants have not refuted or challenged those arguments. Consequently, Plaintiffs’ interpretation must prevail under the well-settled rules of contract construction and because Defendants never challenged it in prior briefs. If the Rights Plan is construed as Plaintiffs contend, the Court need not reach the issues of whether the Rights Plan can be used to preclude the formation of “groups” for the purpose of conducting proxy contests to elect directors, *infra* Argument II, or whether the operation of the Beneficial Ownership provision in this case is reasonable under *Unocal*, *infra* Argument III.B. The only remaining issue under *Unocal* is the reasonableness of trigger level.

⁹ Pls.’ Post-Trial OB at 13-14; Pls.’ Pre-Trial OB at 28-34.

¹⁰ 771 A.2d 293, 353 (Del. Ch. 2000).

¹¹ See *supra* note 9.

II. DEFENDANTS ATTEMPT TO USE THE RIGHTS PLAN FOR A PURPOSE NEVER BEFORE SANCTIONED AND NEVER APPROVED BY THE BOARD: TO BLOCK STOCKHOLDERS FROM ORGANIZING TO ELECT DIRECTORS OR REMOVE THE RIGHTS PLAN

Under *Unocal*, the threshold issue with respect to a rights plan is whether it is being used for a cognizable corporate objective. Plaintiffs have demonstrated that a rights plan may not be used to prevent stockholders from organizing to conduct a proxy contest for the election of directors.¹² Indeed, such a purpose for a rights plan has never been sanctioned.

Throughout their briefing, Defendants avoided confronting this issue by an act of “cognitive dissonance.” On the one hand, Defendants now contend that the Company intends to use the Rights Plan to prevent the formation of “groups” in excess of 20% for the purpose of conducting a proxy contest to elect directors. This is evidenced by the trial testimony of Scott Barshay:

Q. Did you ever describe for the board the threat to a corporate policy, or its effectiveness in preventing stockholders owning more than 20 percent of the shares, from forming a group for the limited purpose of electing three directors to the board?

A. I never said anything to the board in the way that you’re saying it.

Q. And if your limited purpose of this group—the only thing that these people agree on, they all own their own shares, they vote their own shares—is they’d like to see three directors elected to the board, how can they pay a control premium? Where is the justification for a control premium to vote your shares?

A. My view is that you’re creating a group in that instance. You’re creating a 13D-type poison pill-type group in that instance. I believe that the board was doing the right thing in preventing the formation of groups at greater than 20 percent.

* * * *

But the thrust of the question which I [answered] before—I understand your point—which is the board can do things here that

¹² Pls.’ Pre-Trial OB at 47-48; Pls.’ Pre-Trial AB at 21; Pls.’ Post-Trial OB at 15-26.

stockholders who aggregate more than—stockholders aggregating more than 20 percent cannot do.

- Q. And they can do it with the express purpose and desire of preventing a proxy contest; correct?
- A. If they get to 51 percent, I guess they make a proxy contest impossible.¹³

Thus, according to Barshay, the Rights Plan can be used to prevent the Company's stockholders from organizing a "group" to conduct a proxy contest (by preventing them from entering into "agreement[s], arrangement[s] or understanding[s]"), but the Board can reach even binding agreements with other stockholders as to how they will vote and lock up the entire election.

Yet, while Defendants testify that the Company intends to use the Rights Plan in the foregoing manner, their justification for this unusual and extreme use of the Rights Plan is the traditional one: preventing someone from purchasing shares sufficient to acquire control without paying a control premium. This mantra is repeated in Defendants' Post-Trial Opening Brief.¹⁴ By eliding the difference between the use to which the Rights are being put and the purpose for which they were adopted, Defendants have attempted to avoid confronting the issue of whether the Rights can be used to prevent the formation of groups solely to elect directors. As Plaintiffs previously explained, neither *Moran* nor *Stahl* permitted rights plans to be used for this purpose.

Defendants' *sub silentio* effort to equate forming a group to conduct a proxy contest to elect directors with a "change of control" for which a "premium" should be paid fails for multiple reasons:

¹³ Tr. 961:24-962:24, 963:10-17 & 21-22 (Barshay).

¹⁴ Defs.' Post-Trial OB at 23-30.

- The pending election is not a “change in control” even at the Board level. Only three of nine directors are being elected, and, unless Yucaipa is allowed to purchase additional shares, the Riggios will remain the largest stockholders in the Company by a substantial margin.¹⁵
- Stockholders agreeing to vote shares they already own is vastly different than stockholders purchasing shares. In the latter case, it may be appropriate for a board to negotiate for a premium, but in the former case—as Defendants admit—there is no rationale for seeking a premium.¹⁶
- The election of directors is not a referendum on a proposal by the party conducting the proxy contest to purchase the shares of other stockholders or acquire the Company—as was the hypothetical case in *Moran* and the actual case in *Stahl*.
- In this case, the election of directors is not a referendum on any business proposal by Yucaipa. It is a referendum on whether this Board and corporate governance would be improved by electing new directors who are independent of or more independent of the Riggios than the current Board.
- Even if it were a referendum on a future business course, so long as the proposal does not involve an acquisition of the Company by one of the parties in the “group,” such platforms are the essence of a meaningful exercise of the stockholder franchise. In this case, however, any proposals of any type could not be effectuated by the election of three directors.

In addition to the illogic of equating an election of directors with a “change of control” for which a premium could be paid, there are two additional reasons why the Rights Plan ought not be used in this case to prevent the formation of groups. First, the Board never made the decision to do so. The ultimate issue for this Board—or for any board evaluating whether to use a rights plan for this purpose—is whether stockholders are better served by being free to exercise their franchise to elect directors unrestrained by the provisions of the Rights Plan or better served by restricting groups when attempting to elect directors. This Board never made that decision, never performed that analysis, and did not have information before it upon which it could perform that analysis.¹⁷

¹⁵ See Tr. 1042:9-14 (Del Giudice).

¹⁶ Tr. 1059:9-15, 1062:14-1063:24 (Del Giudice).

¹⁷ See Pls.’ Post-Trial OB at 10-11, 24.

