IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

CITY OF WESTLAND POLICE & FIRE RETIREMENT SYSTEM,	)	
Plaintiff,	)	Civil Action No. 4473-VCN
v.	)	
AXCELIS TECHNOLOGIES, INC.,	)	
Defendant.	)	

PLAINTIFF'S PRETRIAL BRIEF

DATED: June 12, 2009

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PRELIMINARY STATEMENT

Plaintiff Westland Police & Fire Retirement System ("Westland P&F" or "Plaintiff") seek to enforce its right to inspect certain corporate books and records of Defendant Axcelis Technologies ("Axcelis" or "the Company" or "Defendant"), a Delaware corporation, under Section 220 of the Delaware General Corporation Law ("Section 220"). Plaintiff seeks inspection of these records for the purposes of investigating whether members of Axcelis' board of directors ("Board" or "Axcelis Board") have breached their fiduciary duties in connection with: (1) the Board's handling of Sumitomo Heavy Industries' ("SHI") acquisition proposals; and (2) the Board's decision to retain rejected candidates, Messrs. Hardis, Fletcher, and Thompson, on the Board.

Plaintiff's Section 220 demand letter satisfies the requirements of Delaware law. First, Plaintiff's letter states a proper purpose – to investigate corporate wrongdoing and mismanagement. And Delaware courts have repeatedly encouraged shareholders to use Section 220 demands as one of the "tools at hand" to investigate corporate wrongdoing and mismanagement. *See, e.g., La. Mun. Police Employees' Ret. Sys. v. Countrywide Fin. Corp.*, 2007 WL 2896540, at *10 (Del. Ch. Oct. 2, 2007) ("The Section 220 inspection is 'an important part of the corporate governance landscape in Delaware' and is now firmly entrenched as one of the 'tools at hand' frequently employed by shareholders to gather information concerning the management of Delaware corporations.") (quoting *Freund v. Lucent Tech.*, 2003 WL 139766, at *4 (Del. Ch. Jan. 9, 2003).

Second, Plaintiff's allegations provide a credible basis from which this Court can infer the Board breached its fiduciary duties to shareholders. As detailed in Plaintiff's Complaint, the Board: (1) rebuffed SHI's attempts at merger negotiations for over 18 months; (2) then rejected two above-market acquisition proposals from SHI as "inadequate;" (3) retained rejected

candidates for the Board after shareholders refused to support them, at least in part, for their failure to negotiate with SHI; and (4) sold one of its most important assets, its stake in SEN Corporation ("SEN"), to SHI. Since full control of SEN was long sought after by SHI, Axcelis' stake in SEN would have been important leverage in any negotiations with SHI. By selling its stake in SEN to SHI, Axcelis' Board members were able to keep their positions on the Board, SHI was able to acquire a key asset it wanted all along, and shareholders were left holding the bag.

Third, the scope of Plaintiff's requests is proper because the requested documents are essential to Plaintiff's investigation. As detailed in Plaintiff's demand letter, Plaintiff only seeks Axcelis documents related to SHI's acquisition proposals and the Board's decision to retain rejected candidates on the Board. Plaintiff's narrowly-tailored requests are allowed – and indeed encouraged – under Delaware law.

Therefore, Plaintiff respectfully requests this Court to compel Defendant to produce the requested books and records.

STATEMENT OF FACTS

Axcelis' and SHI's Joint Venture

Axcelis is a Delaware corporation specializing in the manufacture of ion implantation and semiconductor equipment. (J. Stip. ¶¶ 1, 2.)[1] SHI is a Japanese company that also makes and sells semiconductor equipment. (J. Stip. ¶ 3.) Since 1983, Axcelis and SHI have been equal partners in a joint venture called SEN. (J. Stip. ¶ 4.) SEN, like Axcelis and SHI, manufactures ion implantation and semiconductor equipment. (J. Stip. ¶ 5.)

SEN was, by all accounts, an important asset to both Axcelis and SHI. (J. Stip. ¶ 17) (incorporating by reference Axcelis' March 17, 2008 8-K) (Axcelis' Chairperson and CEO Mary G. Puma called SEN an "important Axcelis asset."). In Axcelis' 2007 Annual Report, Axcelis stated, "Royalties and income from SEN have been a substantial contribution to our earnings, and a substantial decline in SEN's sales and net income, or a failure of SEN to pay royalties to Axcelis, could have a material adverse effect on our net income." (J. Stip. ¶ 8) (incorporating by reference Axcelis' 2007 Annual Report). And according to SHI, SEN "has the largest market share of any ion implantation equipment company in Japan . . ." (J. Stip. ¶ 12) (incorporating by reference SHI's February 11, 2008 letter to Axcelis).

SEN has been remarkably successful, but it has also been a source of conflict for Axcelis and SHI. (J. Stip. ¶ 33) (incorporating by reference Axcelis' September 15, 2008 8-K). For instance, in 2006, Axcelis and SEN entered into arbitration in Japan over royalties from SEN. (J. Stip. ¶ 8) (incorporating by reference Axcelis' 2007 Annual Report). Additionally, Axcelis and SHI disputed the amount of dividends Axcelis should receive from SEN. In a later 8-K, Chairperson and CEO Mary G. Puma described this dispute to some extent when she stated,

[1] Citations to "J. Stip. ¶ ___" refers to the Joint Stipulation of Uncontested Facts.

