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Case No. 5465-VCS

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

YUCAIPA AMERICAN ALLIANCE FUND II, L.P., a Delaware limited partnership, and YUCAIPA AMERICAN ALLIANCE (PARALLEL) FUND II, L.P., a Delaware limited partnership, Plaintiffs, 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

DEFENDANTS' POST-TRIAL OPENING BRIEF

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PRELIMINARY STATEMENT

After nineteen depositions, three expert reports, two pre-trial briefs and a four-day trial before this Court, Plaintiffs continue to assert that the Board of Directors (the "Board") of Barnes & Noble, Inc. ("Barnes & Noble" or the "Company") violated its obligations under *Unocal* in adopting the Rights Plan, but they have not identified a single factual or legal basis for that claim.

At the inception of this case, Plaintiffs alleged that the Rights Plan was preclusive. They have since abandoned that argument, with their own experts confirming that it is *not* preclusive and concluding that plaintiffs are likely to win a proxy contest. Plaintiffs also previously argued that the definition of Beneficial Ownership in the Rights Plan was so broad that it chilled *all* communications among Company stockholders. Plaintiffs' experts, along with Mr. Burkle, have now admitted that they are free to engage in all communications that would allow them to "take the temperature" of, and receive input from, other Company stockholders before mounting a proxy contest.

Stated simply, Plaintiffs' arguments in this litigation have been, and continue to be, an ever-moving target. That is because Plaintiffs cannot satisfy the standards that apply to the claims they have asserted. The fundamental problem Plaintiffs face is that the Board adopted the Rights Plan in response to a rapid accumulation of shares that had all the hallmarks of an attempt to acquire control without the payment of an adequate control premium. The fact that the accumulation was made by Mr. Burkle, as opposed to any other stockholder, was irrelevant. The trial testimony is clear that the Board's advisors would have recommended the adoption of a poison pill no matter who had engaged in that conduct. Thus, there is no credible argument that the Board was not acting in response to a legitimate threat to corporate policy.

The only question that remains, therefore, is whether the Board's actions fall within the range of reasonableness. Plaintiffs' challenge to the Rights Plan appears to be twofold: (1) that it is outside the range of reasonableness to prohibit Mr. Burkle from purchasing up to 30% of the voting shares; and (2) that the Board acted unreasonably in utilizing a definition of "Beneficial Ownership" that restricted the formation of voting groups aggregating more than 20% of the Company's stock. As set forth below, neither argument has any merit.

First, the Board's decision not to allow Mr. Burkle to acquire 30% or more of the Company's common stock falls within the range of reasonableness. Since the first Board meeting to discuss the Rights Plan in November 2009, there has been a concern about Mr. Burkle acting with others to acquire control of the Company without paying an appropriate control premium. By capping Mr. Burkle's holdings at 20%, the Board has ensured that he cannot form a control block with a single additional investor, such as Aletheia. It is for this reason that pills with triggers above 20% are exceedingly rare, particularly given the well-developed etiquette among activist investors that allows them to cooperate without triggering the obligation to report themselves as groups under the federal securities laws.

Second, the same concerns support the reasonableness of the Board's decision to restrict the formation of large voting groups. Every poison pill since *Moran* has used a similar definition of "Beneficial Ownership" for an obvious reason: The ownership threshold has no meaning if the pill can be circumvented through the simple expedient of group conduct. Yucaipa's desire here is not to form a group with a small stockholder. Instead, by its own admission, it wants to form a group with the Company's third-largest stockholder – Aletheia. It was reasonable for the Board to restrict such conduct, and Yucaipa's stated concerns about being unable to share costs and form joint slates are specious. Yucaipa has invested hundreds of millions of dollars into this Company; it clearly has the wherewithal and the economic incentive to fund a proxy contest and it also has the economic incentive to do so if it believes that a contest would benefit the share price.