Second, whatever sanction might be given to using a rights plan to prevent groups from forming to conduct a proxy contest to elect directors, that sanction ought not apply where there is a preexisting, insider group of the size of the group here. In this case, the effect of preventing the formation of groups only serves to entrench the control or dominance already exercised by the internal group.

III. DEFENDANTS' ADOPTION AND USE OF THE RIGHTS PLAN HAS NOT BEEN REASONABLE IN RESPONSE TO ANY COGNIZABLE THREAT

A. Defendants Have the Burden to Demonstrate the Reasonableness of the Rights Plan

There is no dispute that Defendants bear the burden to demonstrate the reasonableness of their use of the Rights Plan. Defendants again make the point that they need not show the Rights Plan is “necessary” to accomplish a legitimate goal. However, as noted *supra* Argument II, this Rights Plan is being used for a purpose not sanctioned under Delaware law. Moreover, if it were being used for a legitimate purpose and had the effect of infringing the shareholder franchise, the necessity of such infringement certainly is a relevant factor and merely coming within a “range of reasonableness” would not meet the *Unocal* standard when the stockholder franchise is impacted.

“The Supreme Court has instructed this court to consider [the question of proportionality] in light of whether the defensive measure at issue is a statutorily authorized form of business decision which a board of directors may routinely make in a non-takeover context and is limited and corresponded in degree or magnitude to the degree or magnitude of the threat”¹⁸ Here, interference with the upcoming proxy contest is not “a statutorily

¹⁸ *Chesapeake*, 771 A.2d at 342-43 (applying a *Unocal* analysis) (internal quotation marks and citation omitted).

authorized form of business decision”: “[A] board of directors may not use the corporate machinery for the purpose of obstructing the legitimate efforts of dissident stockholders to undertake a proxy contest against management.”¹⁹ Therefore, the proportionality analysis “must recognize the special import of protecting the shareholders’ franchise within *Unocal*’s requirement that any defensive measure be proportionate and reasonable in relation to the threat posed.”²⁰ “Where the franchise is involved a special obligation falls upon courts to review with care action that impinges upon legitimate election activities.”²¹

Defendants assert that “it is emphatically *not* the law of Delaware that a defensive measure is unreasonable if it has *any* impact on the likelihood of a dissident’s success in a proxy contest.”²² Plaintiffs, however, are not arguing that a defensive response is unreasonable if it has any impact on a proxy contest. Rather, Plaintiffs argue that a rights plan adopted to prevent “groups” from forming solely to elect directors is *not* a permissible use of that rights plan, and, when a rights plan is adopted for a *permissible* purpose, but has a significant effect on the stockholders’ ability to exercise their franchise, the reasonableness of that rights plan is measured by the importance of the permissible objective, the degree of interference with the franchise, and whether alternatives are available to accomplish the permissible objective without any or the same degree of impact on the franchise. In this

¹⁹ *Moran v. Household Int’l, Inc.*, 490 A.2d 1059, 1070 (Del. Ch. 1985), *aff’d*, 500 A.2d 1346 (Del. 1985) (applying a *Unocal* analysis).

²⁰ *MM Cos. v. Liquid Audio, Inc.*, 813 A.2d 1118, 1130 (Del. 2003) (rationalizing *Unocal* and *Blasius*) (internal quotation marks and citations omitted).

²¹ *Stahl v. Apple Bancorp, Inc.*, 1990 Del. Ch. LEXIS 121, at *15 (Aug. 9, 1990) (applying *Unocal*, interpreting *Moran* to create an “immateriality test” for imposition on stockholder franchise).

²² Defs.’ Post-Trial OB at 38-39 (emphasis in original).

case, when measuring each of those parameters, the use of the Beneficial Ownership provision is unreasonable, if it is even permitted at all.

B. Defendants' Use of the Rights Plan to Prevent Collective Stockholder Action in a Proxy Contest Is Not Reasonable in Relation to a Proper Corporate Objective

1. Defendants' Interpretation of the Beneficial Ownership Provision Materially Impairs the Conduct of a Proxy Contest

The evidence concerning the effect of the Beneficial Ownership provision—as interpreted by Defendants—on a proxy contest is largely un rebutted. Both of Plaintiffs' experts testified that being precluded from entering into “agreement[s], arrangement[s] or understanding[s]” would materially impair the ability of Yucaipa or any other stockholder to conduct a proxy contest because (1) some institutional investors would avoid meaningful communications with Yucaipa for fear that the conversations might be deemed by an interested Board to trigger the Rights and massively dilute the investors' holdings²³ and (2) entering into nonbinding, revocable understandings about how stockholders will vote in the proxy contest is an integral part of conducting a proxy campaign.²⁴ This disadvantage to Yucaipa is compounded by the fact that the Board may enter into such “agreement[s], arrangement[s] or understanding[s],” even—as Barshay testified—to the point of locking up the election.²⁵ Defendants' expert does not offer any meaningful rebuttal because his opinion was conclusory, and he did not know what the Rights Plan effectively prevented—an

²³ See Tr. 352:13-353:20, 354:11-355:11 (Taxin), 690:8-17 (Burch).

²⁴ Tr. 357:17-359:23 (Taxin), 610:15-611:19, 629:12-630:2 (Burch).

²⁵ Tr. 962:19-963:21 (Barshay).

essential element of opining whether it has an adverse effect.²⁶ Moreover, he never considered the comparative disadvantage to Yucaipa resulting from preclusion of the very ability that the Board retained.²⁷

All of the experts agree that the vote of Aletheia or its institutional clients in favor of Yucaipa's slate is critical for Yucaipa to win any proxy contest.²⁸ There is also no dispute that, even were Yucaipa to get the support of *both* RiskMetrics and Aletheia or its institutional clients, the race still will be extremely close.²⁹

As detailed below, even were Aletheia to vote its shares, Eichler has not decided whether he is in favor of management or Yucaipa.³⁰ Instead, management and Yucaipa will be required to win over Eichler based on an agreement, arrangement, or understanding, or otherwise on the merits of the respective slates. This is the crux of the problem with the Rights Plan creating a slanted playing field. Yucaipa is prohibited from reaching an agreement, arrangement, or understanding with Aletheia—which holds the votes critical to its success—and any substantive, two-way communication with Aletheia risks economic suicide by triggering the Rights Plan. The Company, on the other hand, is free to communicate with Aletheia on the merits and reach agreements, arrangements, or understandings.³¹

²⁶ Tr. 755:24-756:18 (Harkins).