"Axcelis' share of SEN's cash has been trapped in Japan because SHI has declined to join Axcelis in approving dividends which appropriately reflect the amount by which SEN's cash generation over the last few years has exceeded SEN's cash needs." (J. Stip. ¶ 33) (incorporating by reference Axcelis' September 15, 2008 8-K).

SHI Proposes to Acquire Axcelis

For approximately eighteen months, SHI attempted to discuss with Axcelis' Board a way to combine SHI, Axcelis, and SEN into one company. (J. Stip. ¶ 12) (incorporating by reference SHI's February 11, 2008 letter to Axcelis). But the Board continually rejected SHI's overtures. *Id.* Throughout that period, Axcelis' market share continued to decline. *Id.* And by its own estimation, Axcelis expected market conditions to be increasingly difficult. *Id.* Rather than continue the apparently futile process of attempting to engage the Axcelis Board in substantive merger discussions, SHI along with its financing partner TPG Capital LLP ("TPG"), decided to make its offer public.

Thus, on February 4, 2008, SHI and TPG made an unsolicited offer to acquire fellow semiconductor equipment manufacturer Axcelis for $5.20 per share. (J. Stip. ¶ 9.) SHI's offer represented a significant premium over Axcelis' then $4.18 share price. (J. Stip. ¶ 10.)

Many believed that SHI's proposal to acquire Axcelis was motivated, at least in part, by a desire to end the troubled relationship over SEN. *See, e.g.*, Forbes.com Article "Axcelis Bites Back," dated April 16, 2008, Keeney Decl., Ex. A. And Axcelis' public statements indicated the value of SEN was a major sticking point for it in considering any offers from SHI. For instance, Axcelis Director Stephen R. Hardis stated, "[SHI's] proposal ignores the value SHI would obtain by acquiring full ownership of SEN, a Japanese joint venture Axcelis has with SHI." (J. Stip. ¶ 13) (incorporating by reference Axcelis' February 25, 2008 8-K).

After receiving SHI's offer, Axcelis' Board informed SHI that it would discuss the proposal with its advisors. (J. Stip. ¶ 11.) Although the Board claimed that it "thoroughly review[ed] the proposal," (J. Stip. ¶ 13) (incorporating by reference Axcelis' February 25, 2008 8-K), in fact, SHI informed Axcelis's public investors that the Axcelis Board did *not* actually engage in any discussions with SHI regarding SHI's offer. (J. Stip. ¶ 12) (incorporating by reference SHI's February 11, 2008 letter to Axcelis' Board). Nonetheless, just a few weeks later, Axcelis rejected SHI's offer, claiming it was "inadequate." (J. Stip. ¶ 13) (incorporating by reference Axcelis' February 25, 2008 8-K). The Axcelis Board, however, did not disclose what, if any, valuation analyses it conducted to determine whether SHI's offer fairly valued Axcelis, or make any suggestion as to what price (or range of prices) the Axcelis Board might consider "adequate." (J. Stip. ¶ 13) (incorporating by reference Axcelis' February 25, 2008 8-K).

SHI Revises its Acquisition Proposal

After Axcelis rejected SHI's initial offer, SHI met with Axcelis shareholders representing a substantial majority of Axcelis' outstanding shares for input on a revised acquisition proposal. (J. Stip. ¶ 12) (incorporating by reference SHI's February 11, 2008 letter to Axcelis). On March 10, 2008, based in part on these discussions, SHI revised its offer to acquire Axcelis for $6 per share. (J. Stip. ¶¶ 14, 15.) Again, SHI's offer represented a significant premium over Axcelis' trading price; then $5.45 per share. (J. Stip. ¶ 16.)

Axcelis shareholders supported a combination between Axcelis and SHI. For instance, Sterling Capital Management ("Sterling Capital"), an approximately 12 percent stakeholder in Axcelis sent Axcelis several letters expressing its support for a merger between Axcelis and SHI.[2]

[2] *See* Letter from Brian R. Walton, Managing Director, Sterling Capital Management to Mary Puma, Chairperson and CEO, Axcelis Technologies, Inc., dated February 11, 2008, as reprinted in an EETimes.com article, dated February 11, 2008, Keeney Decl., Ex. B; Letter from Brian R. Walton, Managing Director, Sterling Capital Management to Mary Puma, Chairperson and CEO, Axcelis Technologies, Inc., dated March 28, 2008, Keeney Decl., Ex. C; and Letter from Brian R. Walton,

As Defendant acknowledges in its Answer, even shareholders who quibbled over the price still expressed enthusiasm for a combination between SHI and Axcelis. (Def.'s Answer ¶ 12) ("[T]he best outcome for Axcelis is some combination with Sumitomo Heavy.").