The Board has been proactive in addressing Mr. Burkle's concerns, speaking through intermediaries in an effort to ensure productive conversations, amending the Rights Plan where doing so would address concerns raised by Mr. Burkle and arranging for independent directors to meet with Mr. Burkle. As much as Yucaipa may strain to suggest otherwise, this case is not really about Board seats. It is not really about a proxy contest. Yucaipa already believes that it is likely to win that contest because its experts have said so. Instead, this case is about Mr. Burkle's demand that he be entitled to purchase at least 30% of the Company, and then work together with other investors to form a control block, without paying an appropriate premium. That is his demand now, and it has been his unwavering demand since the letter he wrote in December 2009. It is a demand with which the Board cannot comply in an exercise of its fiduciary duties.

STATEMENT OF FACTS

A. Barnes & Noble.

Leonard Riggio went into the bookselling business in 1965 and founded the entity that became Barnes & Noble in partnership with Dutch retailer Vendex in 1971. Tr. 504-05 (Riggio). Mr. Riggio retained an approximate 33% stake in Barnes & Noble when it went public in 1993, and his ownership of the Company has hovered between approximately 20% and 30% since that time. Tr. 508 (Riggio); JX 5. Mr. Riggio has always discussed any intent to buy or sell the Company's stock with the Board before he has taken any such action. Tr. 509-10 (Riggio). Leonard Riggio and his brother Stephen Riggio together hold a total of 28.91% of the Company's voting stock. Tr. 698-99 (Harkins); JX 763 at 5 (Harkins Report); JX 714 at cell I21 ("Summary of Beneficial Ownership" spreadsheet). Including Leonard and Stephen Riggio's shares, Barnes & Noble's directors and officers collectively hold 32.17%. JX 763 at 5 (Harkins Report); Tr. 563-64, 638 (Burch), 698-99 (Harkins); *see also* JX 714 at cell I36.

The Barnes & Noble Board is composed of nine directors, six of whom are independent. Tr. 235 (Higgins), 510 (Riggio); JX 234 at 2-4; JX 748 at 5-10.

B. Burkle and Yucaipa.

The Yucaipa family of investment funds is controlled by Ronald Burkle. Tr. 8 (Burkle) ("[A]t the end of the day, everything ends up being my decision."). Yucaipa manages more than $9 billion in assets (Tr. 109) and typically seeks to exert influence over the management of those companies in which it invests. Tr. 8-10. Plaintiffs in this action are two specific Yucaipa funds that were created to invest through "typically private equity type transactions where we would buy the whole company". Tr. 7-8 (Burkle).

In the past, Yucaipa has been able to obtain a significant degree of effective control without purchasing an outright majority of a company's stock. For example, Yucaipa currently owns 4.6% of the common stock of The Great Atlantic & Pacific Tea Company ("A&P"), and also owns shares of preferred stock that, if converted into common stock, would give Yucaipa aggregate ownership of between 28% and 32% of the company's common stock. Tr. 103-04 (Burkle). With that investment, Yucaipa has "negotiated all kinds of stockholder rights". Tr. 105. Specifically, (1) Yucaipa has placed two designees on the A&P board of directors, (2) A&P needs Yucaipa's approval to enter into any business combinations that exceed $50 million, to issue equity securities subject to certain exceptions or to amend its charter or bylaws, and (3) A&P needs the approval of at least one of the Yucaipa directors to incur debt in an amount more than $50 million, subject to certain exceptions, or to declare dividends. Tr. 104-07 (Burkle); JX 497 at 19. This, as Mr. Burkle conceded, "gives Yucaipa a substantial amount of power with respect to A&P". Tr. 107. Mr. Burkle also conceded that he never made a tender offer for that power, nor did any stockholder receive a premium when he acquired that power. Tr. 107-08 (Burkle).

Yucaipa also invested in Wild Oats Markets, Inc. ("Wild Oats") in early 2005 (DX 54), and as of February 3, 2006, had bought 14.9%, just below the 15% trigger of Wild Oats' then-existing poison pill. DX 71; Tr. 128-29 (Burkle). After Wild Oats agreed to raise its pill trigger to 20% for Yucaipa only, Yucaipa bought more shares, raising its stake to 17.3% of Wild Oats' common stock. Tr. 129-130 (Burkle); DX 85. Less than one year later, Wild Oats was acquired by Whole Foods Markets, Inc. ("Whole Foods"). Tr. 130.