²⁷ Tr. 696:12-14 (Harkins).

²⁸ Tr. 608:11-609:10 (Burch); Burch Report (JX 762) at 10; Tr. 412:14-17 (Taxin); Harkins Report (JX 763) at 24-25.

²⁹ See Burch Rebuttal Report (JX 783) at 4, Table 3.

³⁰ See Eichler Dep. 198:13-200:11. See also *infra* pp. 20-21.

³¹ Tr. 961:24-962:24, 963:10-17 & 21-22 (Barshay).

If Aletheia passes through the vote to its institutional clients, it only exacerbates the problem because, as Harkins and Burch assume,³² only approximately 81-85% of the shares represented by Aletheia will be expected to vote.³³ Yucaipa needs the cooperation of Aletheia to reach and persuade Aletheia's investors, which may be difficult if the Company already has a relationship with some or all of them.³⁴ Being able to reach an agreement with those investors, including agreements on nominees or platform, may make the difference.

Aletheia is not the only institutional stockholder with whom Yucaipa would like to talk. As Burch testified, this proxy contest likely will come down to one to three institutional investors who collectively hold 2-5% of the shares.³⁵ Yucaipa hopes to talk to the top five to ten institutional investors to determine whether they are willing to give some sort of commitment (albeit nonbinding) as to the circumstances in which they would support a proxy contest by Yucaipa. The Ten-Person Rule³⁶ was designed to permit such discussions and commitments from up to ten stockholders in advance of an actual solicitation. Whether or not this requires disclosure of a "group" under Sections 13(d) or 14(a), it is clear under the federal proxy rules that this conduct is allowed and, indeed, expected and encouraged.

Defendants argue that there is a "well-understood etiquette" among institutional investors to avoid forming "groups" under Section 13(d), and this practice undermines the

³² Neither Burch nor Harkins have any experience with Aletheia and do not know who its investors or clients are, thereby formulating *assumptions* in their reports rather than projections about how many shares will be voted or for whom they will be voted. *See* Tr. 580:11-15, 612:1-7 (Burch), 749:4-750:1 (Harkins).

³³ Harkins Report (JX 763) at 21 n.5; Burch Rebuttal Report (JX 783) at 4 & n.4.

³⁴ Tr. 309:17-21, 312:9-12 (Taxin).

³⁵ Tr. 576:1-8 (Burch).

³⁶ 17 C.F.R. § 240.14a-2(b)(2).

adverse effect of the Beneficial Ownership provision on the conduct of a proxy contest.³⁷ There are several rebuttals to this point. First, this etiquette does not eliminate the adverse effect at all for those who are willing and desire to form a group to conduct a proxy contest. Burch gave one specific example of proxy contestants prevented from forming a group—thereby lessening their effectiveness—in a proxy contest at Amylin Pharmaceuticals, Inc.³⁸ The same may be true for Yucaipa and Aletheia or other institutional stockholders. Second, the etiquette that allows institutional investors to navigate the risks of being required to make Section 13(d) disclosures is not adequate to address the risks of triggering the Rights, because triggering the Rights have profoundly greater consequences and, as Taxin explained, the arbiter of a triggering event is the interested Board, not the SEC.³⁹

Third, the conduct that this Board says triggers the Rights Plan is broader than the conduct that creates a group under Section 13(d).⁴⁰ For example, Higgins and Barshay testified that the Rights Plan would be triggered as soon as one stockholder agreed to vote for the dissident's slate, even though the agreement was not binding and could be revoked.⁴¹ Such agreements would not create a “group” under Section 13(d), but foreclosing such

³⁷ Defs.’ Post-Trial OB at 45-46.

³⁸ Burch Report (JX 762) at 9.

³⁹ Tr. 338:5-9, 354:11-355:7 (Taxin).

⁴⁰ Defendants argue that Plaintiffs admit that the scope of the Beneficial Ownership provision in the Rights Plan is *not* as broad as the scope of groups under Section 13(d). *See* Tr. 408:18-409:24 (K. Nachbar); Defs.’ Post-Trial OB at 45 n.14. This misstates Plaintiffs’ position. The passage Defendants cite explains that the Beneficial Ownership provision—as *Plaintiffs contend it should be interpreted*—could be read less broadly than the definition of “group” under Section 13(d) because the language of the relevant rules and regulations differs from the language of the Rights Plan. Plaintiffs have never asserted or conceded that *Defendants’ interpretation* of the Beneficial Ownership provision is narrower than the definition of a “group” under Section 13(d).

⁴¹ Tr. 272:3-18 (Higgins); Barshay Dep. 268:14-21.

agreements would render the work of a proxy solicitor largely ineffectual. Burch testified that precluding reaching agreements concerning voting would have a dramatic effect on the ability to conduct a proxy contest:

It's like tying both hands behind your back in a proxy contest if you can't ask somebody for a vote and if -- more importantly, if they can't tell you they're going to vote for you, it's very hard to count noses and tell your client where they are in the proxy contest if you can't have a stockholder, you know, tell you they're voting for you or against you. Sometimes more important against you. I'm not sure that's an agreement, but that's an understanding.⁴²

“Part of the actual solicitation process is to ask for the order; and hopefully you do, when you ask for the order, get a commitment that they will vote for your side.”⁴³

2. Attribution Rules Addressing a Proxy Contest for the Election of Directors Are Not Needed to Protect Against Changes of Control

Plaintiffs pointed out in their briefs that the Beneficial Ownership provision could be amended to eliminate its effect on forming “groups” to conduct a proxy contest to elect directors without impairing its effectiveness with respect to preventing share acquisitions or the formation of groups for the purpose of acquiring the Company. Defendants never accepted the invitation to amend or otherwise responded to these arguments. Similarly, the Court raised the possibility of a different trigger level relating to the formation of “groups.” While such an amendment would not eliminate the use of the Rights Plan to preclude the formation of groups for the purpose of a proxy contest, it would lessen the impact of that prohibition on this contest.