The Board again claimed it would "thoroughly evaluate" SHI's proposal. (J. Stip. ¶ 15) (incorporating by reference Axcelis' March 10, 2008 press release). Although the Axcelis Board once again claimed to have conducted "extensive valuation analyses" in evaluating SHI's revised proposal (J. Stip. ¶ 17) (incorporating by reference Axcelis' March 17, 2008 8-K), only a week after receiving SHI's revised offer, and without any meaningful discussions with SHI, Axcelis' Board rejected SHI's revised offer. *Id.* And again, although the Board claimed SHI's offer "undervalued" Axcelis, the Board never disclosed what methods, if any, it used to determine Axcelis' value; did not disclose what range it considered to be a fair value for Axcelis; and did not provide any specifics *at all* regarding the alleged "valuation analyses" the Axcelis Board considered before summarily rejecting SHI's revised offer. (*Id.*)

Axcelis Shareholders Withhold Support for Axcelis Directors

Approaching Axcelis' 2008 Annual Meeting, shareholders were widely dissatisfied with the Board's responses to SHI's offers. For instance, in a March 28, 2008 letter from Sterling Capital to Axcelis' Board, Sterling Capital said it would likely withhold its support for Axcelis' directors in the upcoming director elections because of its dissatisfaction with the Board's handling of SHI's offers. *See* Keeney Decl., Ex. C. Additionally, Glass Lewis, a proxy advisory firm, advised shareholders to "send a message to the board, expressing their discontent with the company's unresponsiveness to SHI" by withholding support for the Directors at the 2008

Managing Director, Sterling Capital Management to Mary Puma, Chairperson and CEO, Axcelis Technologies, Inc. dated May 2, 2008, Keeney Decl., Ex. D.

Annual Meeting. *See* Reuters Article Quoting Glass Lewis' Recommendations to Axcelis Shareholders, dated April 18, 2008, Keeney Decl., Ex. E.

Axcelis' voting policy requires directors who fail to receive a majority of the stockholder vote to submit their resignations to the Nominating and Corporate Governance Committee ("Committee"). (J. Stip. ¶ 20.) Once it receives a resignation, the Committee is required to consider it and recommend to the Board whether to accept or reject it. (J. Stip. ¶¶ 21, 22.) The Board is then charged with the final determination of whether to accept or reject a director's resignation. (J. Stip. ¶ 23.)

At the 2008 Annual Meeting, held on May 1, 2008, directors Stephen R. Hardis, R. John Fletcher, and H. Brian Thompson were up for reelection to the Board. (J. Stip. ¶ 24.) All three received less than a majority of the shareholder vote. (J. Stip. ¶¶ 25, 26, 27.) All three submitted their resignations to the Committee. (J. Stip. ¶¶ 28, 29, 30.)

Axcelis' Board Thwarts Shareholders' Will

After the shareholder vote, the Board declared it would "act on the [Committee's] recommendation as [the Board] determine[s] appropriate and in the best interests of the shareholders." (J. Stip. ¶ 28) (incorporating by reference Axcelis' May 1, 2008 8-K). But contrary to the clearly expressed will of shareholders, the Board rejected their resignations and retained Messrs. Hardis, Fletcher, and Thompson anyway. (J. Stip. ¶ 31.)

The Board claimed its decision was necessary to "move forward on discussions with SHI…." *Id.* (incorporating by reference Axcelis' May 23, 2008 press release). But shareholders refused to support the rejected directors, at least in part, because of their unwillingness to negotiate with SHI. As Sterling Capital stated in its May 2, 2008 letter to the Axcelis Board, "the failure of [Messrs. Hardis, Fletcher, and Thompson] to receive a majority of the shareholder vote in support of their re-election represents ***a clear message from shareholders of their discontent***

with the failure of the Board to fully engage SHI in negotiations that could ultimately lead to a transaction that fairly values our company." *See* Keeney Decl., Ex. D (emphasis added). Thus, by retaining directors Hardis, Fletcher, and Thompson on the Board specifically to further the Board's strategy of responding to SHI's acquisition proposals, the Board directly thwarted the expressed will of Axcelis shareholders to remove these unresponsive directors from the Board for that very reason.

Finally, Axcelis Purports To Engage In Discussions With SHI, But The Board's Conduct Raises Questions Regarding Its Good Faith

Even taking the Board at its word that it retained the rejected directors for their ability to "move forward on discussions with SHI," their resulting failure to make any progress in those discussions contradicts that assertion.

Shortly after the Board retained Messrs. Hardis, Fletcher, and Thompson, it entered into a confidentiality agreement to discuss SHI's acquisition proposals. (J. Stip. ¶ 32). Sometime in June 2008, representatives from Axcelis and SHI met to discuss SHI's acquisition proposals. (J. Stip. ¶ 33). After that meeting, SHI requested additional information from Axcelis in order to perform due diligence in formulating a revised acquisition proposal. (J. Stip. ¶ 34). Axcelis agreed to provide additional information to SHI on condition that SHI agree to submit a revised acquisition proposal by August 1, 2008. (J. Stip. ¶ 36). But when SHI requested additional time to formulate a revised proposal – a mere seven weeks – Axcelis rejected SHI's request. (J. Stip. ¶¶ 37, 38). Axcelis' refusal to grant SHI's request for additional time for SHI to formulate an offer effectively ended negotiations. (J. Stip. ¶ 41).