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

In late 2008, Mr. Riggio received a call from Mr. Burkle informing him that Mr. Burkle intended to start purchasing shares in Barnes & Noble. Tr. 469-70 (Riggio). Before that time, Mr. Burkle and Mr. Riggio had known each other through their investments in a company that was formed to acquire the Source Interlink Companies, an investment through which Mr. Riggio, along with the other investors, had lost tens of millions of dollars. Tr. 16-17 (Burkle), 520-24 (Riggio). While Mr. Burkle and Mr. Riggio had always treated each other "professionally and cordially" (Tr. 487 (Riggio)), Mr. Riggio was "completely unhappy with [their] partnership" and "didn't think highly of [Mr. Burkle] as a partner" because of his experience. Tr. 477-78. Mr. Riggio was particularly concerned about the fact that under Mr. Burkle's management, the stockholders of the company got "wiped out". Tr. 522-24.

On January 2, 2009, Yucaipa filed a Form 13D with the Securities and Exchange Commission (the "SEC") disclosing an 8.3% stake in Barnes & Noble. JX 184. Mr. Burkle and Mr. Riggio spoke by phone about Yucaipa's investment on January 5, 2009 (Tr. 20-21 (Burkle)), and the Board was informed about Yucaipa's purchases and the filing of its 13D at the January 6, 2009, Board meeting (JX 191).

In late March 2009, Mr. Riggio and Mr. Burkle met in New York, where Mr. Burkle shared with Mr. Riggio his ideas for the Company. Tr. 20-25 (Burkle), 470

(Riggio). Mr. Burkle mentioned that he had previously met with William Ackman of Pershing Square Capital, the largest stockholder of Borders and a previous large stockholder of Barnes & Noble. Tr. 26-27 (Burkle), 472 (Riggio). As to the details of that discussion regarding Mr. Ackman and Borders, and the extent to which Mr. Burkle pushed for a transaction with Borders, Mr. Riggio and Mr. Burkle's memories differ. *Compare* Tr. 27-29 (Burkle) *with* Tr. 488 (Riggio). Mr. Riggio did not hear from Mr. Burkle again until August 14, 2009, when he received a letter from Mr. Burkle, copying the Board, that expressed Mr. Burkle's unhappiness and dissatisfaction with the Company's announced acquisition of Barnes & Noble College Booksellers. JX 264; Tr. 485-86. The Board discussed this letter at its next regularly scheduled meeting in September 2009. JX 276 at BKS00052048 (9/9/09 Daniels Notes); Tr. 489-90 (Riggio).

D. Yucaipa's November 2009 Acquisitions.

On November 13, 2009, the Company learned of Yucaipa's sudden and rapid doubling of its stake when Yucaipa amended its original 13D late in the day. JX 311. The vast majority of the purchases accounting for Yucaipa's jump from its previously-disclosed level of just over 8% to its then-current level of nearly 17% had taken place over the previous four days. *Id.*; Tr. 116-17 (Burkle), 764-65 (Daniels), 881 (Barshay) ("It was a lot of stock that had been bought in a very short period of time."). In its filing, Yucaipa criticized the Company's management and the adequacy of its corporate governance policies and reserved its rights to pursue, among other things, an extraordinary corporate transaction such as a merger or sale of the Company. JX 311; Tr. 118 (Burkle), 765 (Daniels).

The same evening that it learned of this filing, Barnes & Noble received HSR notifications from two Yucaipa investment entities – only one of which had provided an HSR notification when Yucaipa filed its original Schedule 13D – Yucaipa American Alliance Fund II, L.P. ("YAAF II") and Yucaipa American Alliance (Parallel) Fund II, L.P. ("YAAF Parallel"). JX 321 at BKS00002750-2773; Tr. 766 (Daniels). Each of these notifications disclosed an intent to purchase between $130.3 million and $651.7 million in Company stock. JX 321 at BKS00002770-73. Based on the November 13, 2009, approximate price per share of Barnes & Noble common stock ($20.1163) and the number of shares outstanding as of October 31, 2009 (57,429,478 shares), purchases valued at the top end of this range by either fund alone would have constituted majority control of the Company, and purchases valued at just above the mid-point of the range would have made the funds, together, the Company's majority stockholder. JX 311 at 9; Tr. 766. These HSR notifications caused additional concern within the Company regarding Yucaipa's intent. Tr. 765-66 (Daniels).