⁴² Tr. 618:2-11 (Burch).

⁴³ Tr. 605:19-24 (Burch).

But even that modest suggestion has now been rejected by the Board. Defendants' rejection does not make sense. First, Defendants suggest that there is problem setting the trigger "low enough to avoid the threat of a coercive bid for irrevocable proxies."⁴⁴ As Defendants well know, however, Yucaipa is not seeking to obtain irrevocable proxies. The relief Yucaipa seeks relates only to agreements that would not bind the other party to vote in any manner. Yucaipa also is not making a "coercive bid" to do anything.

Defendants also argue that lifting the trigger level would not "provide any meaningful benefit to a large minority stockholder such as Yucaipa."⁴⁵ Defendants argue that a joint slate or sharing proxy expenses would constitute a "group" under Section 13(d), and assert that Burkle supposedly testified that Yucaipa would not take actions that would result in the formation of a Section 13(d) group. Defendants distort Burkle's testimony. At the page cited by Defendants, Burkle expressly testified that he would like to have an agreement with another stockholder to share expenses:

Q. But you have no desire to do anything with another stockholder that would result in you and that stockholder being a joint 13D group; right?

A. *Well, the one thing we would like to be able to consider is whether or not we could ask people to share expenses.*

Q. Right. And if you did that, then you'd be a 13D group?

A. I'd rely on counsel to tell me if that was the case, but I would assume so.

Q. But your desire is to avoid being a 13D group; right?

A. Yes.⁴⁶

⁴⁴ Defs.' Post-Trial OB at 43.

⁴⁵ *Id.*

⁴⁶ Tr. 75:5-17 (Burkle).

In addition, allowing the formation of larger groups would lessen the concern that conversations resulting in nonbinding “agreements, arrangements or understandings” would trigger the Rights Plan because—even if the shares were attributed to Yucaipa under the Beneficial Ownership provision—the higher trigger would not have been crossed. Finally, Defendants conclude that “it is unlikely . . . that Yucaipa would even be interested in making use of a ‘second trigger’”⁴⁷ For the record, while Yucaipa does not believe such a modification would be sufficient relief, it would certainly be welcomed relief, and this Court obviously has the broad equitable power to fashion such relief.⁴⁸

Defendants offered a “binding judicial admission” that “neither Barnes & Noble nor any of the other Defendants intends to seek to enforce the definition of beneficial owner in its current rights plan any differently than that language is interpreted when it appears in hundreds of other rights plans or in 8 Del. Code, Section 203.”⁴⁹ Defendants assert that this admission eliminates any ambiguity about the meaning or operation of this provision and, thus, eliminates any *in terrorem* effect. But, when asked whether that admission changed the testimony of Defendants’ witnesses (including the attorney who drafted the Rights Plan), Defendants responded: “It doesn’t change the testimony of any witness. What —what it is is a binding judicial admission and it is the position of the defendants.”⁵⁰ So really, even after this “admission,” nothing is any clearer.

⁴⁷ Defs.’ Post-Trial OB at 43.

⁴⁸ Pls.’ Pre-Trial OB at 68-69.

⁴⁹ Defs.’ Post-Trial OB at 22.

⁵⁰ Tr. 436:6-13 (K. Nachbar).

C. A 20% Trigger Is Unreasonable When There is a Preexisting Insider Voting Group at 32-38%

1. Freezing Yucaipa at 20% Hinders Yucaipa and Advantages Leonard Riggio in a Proxy Contest

Defendants offer no rebuttal to the proposition that freezing Yucaipa at 20% does not materially advantage the Riggios and the other insiders and materially disadvantage Yucaipa. Rather, Defendants argue that the Board may impose that material disadvantage on Yucaipa and create that material advantage for itself so long as Yucaipa retains a realistic possibility of winning a proxy contest. Yucaipa does not dispute that it has a realistic possibility of winning a proxy contest, and Defendants do not and cannot dispute that freezing Yucaipa at 20% provides a material disadvantage to Yucaipa and a material advantage to the Board and the Riggios. The question is whether the dramatic effect this freeze will have on the proxy contest is justified by some countervailing corporate purpose.

There can be no dispute that the proxy contest will be close. Even if both RiskMetrics and Aletheia or its investors support Yucaipa, the swing vote that might change the election outcome is approximately 1% if Aletheia's institutional investors support Yucaipa, or less than 5% if all of Aletheia's shares vote for Yucaipa, which in light of Eichler's testimony is highly unlikely.⁵¹ As Taxin, Burch, and Harkins all testified, both margins could be changed by one or a few institutional stockholders voting with the Board, or by the acquisition of shares by Yucaipa, which is currently prohibited by the Rights Plan, or the acquisition of shares by the Riggios or members of the Riggio family, which is allowed by the Rights Plan.⁵² Moreover, even these close margins are predicated on two difficult predictions: what

⁵¹ Burch Rebuttal Report (JX 783) at Table 3.

⁵² See Pls.' Post-Trial OB at 39-40.

RiskMetrics will recommend and how Aletheia (or its client) will vote, and how many of Aletheia's shares will be voted.

Defendants characterize Aletheia as “extremely likely” to support Yucaipa in a proxy contest because Aletheia appeared to follow Yucaipa in its B&N and other investments, and due to Eichler's admiration for Burkle.⁵³ This ignores, however, the facts about Aletheia's investments in B&N. Aletheia's investment history in B&N has been based primarily *on the actions of the Company and Riggio*, not on Yucaipa's purchases:

- Aletheia initiated its investment in the Company in 2005 based in large part upon Leonard Riggio's own purchases of the Company's stock.⁵⁴ This was years before Yucaipa owned any Barnes & Noble stock.
- Aletheia increased its position in early 2009 based on purchases by both Leonard Riggio and Yucaipa, explaining “Len Riggio has a tremendous record as an investor in his own shares” and “you had two smart people buying at the same time.”⁵⁵
- Aletheia further increased its position in November 2009 based upon the swift speed at which the Board adopted the Rights Plan, signaling to Aletheia that management had “great knowledge of the company, believed that Barnes & Noble was severely undervalued . . . [s]o you could say that that poison pill that the company established is the reason that we increased our weighting [at that time]”⁵⁶
- Aletheia recently *decreased* its net position in B&N, from 17.44% to 16.28%.⁵⁷

In an effort to understate the advantage that the freeze confers upon the Riggios, Defendants assert that “Plaintiffs' constant refrain that the Riggios control an ‘Insider Block’ of 38% of the Company has *no basis in the evidence*.”⁵⁸ However, the factual basis for that

⁵³ See Defs.' Post-Trial OB at 14.