On September 15, 2008, Axcelis announced to shareholders that negotiations between itself and SHI were over. *Id* (Incorporating by reference Axcelis' September 15, 2008 8-K).

That same day, Axcelis' stock price dropped 67% from $4.34 to $1.43, wiping out over $300 million in shareholder equity. (J. Stip, ¶ 42).

Westland P&F Requests – and is Denied – Access to Axcelis' Books and Records

On December 9, 2008, Westland P&F sent Axcelis a demand letter requesting for inspection, books and records related to the Board's rejection of SHI's acquisition proposals and the Board's decision to retain Messrs. Hardis, Fletcher, and Thompson. (J. Stip. ¶ 43.) Westland P&F's letter complied with all the requirements of Section 220: (a) it included a power of attorney form authorizing Westland P&F's counsel to make the demand; (b) contained proof of Westland P&F's beneficial ownership of Axcelis; (c) and stated a proper purpose. (J. Stip. ¶¶ 44, 47). Westland P&F's stated purpose was – and still is – to investigate whether the Board breached its fiduciary duties to the Company and its shareholders in connection with SHI's acquisition proposals, and by refusing to accept the resignations of Messrs. Hardis, Fletcher, and Thompson. (J. Stip. ¶ 43).

Axcelis flatly refused Westland P&F's lawful request. (J. Stip. ¶ 48). In its December 12, 2008 letter, Axcelis claimed that Westland P&F failed to "satisfy the standard set forth in Section 220 and Delaware's jurisprudence interpreting Section 220." *Id* (incorporating by reference Axcelis' September 15, 2008 8-K). Axcelis' letter did not say why Westland P&F's demand apparently did not satisfy the requirements of Delaware law – only that it did not. *Id.*

Axcelis Sells SEN to SHI

Only months after denying SHI's request for several additional weeks to formulate an acquisition proposal for Axcelis, the Board chose instead to sell SEN to SHI outright. (J. Stip. ¶ 50). Instead of spending over $615 million to purchase Axcelis, SHI was able to buy SEN for just $132 million. *Id.* And SEN provided, by Axcelis' admission, a "substantial contribution" to

Axcelis' earnings. (J. Stip. ¶ 8) (incorporating by reference Axcelis' 2007 Annual Report). But by selling SEN, the Board retained control of Axcelis and SHI got something it wanted all along: sole control over SEN. (J. Stip. ¶ 19) (incorporating by reference SHI's April 16, 2008 press release discussing its efforts to acquire Axcelis) ("SEN is not for sale."). By contrast, the Board's actions deprived shareholders of the opportunity to consider a premium offer from SHI. SHI previously offered $6.00 per share, which Axcelis' Board said "undervalue[d]" Axcelis. (J. Stip. ¶¶ 15, 17). But Axcelis' stock now trades at around $.0.50 per share. (J. Stip. ¶ 56). Thus, Axcelis' rejection of SHI's $6.00 per share offer cost shareholders over $550 million in shareholder equity. (J. Stip. ¶ 17) (incorporating by reference Axcelis' March 17, 2008 8-K announcing Axcelis' rejection of SHI's $6.00 per share offer). And the sale of SEN drained the already struggling Axcelis of one of its most significant assets.

ARGUMENT

I. PLAINTIFF'S DEMAND LETTER STATED A "PROPER PURPOSE."

Under Delaware law, a stockholder is entitled to inspect corporate books and records where the stockholder: (1) shows a proper purpose; and (2) complies with the procedural requirements of Section 220. *Security First Corp. v. U.S. Die Casting and Dev. Co.*, 687 A.2d 563, 568 (Del. 1997). Defendant here does not dispute that Plaintiff complied with Section 220's procedural requirements. Instead, Defendant claims Plaintiff failed to state a proper purpose. (Def.'s Answer ¶ 30.) But Defendant is wrong.

"A purpose is 'proper' if it is 'reasonably related to [the stockholder's] interest as a stockholder.'" S*ahagen Satellite Tech. Group, LLC v. Ellipso, Inc.*, 791 A.2d 794, 796 (Del. Ch. 2000) (quoting 8 *Del. C.* § 220(b)). Investigations into breaches of fiduciary duties, mismanagement, and wrongdoing are "well established" proper purposes. *See Seinfeld v. Verizon Commc'ns, Inc.*, 909 A.2d 117, 121 (Del. 2006) ("It is well established that a stockholder's desire to investigate wrongdoing or mismanagement is a 'proper purpose.'"); *Sutherland v. Dardanelle Timber Co.*, 2006 WL 1451531, at *8 (Del. Ch. May 16, 2006) ("The investigation of possible breaches of fiduciary duty is such a proper purpose.").