E. <u>The Company's General Counsel Engages Outside Legal Advisors.</u>

Upon learning of Yucaipa's sudden and rapid doubling of its stake in the Company, Barnes & Noble's General Counsel at the time, Jennifer Daniels, immediately reached out to Cravath, Swaine & Moore LLP ("Cravath"), and spoke that night with Scott Barshay, a partner in Cravath's corporate department. Tr. 766-67 (Daniels), 879 (Barshay). In discussing potential responses, Mr. Barshay suggested the possibility that he might recommend that the Company put a rights plan in place. Tr. 767-68, 771 (Daniels), 879 (Barshay). Over that weekend, a team of Cravath attorneys worked to analyze the situation and put together a draft stockholder rights plan. Tr. 768 (Daniels), 882-83 (Barshay). Among other things, Mr. Barshay specifically considered what trigger would be appropriate for a proposed poison pill given Mr. Riggio's holdings and concluded that a 20% trigger would be prudent. Tr. 888-89 (Barshay).

The following Monday, Ms. Daniels notified the Board by email of Yucaipa's actions and provided the Board members with Yucaipa's recent Schedule 13D/A and HSR notification letters. JX 321. In that email, Ms. Daniels suggested that the Board convene for a telephonic meeting the following day. *Id.*; Tr. 774-76 (Daniels).

Also on Monday, Ms. Daniels and other members of management met with Mr. Barshay and Cravath attorney George Schoen to discuss the threat posed by Yucaipa, the appropriate features of a potential stockholder rights plan that could be proposed for the Board to adopt, and the logistics of putting a rights plan in place. Tr. 771-72 (Daniels), 890-91 (Barshay); DX 342 at BKS00009519. The meeting attendees discussed the fact that "we don't know what Burkle wants" and that "we have zero leverage" without a rights plan in place, especially if Yucaipa had "fellow travelers". DX 342 at BKS00009520-21. Mr. Barshay also noted that "we have [a] fid[uciary] duty to do what is in [the stockholders'] best interest" and that Yucaipa "could be buying shares now". *Id.* at BKS00009520; Tr. 886-91 (Barshay).

The observation at the meeting that Yucaipa "could be buying shares now" (*Id.* at BKS00003519) was confirmed when Yucaipa filed a Form 4 with the SEC later that day, and a Schedule 13D/A the following day, disclosing the purchase of almost 460,000 additional shares on Monday, November 16. JX 320 (Form 4); JX 399

(Schedule 13D/A).[1] Those additional purchases raised Yucaipa's stake in the Company another percentage point, to 17.8%. JX 399; Tr. 772 (Daniels).

Mr. Riggio was not involved in these early discussions. Tr. 491 (Riggio) ("I don't believe I knew [about the Rights Plan] at all until the day before the board meeting"), 533-34 (Mr. Riggio was unaware that a rights plan would be a permissible corporate action and did not speak to any other Board members before the November 17 meeting), 767 (Daniels) (Ms. Daniels did not speak with Mr. Riggio before calling Cravath), 772 (Mr. Riggio did not attend the November 16 meeting).

F. The Board Adopts the Rights Plan on November 17, 2009.

Before the November 17, 2009 Board meeting, the directors received two "advance packets" containing presentations by Cravath and Morgan Stanley, a proposed rights agreement, a summary of the proposed rights agreement, proposed resolutions and a draft press release that would be issued if the Board elected to adopt a rights plan. JX 350; JX 351; Tr. 778-79 (Daniels), 893-95 (Barshay). Each of the independent directors who testified at trial confirmed that they had sufficient opportunity to review those materials before the Board meeting. Tr. 238 (Higgins), 979 (Del Giudice). Also prior to the meeting, one of the independent directors (and Audit Committee Chair), Patricia Higgins, called Ms. Daniels to confirm that the Board members would be advised by

[1] The Schedule 13D that Yucaipa filed on November 17 also disclosed that Yucaipa had acquired over 160,000 additional shares on Friday, November 13 that were not reported in the Schedule 13D/A that was filed late on that Friday. JX 399 at 8-9.