⁵⁴ Eichler Dep. 46:19-47:9.

⁵⁵ Eichler Dep. 82:3-86:19, 84:10-12.

⁵⁶ Eichler Dep. 67:18-68:20.8, 90:2-21.

⁵⁷ See Aletheia, Schedule 13D/A, May 18, 2010 (DX 713), at 3.

⁵⁸ Defs.' Post-Trial OB at 37 (emphasis added).

assertion comes from the calculations done in the report of *Defendants' expert*—Harkins. Harkins concluded that the block owned by the Riggios, directors, officers, and employees was 36.79% of the *outstanding* stock, *not* including options.⁵⁹ Moreover, Harkins concluded that this block would overwhelmingly vote for the incumbents, and agreed that the shares of this group, *expected to vote for the incumbent slate*, constituted 38.73% of the shares expected to vote, a.k.a. the “quorum” (assuming all of the Aletheia shares voted).⁶⁰ If Aletheia’s shares were not voted, the expected vote of the Insider Block would constitute 47.28% of the expected voter turnout.⁶¹ Plaintiffs did not overstate the voting power of the insiders.

2. The 20% Trigger Is Not a Reasonable or Proportionate Means to Prevent Yucaipa From Acquiring Control

a. Yucaipa Cannot Acquire Control With Fewer Shares Than the Riggios

There is no dispute that Yucaipa cannot obtain control at a percentage of shares less than the percentage held by the Riggios, and there also is no dispute that the Company is not even concerned about a possible acquisition of control until a stockholder reaches between 35-45% of the stock.⁶² There also is no dispute that the only information provided to the Board in connection with selecting the trigger level was the assertion that 20% was ISS

⁵⁹ Harkins Report (JX 763) at 9.

⁶⁰ *See* Tr. 722:14-723:14 (Harkins); Harkins Report (JX 763) at Table 3; Burch Rebuttal Report (JX 783) at Table 2 (comparing Burch percentages to Harkins percentages).

⁶¹ Burch Rebuttal Report (JX 783) at Table 2.

⁶² Tr. 769:21-24 (Daniels) (“if [L. Riggio] got over 35 percent, we’d start to have a discussion with him. And certainly if he got to 45 percent, there might be concern that he would be purchasing control of the company.”); Tr. 844:9-843:18 (Daniels) (“35 percent was the moment in time where you would start to have the discussion about what constitutes control. It wasn’t 35 percent.”). *See also* Tr. 496:11-22 (L. Riggio); Pls.’ Pre-Trial OB at 43; Pls.’ Post-Trial OB at 5, 36.

friendly and the trigger was higher than the prior Rights Plan.⁶³ Yet, RiskMetrics never made such a judgment in a situation where an insider group held a 36% stake.⁶⁴ As Taxin explained, there are only four corporations, including the Company, with a stockholder in excess of 30% and a rights plan. Of the 522 corporations that presently have rights plans, 465 of them do not have any stockholders holding more than 10% of their stock.⁶⁵

Based upon the foregoing, this Board had no basis to select a 20% trigger. Defendants' rebuttal is that the 20% trigger was to address the problem of a "group" forming to acquire control of the Company. But, the 20% trigger limits not only what one stockholder may own, but limits what any group may own. If 35% is the correct level at which a concern about control develops, it is the same level for an individual or a group, especially when there already is a group at that level. Simply put, if the concern is that a group ought not exceed 35%, the correct trigger level for the Rights Plan is 35%, not 20%.

Realizing the illogic of their effort to justify a 20% trigger by reference to the formation of a group, Defendants create yet another new justification for the 20%. It is the possibility that there is "an elaborate system of 'nods and winks'" that allows "activist investors . . . to work in concert without actually triggering poison pills or Rule 13d disclosures."⁶⁶ Thus, Defendants now seek to expand the use of the Rights Plan not only to prevent the formation of "groups," but to prevent stockholders from forming non-groups. This new purpose is to prevent stockholders from becoming large enough to act together by

⁶³ Tr. 863:16-864:8 (Daniels); Daniels Dep. 178:2-20.

⁶⁴ RiskMetrics Proxy Voting Guidelines (JX 474) at BKS102387-88 (stockholder rights plans should maintain "no lower than" a 20% trigger).

⁶⁵ Taxin Report (JX 474) at Table 15.

⁶⁶ Defs.' Post-Trial OB at 41.

“winks and nods.” Suffice it to say that this Rights Plan is being used for purposes divorced from any use sanctioned either by Delaware law or this Board. It is being used not simply to prevent the formation of groups, but to limit the size and number of stockholders who might “wink or nod” to each other. Even Defendants’ own expert, who reviewed the prevalence of various trigger levels in other rights plans, declined to opine that the 20% trigger was reasonable in light of the internal voting control levels maintained by the Riggios.⁶⁷

And what is the conduct that the Company fears these “activist stockholders” might undertake by undisclosed “winks and nods?” Certainly an effort to acquire control without paying a premium could not be accomplished by “winks and nods.” The example the Company cites of Yucaipa influencing management in A&P was not done by winks and nods; rather, it was done by express agreements approved by those companies’ directors and their stockholders.⁶⁸

b. Yucaipa Is Not a Threat to Acquire Control

There is no dispute that Yucaipa has never even attempted the “hostile” acquisition of control of any public company—whether by “creeping” acquisitions, tender offers, or proxy contests.⁶⁹ It also is undisputed that Yucaipa has never attempted to acquire control of B&N. In any event, Yucaipa could not acquire control by electing three directors to the nine-director Board. Consequently, the Board must search for some other “threat” that Yucaipa

⁶⁷ Tr. 759:11-760:6 (Harkins).