Plaintiff's demand letter expressly stated such a proper purpose. Specifically, Plaintiff requested from Defendant books and records to further Plaintiff's investigation into possible breaches of fiduciary duties in connection with SHI's acquisition proposals, and the Board's decision to retain Messrs. Hardis, Fletcher, and Thompson. Still, Defendant refused Plaintiff's demand. Since Plaintiff's demand letter stated a proper purpose, Defendant's refusal on that basis is wrong.

A. There Is A "Credible Basis" From Which The Court Can Infer That The Axcelis Board Breached Its Fiduciary Duties To Shareholders.

Admittedly, Plaintiff has the burden of showing its purpose is proper. As the Delaware Supreme Court said in *Security First*, "In a Section 220 action, a stockholder has the burden of proof to demonstrate a proper purpose . . ." 687 A.2d at 568; *Thomas & Betts Corp. v. Leviton Mfg. Co., Inc.*, 681 A.2d 1026, 1030 (Del. 1996). "In order to meet that burden of proof, a stockholder must present some credible basis from which the court can infer that waste or mismanagement *may* have occurred." *Thomas & Betts*, 681 A.2d at 1031 (citing *Skouras v. Admiralty Enters.*, 386 A.2d 674, 678 (Del. Ch. 1978)) (emphasis added). And as the Delaware Supreme Court said in *Seinfeld*, "In Delaware and elsewhere, the 'credible-basis-from-some-evidence' standard is settled law." 909 A.2d at 123-24. But a stockholder is not required to prove wrongdoing *did* occur. In fact, a sufficient showing in a Section 220 proceeding "may ultimately fall well short of demonstrating that anything wrong occurred." *Khanna v. Covad Commc'ns Group, Inc.*, 2004 WL 187274, at *6 n.25 (Del. Ch. Jan. 23, 2004); *see also Security First*, 687 A.2d at 567 ("The actual wrongdoing itself need not be proved in a Section 220 proceeding . . .").

A stockholder may establish a credible basis "through documents, logic, testimony or otherwise." *Security First*, 687 A.2d at 568. This Court has even considered allegations in a stockholder's complaint sufficient to meet the credible-basis threshold. *Deephaven Risk Arb. Trading Ltd. v. UnitedGlobalCom, Inc.*, 2004 WL 1945546, at *8 (Del. Ch. Aug. 30, 2004).

Plaintiff meets this credible-basis threshold for two reasons: (1) Plaintiff's allegations regarding the Board's retention of rejected directors; and (2) Plaintiff's allegations regarding the Board's defensive actions, including the sale of SEN, in the context of SHI's acquisition attempts, establish credible bases from which this Court can infer the Board breached its duty of loyalty to its shareholders.

1. The Axcelis Board's Retention Of Rejected Directors Establishes A "Credible Basis" From Which This Court Can Infer The Board Breached Its Duty of Loyalty

Plaintiff's allegations regarding Axcelis' retention of Messrs. Hardis, Fletcher, and Thompson creates a credible basis from which this Court can infer the Board breached its duty of loyalty. As Plaintiff alleges in its Complaint, Axcelis retained these rejected directors for the principal purpose of entrenching those directors in office. (Compl. ¶ 23.) And the facts overwhelmingly support Plaintiff's contention. For instance, the Board claims it retained Messrs. Hardis, Fletcher, and Thompson because they were essential to "mov[ing] forward" in negotiations with SHI. *See* Press Release, Axcelis, *Axcelis Board Determines Not to Accept Resignations of the Three Directors Elected At Company's Annual Meeting of Stockholders* (May 23, 2008) (incorporated by reference in Plaintiff's Complaint). But this contention fails even the laugh test. SHI attempted for nearly two years to negotiate with Axcelis' Board, and as SHI made clear in its public statements, it was "repeatedly rebuffed." *See* (J. Stip. ¶ 12) (incorporating by reference SHI's February 11, 2008 letter to Axcelis' Board, as reprinted in February 13, 2008 EETimes.com article). It is implausible that the same directors who "repeatedly rebuffed" SHI were also essential to "moving forward" any negotiations with SHI. Instead, the facts as alleged, create the inference that the Board acted primarily out of a desire to entrench itself. (Compl. ¶¶ 21-26.) Under Delaware law, this is not allowed. *See Unocal Corp. v. Mesa Petroleum*, 493 A.2d 946, 955 (Del. 1985) ("directors may not have acted solely or primarily out of a desire to perpetuate themselves in office.").

Moreover, a board may not act to entrench itself at the expense of the shareholder franchise. As this Court said in *Apple Computer v. Exponential Technology*, "the shareholder franchise is a cornerstone of corporate democracy and cannot be subjugated to the board's desire to entrench itself." 1999 WL 39547, at *4 (Del. Ch. Jan. 21, 1999). Thus, where a board acts for

the primary purpose of interfering with the effectiveness of the shareholder vote, the board must demonstrate a "compelling justification" for that action. *Blasius Indus., Inc. v. Atlas Corp.*, 564 A.2d 651, 661 (Del. Ch. 1988). As the "shareholder franchise is the ideological underpinning upon which the legitimacy of directorial power exists," the *Blasius* court held that when a board acts for the primary purpose of interfering with the shareholder franchise, "the board bears the heavy burden of demonstrating a compelling justification for such action." *Id.* at 659, 661.