Cravath of their fiduciary duties with respect to the proposed rights plan, and Ms. Daniels assured her that they would be. Tr. 779-80 (Daniels), 238-39 (Higgins); JX 353.

At the November 17, 2009, meeting, the Board discussed Yucaipa's "recent rapid accumulation of the Company's common stock" that increased Yucaipa's ownership to 16.8% as of Friday, November 13, and to 17.8% as of Monday, November 16. JX 354 at BKS00004278. The Board first discussed potential actions that Yucaipa could take, including "partner[ing] up" or "get[ting] togther with other activists". JX 356 at BKS00051977; JX 355 at BKS00008624; Tr. 241-42 (Higgins). Mr. Riggio pointed out that "we can't predict what [Mr. Burkle] will do", and the Board members discussed a concern that, without paying a control premium for the Company, Yucaipa could exert its influence to try to get the Company to merge with Borders. JX 355 at BKS00008624; Tr. 182-83 (Higgins).

Mr. Barshay discussed with the Board its fiduciary duties with respect to the adoption of any defensive measures under Delaware law. Tr. 896. In addition to the traditional duties of loyalty and care, Mr. Barshay explained the "enhanced duty" applicable when "adopting a takeover defense" under the "Unocal/Unitrin standard". JX 356 at BKS00051977-78; JX 355 at BKS00008625-26; Tr. 785-86 (Daniels), 896 (Barshay). Mr. Barshay advised that under this standard, (1) the Board must have a "reasonable ground" to believe that a "danger [to] corp[orate] policy and effectiveness" existed, and (2) any Board action in response to this danger can be neither coercive nor preclusive and must be reasonable in light of the threat posed. Tr. 245 (Higgins); JX 356 at BKS00051977-78; JX 355 at BKS00008625-26. Mr. Barshay noted that "we [at

Cravath] believe you have" reasonable grounds to conclude that there was a danger to corporate policy and effectiveness because "Burkle can come in [and] control [without] a pr[emium]". JX 355 at BKS00008625-26; Tr. 785-86 (Daniels). Mr. Barshay explained that poison pills are reasonable when adopted in response to the threat of "creeping control". JX 356 at BKS00051978; JX 355 at BKS00008626. Explaining that the Board needed to decide whether to adopt the proposed rights plan, Mr. Barshay stated that the "central responsibility of the [Board was] to protect the [stockholders]", and that Cravath advised in favor of adopting a rights plan. JX 356 at BKS00051979; JX 355 at BKS00008626; *see also* Tr. 245 (Higgins).

Mr. Barshay also advised that a poison pill "buys you time" and provides "flexibility" to react to a perceived threat. JX 356 at BKS00051982; JX 355 at BKS00008628; *see also* Tr. 200 (Higgins) (explaining her understanding that "a rights plan, in essence, stops the continued accumulation of shares but certainly doesn't stop conversation and discussion between the parties"). The Board also discussed the threat that, if it did not adopt a rights plan, Yucaipa and/or Mr. Riggio would accumulate additional shares in an "arms race" that would make the Company look "more and more like a private company w[ith] two big holders". JX 356 at BKS00051982; JX 355 at BKS00008628; Tr. 555 (Riggio), 990-91 (Del Giudice).

Messrs. Barshay and Schoen then took the Board through the specific provisions of the proposed rights plan, and Ms. Molinos discussed Morgan Stanley's presentation on the rights plan and the exercise price. JX 356 at BKS00051983; JX 355 at BKS00008629-30. At the end of the meeting, the Board voted unanimously to adopt the proposed rights plan. JX 356 at BKS00051982; JX 355 at BKS00008630; Tr. 246 (Higgins).