⁶⁸ Tr. 11:4-17, 12:2-15, 134:22-135:8 (Burkle) (demonstrating that A&P approached Yucaipa regarding increasing its stake, and Yucaipa and A&P entered into a standstill agreement that was approved by A&P’s board and by its stockholders). *See also* Morgan Stanley Project Evolution Materials (JX 648) at 8 (indicating that Yucaipa’s agreement with A&P was approved by A&P stockholders).

⁶⁹ Tr. 9:12-13 (Burkle), 885:4-16 (Barshay), 1035:7-11 (Del Giudice).

represents so as to justify freezing Yucaipa at 20% and preserving the electoral advantage currently enjoyed by the Riggios and the incumbent Board.

Presumably for that purpose, Defendants state that Yucaipa “typically seeks to exert influence over the management of those companies in which it invests.”⁷⁰ Yet, the entire purpose of the stockholder franchise is for stockholders to “exert influence over the management of those companies” in which they invest, principally by electing a board sensitive to their interests, especially as impacted by self-dealing. It appears that it is the stockholder franchise that this Board perceives to be the “threat.”

In any event, Exhibit A for Defendants’ portrayal of Yucaipa as a threat is Yucaipa’s investment in A&P.⁷¹ The most striking part of this argument is that Leonard Riggio and Daniels declined the opportunity to learn about Yucaipa’s investment and conduct at A&P. Riggio declined an offer for introduction to Christian Haub, the executive chairman of A&P and a member of the family that owns a controlling interest in that company, to explore the standstill arrangement between Yucaipa and A&P.⁷² Riggio also failed to notify the Board that such an offer was extended.⁷³ Likewise, Daniels never talked with the Cravath partner familiar with A&P (after Barshay offered to arrange it) regarding Yucaipa’s history in connection with its investment in A&P.⁷⁴ In short, neither Riggio, nor any other Board member, considered Yucaipa’s history of investments in public companies.⁷⁵ Further,

⁷⁰ Defs.’ Post-Trial OB at 4 (citing Tr. 8-10 (Burkle)).

⁷¹ Defs.’ Pre-Trial OB at 4-5.

⁷² Tr. 455:6-13, 457:11 (L. Riggio).

⁷³ Tr. 185:14-186:5 (Higgins), 457:13-16 (L. Riggio).

⁷⁴ Tr. 926:2-18 (Barshay).

⁷⁵ See Tr. 459:3-19 (L. Riggio), 182:20-183:9 (Higgins).

Riggio did not provide the Board with the information about Yucaipa that he received from investment bankers, including information about A&P.⁷⁶ The primary information provided to the Board concerning Yucaipa was Riggio's dissatisfaction with his personal investment alongside Burkle in Alliance Entertainment.⁷⁷ This was the subject that began the discussion at the November 17 Board meeting,⁷⁸ and the depth of Riggio's anger about this incident was evident from his trial testimony on the subject.⁷⁹

If the Board had informed itself about A&P, it would have learned that Yucaipa's investment has always been friendly, as acknowledged by B&N's counsel.⁸⁰ A&P approached Burkle and asked him to buy stock to provide capital to the company.⁸¹ Yucaipa and A&P then entered into a standstill agreement by which Yucaipa purchased a significant stake in A&P and agreed to vote for the A&P board's slate of directors and their chairman.⁸² The agreement was approved by A&P's board and its stockholders.⁸³

Defendants also portray Burkle as demanding that he be able to select three or four directors "of his choosing."⁸⁴ The record demonstrates, however, that Burkle suggested a meeting between himself and the Board so that a *mutually agreeable* slate could be

⁷⁶ See Pls.' Post-Trial OB at 53-54.

⁷⁷ For example, Higgins testified that the *only* information she had about Yucaipa she learned at the Board meetings. Higgins Dep. 24:21-25:4.

⁷⁸ Daniels Notes of Nov. 17 Board Meeting (JX 356) at BKS51977.

⁷⁹ Tr. 520:23-524:23 (L. Riggio).

⁸⁰ Tr. 925:22-926:1 (Barshay).

⁸¹ Tr. 11:4-17 (Burkle).

⁸² Tr. 12:2-15 (Burkle).

⁸³ Tr. 134:22-135:8 (Burkle). See also Morgan Stanley Project Evolution Materials (JX 648) at 8.

⁸⁴ Defs.' Post-Trial OB at 21.

identified.⁸⁵ Daniels's handwritten notes of this meeting confirm Burkle's offer,⁸⁶ and Higgins's trial testimony further supports Burkle's testimony in this regard.⁸⁷

Defendants note that Yucaipa's Schedule 13D "reserved its rights to pursue, among other things, an extraordinary corporate transaction such as a merger or sale of the Company."⁸⁸ The insignificance of this reservation is threefold. First, as Barshay testified, this reservation was "boilerplate."⁸⁹ Second, three lines later, Yucaipa explained that it had no "present plan or intention" to undertake any of the investor activities listed in Item 4 of Schedule 13D.⁹⁰ Finally, this boilerplate reservation of rights appeared verbatim in Yucaipa's original 13D, filed January 2, 2009, about which Defendants apparently had no concern whatsoever.⁹¹

Defendants suggest that Ken Moelis, who *Riggio* suggested serve as intermediary and who *Riggio* subsequently met, told *Riggio* that "B&N would need to "give [Burkle] board seats" and that "this thing was going to get dirty," ultimately suggesting that Leonard buy out Burkle or Burkle buy out *Riggio*.⁹² Presumably, this is offered as evidence of *Burkle's* motives. For that purpose, it is inadmissible hearsay. Furthermore, it was *Riggio* who

⁸⁵ Tr. 47:4-9 (Burkle proposing, "hopefully over dinner," that the Board and he "talk about what kind of people might be good directors and pick people who we both thought would do a good job").

⁸⁶ JX 653 (Under "Directors," recording "over dinner" and "Any directors *we* thought added value" (emphasis added)).