The Axcelis Board cannot provide a compelling justification for its actions. The two justifications Axcelis has offered fail to satisfy Blasius' compelling justification standard. These are: (1) that the Board would be shorthanded without the rejected directors; and (2) the rejected directors were "particularly important" for Axcelis to "move forward" on discussions with SHI. (J. Stip. ¶ 31) (incorporating by reference Axcelis' May 23, 2008 press release).

The first justification is not really a justification at all. Under Delaware law, shareholders – not directors – are vested with the right to choose who serves on the Board. The Board may not, by executive fiat, overrule a lawful shareholder vote simply because it disagrees with the outcome. As this Court said in *Blasius*:

> The only justification that can, in such a situation, be offered for the action taken is that the board knows better than do the shareholders what is in the corporation's best interest. While that premise is no doubt true for any number of matters, it is irrelevant (except insofar as the shareholders wish to be guided by the board's recommendation) when the question is who should comprise the board of directors. The theory of our corporation law confers powers upon directors as the agents of shareholders; it does not create Platonic masters.

564 A.2d at 663; *see also MM Companies v. Liquid Audio, Inc.*, 813 A.2d 1118, 1126 (Del. 2003) ("The stockholders' power is the right to vote on specific matters, in particular, in an election of directors.").

Moreover, it is self-evident that by refusing to support the directors up for reelection that, at least temporarily, vacancies would exist in their place. Certainly, Axcelis' shareholders were

aware of this fact. Indeed, every indication is that the shareholders intended it. After watching Axcelis' performance consistently and dramatically decline, it seems the shareholders concluded the Company would be better off with vacancies than unresponsive and incapable directors. And under Delaware law, that is certainly the shareholders' prerogative. As the Supreme Court of Delaware said in *MM Companies* "if the stockholders are not satisfied with the management or actions of their elected representatives on the board of directors, the power of corporate democracy is available to the stockholders to replace the incumbent directors when they stand for re-election." 813 A.2d at 1127.

Second, the Board's contention that the rejected directors were somehow "particularly important" for "mov[ing] forward" with negotiations that they, in fact, impeded is, as discussed above, completely nonsensical. But even assuming *arguendo* that Axcelis offered that justification in good faith, it is of no moment. As this Court explained in *Blasius*, "Our authorities, as well as sound principles, suggest that the central importance of the franchise to the scheme of corporate governance, requires that, in this setting, [the rule that good faith may validate a board's actions] not be applied . . ." 564 A.2d at 659. Additionally, "even finding the action taken was in good faith, it constituted an unintended violation of the duty of loyalty that the board owed to the shareholders." *Id.* at 663; *see also AC Acquisitions Corp. v. Anderson, Clayton & Co.*, 519 A.2d 103, 115 (Del. Ch. 1986) ("Where director action is not protected by the business judgment rule, mere good faith will not preclude a finding of a breach of the duty of loyalty.").

It is also irrelevant that Axcelis' voting policy contained a loophole allowing the Board to effectively overturn the results of its director elections. Under Delaware law, "inequitable action does not become permissible simply because it is legally possible." *Schnell v. Chris-Craft, Indus., Inc.*, 285 A.2d 437, 439 (Del. 1971). The majority voting policy used by Axcelis is a

relatively new development in corporate governance. As such, Plaintiff is unaware of any case directly addressing this policy, or more pertinently, a board's manipulation of it. Even so, the Delaware Supreme Court's analysis of a board's plan to expand the size of its membership in order to interfere with its shareholders' vote is instructive:

> At issue in this case is not the validity generally of either a bylaw that permits a board of directors to expand the size of its membership or a board's power to appoint successor members to fill board vacancies. In this case, however, the incumbent Board timed its utilization of these otherwise valid powers to expand the size and composition of [its] board for the primary purpose of impeding and interfering with the efforts of the stockholders' power to effectively exercise their voting rights in a contested election for directors. As this Court held more than three decades ago, '***these are inequitable purposes, contrary to established principles of corporate democracy . . . and may not be permitted to stand***.'

MM Companies, 813 A.2d at 1132 (quoting *Schnell*, 285 A.2d at 439) (emphasis added).

In sum, the Board's retention of directors that were expressly rejected by shareholders establishes a credible basis from which this Court can infer Axcelis' Board breached its duty of loyalty. And Axcelis cannot, as *Blasius* requires, provide a compelling justification for its actions.

But even assuming *arguendo* that this Court deems *Blasius* inapplicable, Axcelis' conduct still fails under *Unocal*. *Unocal* is applicable, even where *Blasius* may not be, to corporate actions designed to defeat or which have the effect of impeding a threatened change in control. *Id.* at 954-55. It requires a board to show that its actions in response to a takeover threat were both reasonable and proportionate. *Id.*; *Unitrin, Inc., v. Am. Gen. Corp.*, 651 A.2d 1361, 1373 (Del. 1995).