G. Aletheia.

Shortly after the Rights Plan was adopted, Aletheia Research and Management, Inc. ("Aletheia"), began rapidly increasing its own stake in the Company. As of November 17, 2009, Aletheia held 6.37% of the Company's common stock, which it had announced by the filing of a Schedule 13G in early 2009. DX 217. However, on December 22, 2009, Aletheia switched to a Schedule 13D and announced that it had acquired a 10.82% stake in the Company. DX 453. In that filing, Aletheia reserved the "right to act in concert with any other stockholders of the Issuer; or other persons, for a common purpose should it determine to do so, and/or to recommend courses of action to management and the stockholders of the Issuer". *Id.* Aletheia increased its stake to 13.12% by January 11, 2010 (DX 478), to 15.71% by January 28, 2010 (DX 511), and to 17.44% by February 9, 2010 (DX 561). As Aletheia rapidly acquired more shares, Ms. Daniels and others at the Company became concerned that Aletheia might be acting with Mr. Burkle to gain effective control of the Company without paying the stockholders an appropriate premium. Tr. 797-99 (Daniels), 254-57 (Higgins); JX 449.

Mr. Eichler, Aletheia's principal, greatly admires Mr. Burkle. Mr. Eichler stated in his deposition that "obviously, being an investor, when you meet a great well-known investor like [Mr. Burkle], it's very exciting". Eichler Dep. 57:23-25. Describing his first lunch with Mr. Burkle, in August 2009, Mr. Eichler testified: "I can say it was so much fun talking to him that I could have sat there for 10 straight hours nonstop. I mean it – this is like – you know, just very, very stimulating. It's my whole life, so it was very exciting." *Id.* at 60:11-15. Mr. Eichler further testified that Mr. Burkle was "a great investor and a kindred spirit and someone [he] admire[d]" (*id.* at 61:10-13), and even went so far as to compare Mr. Burkle to Warren Buffet. *Id.* at 200:2-11; *see also id.* at 168:4-17 (describing Mr. Burkle as "impressive" and "exactly what we look for in America").

Moreover, Aletheia invested in A&P, Wild Oats and Whole Foods *after* Mr. Burkle acquired significant stakes in those companies, even bragging in its marketing materials that it did not buy Whole Foods stock until after "Ron Burkle (Yucaipa) buys 7% stake". DX 804 at ARMI-BN000110; *see also* JX 763 at 29-30.[2] As Mr. Burkle acknowledged at his deposition, "if somebody is following what you're doing, then they at least have a positive impression of whether you make good decisions or not". Burkle Dep. 56:10-57:10.

Mr. Eichler would be extremely likely to support Yucaipa in a proxy contest, particularly if Mr. Burkle chooses to seek election as a director, having opined that "any board would be fortunate to have Mr. Burkle on their board". Eichler Dep.

[2] Aletheia filed a Schedule 13G disclosing its 6.76% stake in Wild Oats on February 1, 2007 (*see* DX 95 at 4), less than six months after Yucaipa disclosed its 17.3% stake in Wild Oats (*see* DX 85 at 4). With respect to Whole Foods, Aletheia filed its Schedule 13G disclosing its 5.29% stake on February 17, 2009 (*see* DX 218 at 4), barely one month after Yucaipa's January 8, 2009, Schedule 13D disclosure of its 7% position (*see* DX 194 at 4). Aletheia filed its Schedule 13D for A&P on December 22, 2009. *See* DX 454. By that time, Yucaipa had publicly disclosed its investment in A&P, most recently on August 12, 2009. *See* DX 260.

200:8-9. Indeed, Mr. Burkle admitted that in the event of a proxy contest, "I think [Aletheia] will give us a good listen. I believe they think that we are good investors." Burkle Dep. 58:21-23.

During trial, various witnesses expressed confusion about whether and to what extent Aletheia will vote its shares. However, Aletheia's Schedule 13G filing represented that it "possesses investment and/or voting power over the securities" (DX 217 at 6), and Aletheia's 13D and 13F filings all state that it has "sole power to vote" its Barnes & Noble shares. DX 453 at 4; DX 478 at 3; DX 511 at 3; DX 561 at 3; DX 565 at BKS00101483; DX 713 at 3. Mr. Eichler testified that the 13G and 13D statements as to Aletheia's "sole power to vote" were "accurate statements". Eichler Dep. 106:22-108:15; *see also id.* at 109:18-24. Aletheia's Code of Conduct and Regulatory Compliance Manual contains a detailed "Proxy Voting" policy, which sets forth Aletheia's voting philosophy with respect to a wide range of issues, including the election of directors and anti-takeover measures. JX 138 at ARMI-BN000036-37. The promulgation of such a detailed voting policy is inconsistent with a hard-and-fast rule against actually voting in all cases.[3]