⁸⁷ Tr. 261:12-19 and 262:18-23 (Higgins) (Burkle "indicated that he might be of some help in identifying some additional board members to join the board" and stating that he hoped "there might be an opportunity . . . [to] look at some of those names and talk about it.").

⁸⁸ Defs.' Post-Trial OB at 7.

⁸⁹ Barshay Dep. 23:9-13.

⁹⁰ Schedule 13D/A, Nov. 13, 2009 (JX 311), at 9.

⁹¹ See Schedule 13D/A, Jan. 2, 2009 (JX 184), at 9.

⁹² Defs.' Post-Trial OB at 17.

suggested Moelis be an intermediary, and it was Riggio who arranged to meet with Moelis.⁹³ Riggio did not state that Moelis was speaking for Burkle. Also, Moelis spoke with Burkle *after* he spoke with Riggio.⁹⁴ Moelis explained to Burkle in a subsequent conversation that “Len basically gave a speech . . . about black hats and white hats. And said, ‘[Burkle] used to be a white hat and now he’s a black hat.’”⁹⁵

D. Defendants Are Not Entitled to Material Enhancement

In an effort to distance Leonard Riggio from the initial proposal and adoption of the Rights Plan, Defendants assert that “Mr. Riggio was not involved in these early discussions [about the Rights Plan]” and “did not speak to any other Board members before the November 17 meeting.”⁹⁶ However, Riggio and his personal advisors were involved in the process before the November 17 Board meeting. Before the other directors⁹⁷ were aware that Cravath was crafting the Rights Plan or that a Board meeting would be scheduled for November 17, Riggio, Daniels, and Joe Lombardi convened with Riggio’s personal legal counsel to discuss the effect that adoption of the Rights Plan might have on his ownership interest in the Company. Not surprisingly, in their timeline of events leading up to the adoption of the Rights Plan at the November 17 Board meeting, Defendants omit this assemblage. It is undisputed, however, that Daniels, Lombardi, and Rosen of Bryan Cave

⁹³ Tr. 538:2-5 (L. Riggio). *See also* Tr. 40:10-15 (Burkle); L. Riggio Dep. 159:20-24, 254:15-255:7.

⁹⁴ Tr. 40:21-41:16 (Burkle).

⁹⁵ Tr. 40:21-41:19 (Burkle).

⁹⁶ Defs.’ Post-Trial OB at 10.

⁹⁷ Defendants attempt to justify the independence of six out of nine members of the Board is unavailing. *Compare* Defs.’ Post-Trial OB at 54-57 *with* Pls.’ Post-Trial OB at 42-45. Of course, the fact that they do not bother to claim the Riggios and Zilavy are independent is a concession that the enactment of the Rights Plan was a self-interested transaction.

participated in a conference call with Riggio on either November 13 or 16 during which they discussed whether Riggio could purchase more shares of B&N stock.⁹⁸ Daniels further testified that she was keeping Riggio informed prior to the November 17 Board meeting.⁹⁹

Defendants argue that the Board's adoption of the Rights Plan was an appropriate exercise of directorial discretion under *Unocal* because the "directors are permitted to rely on the opinions of advisors who are chosen with reasonable care."¹⁰⁰ However, Defendants cannot rely here on the opinions of their advisors because their advisors were *not* chosen with reasonable care, and could not give independent advice to the Board. Furthermore, the extent of the advisors' conflicts were not disclosed to the Board.¹⁰¹

Defendants do not bother to defend the selection of Morgan Stanley or Bryan Cave to advise the Board at the November 17 Board meeting.¹⁰² Nor could they, as these advisors did substantial work for Riggio.¹⁰³ Defendants' sole defense in this regard is that the "primary advice" concerning the adoption of the Rights Plan came from Cravath.¹⁰⁴ The

⁹⁸ Tr. 862:10-863:15 (Daniels). *See also* Daniels Dep. 175:3-176:22.

⁹⁹ Tr. 859:4-18, 862:18-863:6, 865:8-19 (Daniels).

¹⁰⁰ Defs.' Post-Trial OB at 51 (citing 8 *Del. C.* § 141(e)).

¹⁰¹ *See* 8 *Del. C.* § 141(e) (advisors must be "selected with reasonable care by or on behalf of the corporation."); *Mills Acq. Co. v. MacMillan, Inc.*, 559 A.2d 1261, 1283 (Del. 1989) (board decisions not entitled to deference under 8 *Del. C.* § 141(e) when board is deceived by those who will gain from the deception).

¹⁰² Defs.' Post-Trial OB at 52.

¹⁰³ Tr. 496:8-10 (L. Riggio) (M. Rosen of Bryan Cave served as L. Riggio's personal attorney); Tr. 824:9-14 (Daniels) (same); Tr. 1016:1-8 (Del Giudice) (Bryan Cave has represented L. Riggio in certain of L. Riggio's business and personal matters and advised Del Giudice in connection with his investments in Rockland and Midland) (same). *See also* Pls.' Post-Trial OB at 52-53.

¹⁰⁴ Defs.' Post-Trial OB at 52.

record, however, reflects that both Morgan Stanley¹⁰⁵ and Bryan Cave¹⁰⁶ consulted extensively with Cravath prior to the November 17 Board meeting, and then directly advised the Board at that meeting about whether or not to adopt the Rights Plan. Thus, two of the three advisors who told the Board whether the Rights Plan should be adopted were conflicted.¹⁰⁷ Furthermore, Cravath itself could not give independent advice regarding a Rights Plan that favors Riggio. Unlike independent legal counsel advising the Company in the past,¹⁰⁸ Cravath previously has performed substantial work for the Company and expects to do so in the future.¹⁰⁹ This lack of independence is further shown by its advice that Riggio could participate in the Board deliberations regarding the Rights Plan, even when advising the Board regarding about whether Riggio posed a “threat.”¹¹⁰

¹⁰⁵ Nov. 17, 2009 Board Minutes (JX 354) at 2, Tr. 832:15-833:1 (Daniels); Daniels Notes of Nov. 17 Board Meeting (JX 356); Tr. 891:13-24 (Barshay) (Morgan Stanley offered input to Cravath prior to the Board meeting regarding the terms of the Rights Plan).