Reasonableness is shown by "a demonstration that the board of directors had reasonable grounds for believing that a danger to corporate policy and effectiveness existed. . . . " *Unitrin*, 651 A.2d at 1373. A board may satisfy this burden "'by showing good faith and reasonable

investigation. . . . '" *Unocal*, 493 A.2d at 955 (quoting *Cheff v. Mathes*, 199 A.2d 548, 554-55 (Del. 1964)).

Undoubtedly, the Board at least considered SHI's acquisition proposals as a threat to the Board member's positions on the Board. But there is no evidence that SHI's offers represented a threat to Axcelis' corporate policy or effectiveness. In fact, Axcelis shareholders considered a merger to be necessary to Axcelis' long-term success and SHI to be the "most logical" acquirer. (Keeney Decl., Ex. C) (incorporating by reference Sterling Capital's March 28, 2008 letter to Axcelis' Board). But even if this Court concludes that Axcelis' Board satisfies *Unocal*'s reasonableness prong, Axcelis' actions still fail under the proportionality prong. *See Paramount Commc'ns, Inc. v. Time, Inc.*, 571 A.2d 1140, 1154 (Del. 1990) ("[i]t is not until both parts of the *Unocal* inquiry have been satisfied that the business judgment rule attaches to defensive actions of a board of directors.").

To show its actions were proportional, a board must demonstrate: (1) its actions were neither coercive or preclusive; and (2) within the "range of reasonableness." *Unitrin*, 651 A.2d at 1385. Ignoring for the moment whether the Board's actions were coercive or preclusive, they were not within the range of reasonableness. Although there is no comprehensive definition of the "range of reasonableness," the Supreme Court of Delaware set forth three relevant factors for courts to consider: (1) whether the board's action is "a statutorily authorized form of business decision which a board of directors may routinely make in a non-takeover context;" (2) whether the action was "limited and corresponded in degree or magnitude to the degree or magnitude of the threat . . .;" and (3) whether the board "provided immediate liquidity to those shareholders who wanted it." *Id.* at 1389. Factors (1) and (3) are inapposite here, but the Board's conduct plainly violates factor (2).

The Board's deliberate and unlawful interference with the results of director elections impinges on "the cornerstone of corporate democracy" – the shareholder franchise – and therefore cannot be considered "limited" or "correspond[ing] in degree or magnitude to the perceived threat of SHI acquiring Axcelis. The Board overturned the results of a shareholder vote to elect directors. And did so on the flimsy pretense that it was for the purpose of "moving forward" negotiations with SHI. (J. Stip. ¶ 31) (incorporating by reference Axcelis' May 23, 2008 press release). Under Delaware law, this cannot stand. As the Supreme Court of Delaware said in *Giuricich v. Emtrol Corp.*, "[t]he Courts of this State will not allow the wrongful subversion of corporate democracy by manipulation of the corporate machinery or by machinations under the cloak of Delaware law." 449 A.2d 232, 239 (Del. 1982).

Additionally, the Board's overturning of its director elections was also preclusive in that it made it realistically unattainable for SHI to acquire it. *Unitrin*, 651 A.2d at 1388-89 (explaining that a defensive action would be preclusive if it made an acquisition "realistically unattainable"). By retaining directors who repeatedly demonstrated an unwillingness to engage with SHI in good-faith merger negotiations, the Board effectively prevented SHI from acquiring it.

2. The Axcelis Board's Defensive Actions, Including The Sale of SEN, In The Context of SHI's Acquisition Attempts Establish A "Credible Basis" From Which This Court Can Infer The Board Breached Its Duty Of Loyalty

Plaintiff's allegations regarding the Board's defensive actions, including the sale of SEN, in the context of SHI's acquisition attempts also provide a credible basis from which this Court can infer the Board breached its duty of loyalty. Axcelis long maintained that SEN was an "important Axcelis asset." (J. Stip. ¶ 17) (incorporating by reference Axcelis' March 17, 2008 8-K). In fact, Axcelis' Board believed SEN to be so important that it expressly cited the "value of

SEN" as one of its reasons for rejecting SHI's over $630 million acquisition proposal. *Id.* Yet, just months after rejecting that offer, Axcelis sold this most "important Axcelis asset" for the relatively paltry sum of $122 million after fees and expenses. (J. Stip. ¶ 52.) Moreover, unlike a merger, Axcelis' sale of SEN allowed the Board members to keep their jobs. But shareholders were left with a company devoid of one of its most valuable assets and correspondingly, an inability to use that asset as leverage in any future negotiations. (J. Stip. ¶ 17) (incorporating by reference Axcelis' March 17, 2008 8-K).

Axcelis' sale of SEN must also be considered in connection with its handling of SHI's acquisition proposals. The Supreme Court of Delaware held in *Unitrin* that where a target board's actions are closely related, the principles of *Unocal* require such actions to be evaluated collectively. *Unitrin*, 651 A.2d at 1387. Thus, the Board's refusal to negotiate with SHI; its outright rejection of two premium offers from SHI; and its unwillingness to allow SHI sufficient time to formulate an offer must be considered as a unitary response to any threat it may have perceived from SHI.