[3] Rule 206(4)-6 promulgated by the SEC under the Investment Advisors Act of 1940 only requires that such policies be implemented by entities that "exercise voting authority". 17 C.F.R. § 275.206(4)-6 (2010). The SEC has explained that "[t]he duty of care requires an adviser with voting authority to monitor corporate actions and vote client proxies". Proxies need not be voted in all cases, but "[a]n adviser may not . . . ignore or be negligent in fulfilling the obligation it has assumed to vote client proxies". *Id.* (footnote omitted).

Nevertheless, Mr. Eichler insisted that whatever Aletheia's legal power to vote its shares, as a policy matter, Aletheia chooses not to vote. *See* Eichler Dep. 103:12-24.[4] Instead, Mr. Eichler testified that Aletheia's clients, of which approximately 95% are institutional investors, generally vote the shares themselves or ask Aletheia to vote the shares, in which case Aletheia assigns the voting to ISS/RiskMetrics. *See, e.g.*, *id.* at 133:12-19; 103:24-25; 135:3-6.

Whatever the lack of clarity as to whether Aletheia itself will vote its shares (which the undisputed record establishes it *may* do), it is clear that Aletheia's shares likely *will* be voted in any proxy contest. Mr. Eichler's testimony on this point was unambiguous:

> Q. Because in fact the Barnes & Noble shares held by you may be voted in the future. Correct?
>
> A. They may be voted by their owners. They may be voted by ISS [which Aletheia may request] to do that for us. *They probably will be voted*.

Eichler Dep. 154:22-155:5 (emphasis added); *see also* Tr. 760-61 (same). No testimony or other evidence suggests otherwise. Indeed, it would be odd if Aletheia's institutional

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[4] As Mr. Eichler acknowledged, Aletheia's Proxy Voting policy states that it could change its "general" policy against voting upon notice to its clients. Eichler Dep. 130:10 - 132:12; JX 138 at ARMI-BN000036. Mr. Eichler also testified that Aletheia switched from a 13G filing to a 13D filing in late 2009 because, "in consultation with our attorney", Aletheia was "endeavoring to keep all our options open because the situation in Barnes & Noble was becoming more complex and more moving parts *and perhaps proxy battles* and different things. So we weren't committing at all because we are not active as stockholders to do anything, *but it was our belief that that would give us more flexibility should we need it*." Eichler Dep. 115:5-16 (emphasis added).

clients did not vote, in light of Mr. Eichler's testimony that Aletheia does not vote because its clients want to do so themselves. *See id.* at 141:8-10.[5]

H. Burkle Responds Aggressively to the Rights Plan.

On December 23, 2009, Mr. Burkle sent Mr. Riggio a letter criticizing various decisions made by the Company's management and Directors and claimed that the Company had "declared war" by adopting the poison pill. JX 457. Mr. Burkle also accused the Company of not acting in the best interests of its shareholders. *Id.* On January 6, 2010, Mr. Riggio responded that the "personal attacks" in Mr. Burkle's letter were "unfair and unwarranted". JX 469. In this letter, Mr. Riggio suggested that he or Mr. Burkle approach Ken Moelis, a mutual friend, to serve as an intermediary to sort through their "respective positions". *Id.* Mr. Riggio subsequently spoke with Mr. Moelis, who told Mr. Riggio that the Company would need to "give [Mr. Burkle] some board seats", that "this thing was going to get dirty" and asked "why don't you [Mr. Riggio] buy him [Mr. Burkle] out . . . or if you don't want to do that, let him buy you out." Tr. 538-39 (Riggio). Mr. Riggio explained to Mr. Moelis that neither Mr. Burkle nor Mr. Riggio could buy out the other without the Board making a decision to "put the Company to the market". *Id.*

[5] Even if Aletheia ultimately does not vote its shares as a block in favor of Yucaipa, Mr. Eichler's influence over his clients would not disappear. Tr. 370 (Taxin); Eichler Dep. 71:22-72:10 (describing discussions with clients regarding Barnes & Noble). Those clients obviously trust Mr. Eichler's judgment because they have chosen to invest with him, and presumably would be receptive to his views about a potential Barnes & Noble proxy contest.