¹⁰⁶ Nov. 17, 2009 Board Minutes (JX 354) at 2; Tr. 832:15-833:1 (Daniels); Tr. 1018:23-1019:2, 1066:24-1067:5 (Del Giudice); Tr. 890:3-891:5 (Barshay) (Cravath meets with Bryan Cave on Nov. 16 to discuss recommending a rights plan); Tr. 892:13-24 (Barshay) (Bryan Cave advised Cravath regarding adding provisions to the Rights Plan); Tr. 777:2-18 (Daniels); Email from J. Daniels to M. Rosen et al., Nov. 16, 2009 (JX 330) (forwarding draft of Rights Plan to Bryan Cave before Nov. 17 Board meeting).

¹⁰⁷ Tr. 833:5-15 (Daniels).

¹⁰⁸ Tr. 835:13-836:17 (Daniels) (hired Gibson Dunn & Crutcher to give “independent advice” regarding settlement of backdating derivative litigation); Tr. 1021:9-1022:7 (Del Giudice) (special committee for College Bookstore transaction hired Davis Polk as “independent counsel,” and did not use Cravath).

¹⁰⁹ Pls.’ Post-Trial OB at 52. *See also In re Tele-Comm’ns, Inc. S’holders Litig.*, 2005 Del. Ch. LEXIS 206, at *41 (Del. Ch. Dec. 21, 2005).

¹¹⁰ Tr. 809:15-810:6 (Daniels); Tr. 837:4-838:6 (Daniels) (Cravath advises Daniels that no conflict of interest prevents entire Board from voting on Rights Plan).

IV. THE RIGHTS PLAN IS INVALID BECAUSE ITS ADOPTION WAS NOT ENTIRELY FAIR

Defendants do not make any meaningful argument that the Rights Plan is entirely fair, either as to process or substance. In their Post-Trial Opening Brief, Defendants repeat the assertion that a transaction subject to *Unocal* is not also subject to “entire fairness” scrutiny even if it is a “self-dealing” transaction. As Plaintiffs explained in their Opening Post-Trial Brief, however, that argument misconstrues the applicable case law.¹¹¹

Defendants assert that accepting Plaintiffs’ argument would mean that “any poison pill case involving grandfathered-in stockholders would have been subject to entire fairness review.”¹¹² That is not correct. There are four elements that distinguish this case from the cases cited by Defendants and limit the application of the entire fairness doctrine. First, the large block is owned by a director and controlling stockholder. That is not often the case. Taxin noted that there are only four other Delaware corporations with rights plans where insiders own over 30%.¹¹³ Second, the provisions of the Rights Plan that provide special benefits to the Riggios are not limited to the grandfathering of their shares. The family transfer provisions also provide benefits to the Riggios, as Excluded Persons, not provided to the public stockholders. Third, the most significant aspect of the Rights Plan is that it freezes others at 20%, thereby preserving the Riggios’ advantage, in anticipation of a proxy contest with the “frozen” party. This is the “arms race” purpose of the Rights Plan.

¹¹¹ Pls.’ Post-Trial OB at 47-51.

¹¹² Defs.’ Post-Trial OB at 59 n.18.

¹¹³ Tr. 315:1-316:3 (Taxin); Taxin Report (JX 764) at Table 15.

V. THE RIGHTS PLAN WAS ADOPTED AND IMPOSED IN BAD FAITH, IS INVALID UNDER *BLASIUS*, AND SHOULD THEREFORE BE ENJOINED

After Plaintiffs explained the significance of the “arms race” purpose of the Rights Plan to the Board’s motivation in their Pre-Trial Answering Brief,¹¹⁴ Defendants appear to abandon it as one of the Board’s motivations. It is nonetheless still there in black and white in Moayery’s notes of the meeting¹¹⁵ and, therefore, Defendants cannot avoid the implications of this improper purpose.

CONCLUSION

For the foregoing reasons, Plaintiffs request the relief set forth in its Post-Trial Opening Brief and the Joint Pretrial Stipulation and Order.

YOUNG CONAWAY STARGATT
& TAYLOR, LLP

/s/ David C. McBride

David C. McBride (#408)
Richard H. Morse (#531)
Melanie K. Sharp (#2501)
Martin S. Lessner (#3109)
Kristen Salvatore DePalma (#4908)
James L. Higgins (#5021)
Emily V. Burton (#5142)
James M. Yoch, Jr. (#5251)
Kathaleen McCormick (#4579)
Megan C. Haney (#5016)
Richard J. Thomas (#5073)
Nicholas J. Rohrer (#5381)
The Brandywine Building
1000 West Street, 17th Floor
P. O. Box 391
Wilmington, DE 19899-0391
(302) 571-6600

Attorneys for Plaintiffs

OF COUNSEL:

Stephen D. Alexander
Beth I.Z. Boland
J. Warren Rissier
Matthew J. Lawson
Karen J. Pazzani
BINGHAM MCCUTCHEN LLP
Suite 4400
355 South Grand Avenue
Los Angeles, CA 90071-3106

Dated: July 19, 2010

¹¹⁴ Defs.’ Pre-Trial AB at 5, 27.

¹¹⁵ Moayery Notes of Nov. 17 Board Meeting (JX 356) at BKS51982.

CERTIFICATE OF SERVICE

I, Emily V. Burton Esquire, hereby certify that on July 22, 2010, a copy of the foregoing document was served on the following counsel in the manner indicated below:

BY LEXISNEXIS FILE & SERVE AND E-MAIL

Peter J. Walsh, Esquire
William E. Green, Esquire
Potter Anderson & Corroon, LLP
Hercules Plaza
1313 North Market Street
Wilmington, DE 19801

Gregory P. Williams, Esquire
Blake Rohrbacher, Esquire
Richards Layton & Finger, P.A.
One Rodney Square
920 North King Street
Wilmington, DE 19801

Kenneth J. Nachbar,, Esquire
Morris Nichols Arsht & Tunnell, LLP
1201 North Market Street
P.O. Box 1347
Wilmington, DE 19899-1347

/s/ Emily V. Burton
Emily V. Burton (No. 5142)