Accordingly, Axcelis' Board cannot claim the protections of the business judgment rule for these actions. "Because of the omnipresent specter that a board may be acting primarily in its own interests, rather than those of the corporation and its shareholders, there is an enhanced duty which calls for judicial examination at the threshold before the protections of the business judgment rule may be conferred." *Unocal*, 493 A.2d at 954. Instead, the Board must show its defensive actions were reasonable and proportionate responses to SHI's repeated acquisition attempts. *Unocal*, 493 A.2d at 955; *Unitrin*, 651 A.2d at 1373.

Again, there is no evidence SHI's offers posed any threat to Axcelis' corporate policy or effectiveness But even if this Court concludes that the Board satisfies *Unocal*'s reasonableness prong, its actions still fail under the proportionality prong. Proportionality is shown by "a

demonstration that the board of directors' defensive response was reasonable in relation to the threat posed." *Unitrin*, 651 A.2d at 1373. Even assuming *arguendo* SHI's offers represented some kind of threat to Axcelis' corporate policy and effectiveness, the Board's refusal to negotiate with SHI and Axcelis' subsequent distressed sale of SEN cannot be considered proportional. Axcelis' sale of SEN cost the company a major bargaining chip with SHI and deprived shareholders of: (a) a premium offer from SHI; and (b) all future value from SEN. Meanwhile, Axcelis stock trades for around $0.50 per share. (J. Stip. ¶ 56.) Since Axcelis' Board cannot satisfy both prongs of the *Unocal* test, this further heightens the inference that the Board breached its duty of loyalty to its shareholders.

II. THE SCOPE OF WESTLAND P&F'S BOOKS AND RECORDS REQUEST IS PROPER.

The scope of Westland P&F's books and records request was – and is – proper. Plaintiff seeks documents that are essential to its stated purpose. And as this Court indicated in *Grimes v. DSC Commc'ns Corp.*, documents that are essential to a plaintiff's stated purpose must be produced under Section 220. 724 A.2d 561, 567 (Del. Ch. 1998). Since Plaintiff here meets that standard, Defendant must produce the requested documents.

Requests Nos. 1-5

Requests Nos. 1-5 seek minutes and other documents related to SHI's acquisition proposals. Specifically, Requests Nos. 1-5 seek:

1. All minutes of agendas for meetings (including all draft minutes and agendas and exhibits to such minutes and agendas) of the Board at which the Board discussed, considered or was presented with information concerning SHI's acquisition proposals.

2. All documents reviewed, considered, or produced by the Board in connection with SHI's acquisition proposals.

3. Any and all communications between and among Axcelis directors and/or officers and SHI's directors and/or officers.

4. Any and all materials provided by SHI to the Board in connection with SHI's acquisition proposals.

5. Any and all valuation materials used to determine the Company's value in connection with SHI's acquisition proposal.

These materials are essential to determining how, and to what extent, the Board considered SHI's acquisition proposals. Additionally, Requests Nos. 1-5 are appropriately limited to the time period in which Axcelis' Board purportedly considered SHI's acquisition proposals. Since Plaintiff's Requests No. 1-5 are narrowly-tailored and time-limited, Defendant should be required to produce the requested documents. *See Grimes*, 724 A.2d at 567 ("the right to obtain corporate records . . . extends at least to 'reports or minutes reflecting the corporate action.'") (quoting *Grimes v. Donald*, 673 A.2d 1207, 1218 (Del. 1996)).

Requests No. 6-7

Requests Nos. 6-7 five seek minutes and other documents related to the Board's retention of Messrs. Hardis, Fletcher, and Thompson. Specifically, Requests Nos. 6-7 seek:

6. All minutes of agendas for meetings (including all draft minutes and exhibits to such minutes and agendas) of the Board at which the Board discussed, considered or was presented with information concerning or related to the Board's decision not to accept the resignations of Directors Stephen R. Hardis, R. John Fletcher, and H. Brian Thompson.

7. All documents reviewed, considered, or produced by the Board in connection with the Board's decision not to accept the resignations of Directors Stephen R. Hardis, R. John Fletcher, and H. Brian Thompson.

These materials are essential to determining whether the Board complied with its fiduciary duties to the Company and its shareholders in connection with its overturning a shareholder vote on director elections. Additionally, Requests Nos. 6-7 are appropriately limited to the time period in which the Board purportedly evaluated the resignations of Messrs. Hardis, Fletcher, and Thompson. Since Plaintiff's Requests No. 6-7 are narrowly-tailored and time-limited, Defendant should be required to produce the requested documents. *See id.*

CONCLUSION

For the foregoing reasons, Plaintiff respectfully requests that this Court grant its books and records request and Order Defendant to produce for inspection and copying all documents identified in Plaintiff's December 9, 2008 demand letter.

DATED: June 12, 2009

Respectfully submitted,

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