I. The Board Meets on February 16, 2009, and Amends the Rights Plan.

On January 28, 2010, Mr. Burkle sent a letter to each member of the Board in which he demanded that the Board permit an exception to the Rights Plan to allow Yucaipa to acquire as large a stake as Mr. Riggio and other Company "insiders" held, which Mr. Burkle inaccurately described as 37%, and purported to seek clarification regarding the definition of "excluded shares" under the definition of "Acquiring Person". JX 513; Tr. 803-04 (Daniels). Shortly after the Board received this letter, Yucaipa increased its stake once again, to more than 18%. JX 520.

On February 16, 2010, the Barnes & Noble Board met to consider Mr. Burkle's letter and his request to raise the 20% trigger for Yucaipa. JX 587; Tr. 804 (Daniels), 909 (Barshay). Before the meeting, the Board had received a set of materials to review, including a proposed first amendment to the Rights Plan and a PowerPoint presentation regarding the proposed amendment. JX 572; Tr. 804 (Daniels). At the meeting, Mr. Barshay reviewed the original analysis the Board had conducted when the Rights Plan was adopted, and discussed "what has changed since then" – specifically, that Yucaipa continued to buy shares, raising its stake to almost 19%, and that another entity, Aletheia, had also increased its ownership to 17.4%. JX 589 at BKS00051834-35; Tr. 806-07 (Daniels), 909-10 (Barshay). While there was no evidence that Yucaipa and Aletheia were "acting in concert", there was "[a]mple evidence" that Aletheia followed Yucaipa, such as the A&P situation. JX 589 at BKS00051835; Tr. 807 (Daniels).

Mr. Barshay reminded the Board of its fiduciary duties regarding defensive measures, and that the Rights Plan could not preclude a stockholder from "being able to successfully run a proxy contest". JX 589 at BKS00051835. Mr. Barshay then explicitly described for the Board the interplay between the 20% trigger in the Rights Plan and the Riggios' holdings. *Id.* at BKS00051836. Mr. Barshay noted the approximate 31% stake held by Mr. Riggio and his brother, which he then compared to the 19% held by Yucaipa and stated that if you "add Aletheia", Yucaipa had "more than what all directors and officers" have. *Id.*; Tr. 807-08 (Daniels). Mr. Barshay then reminded the Board that the pill's 20% trigger is "common" and "reasonable", and noted that "more often than not", pills are triggered at 15%. JX 589 at BKS00051836; Tr. 808. Mr. Barshay concluded that allowing Mr. Burkle to buy "what the Riggios have" is "not the way the Board . . . achieve[s] [its] purposes". JX 589 at BKS00051836. Thus, Mr. Barshay advised that "it was reasonable for the Board to perceive a threat to the Company and that the Stockholder Rights Agreement's 20% threshold is not preclusive and should not be waived as requested by Yucaipa". JX 587 at BKS00004286; *see* Tr. 809 (Daniels), 910 (Barshay). Following a discussion, the Board unanimously voted against raising the trigger for Yucaipa, finding that raising the trigger would not be in the stockholders' best interests. JX 587 at BKS00004286; Tr. 909-10 (Barshay).

Also at the meeting, Mr. Barshay advised the Board that, while Cravath did not agree with the interpretation of the Rights Plan set forth in Mr. Burkle's January 28, 2010, letter, Mr. Barshay recommended that the Board amend the Rights Plan to clarify an arguable technical ambiguity regarding the circumstances under which "Excluded Persons" could acquire additional shares. JX 589 at BKS00051837; JX 587. While Plaintiffs have implied that this "Family Transfer Provision" was included for nefarious purposes, this provision, and its similar iteration in the Company's 1998 rights plan, exists simply for estate planning purposes. However, the amendment adopted on February 16, 2010, was intended to foreclose any interpretation of the Rights Plan that would allow a relative of Mr. Riggio to own more than the "grandfathered" share level. Tr. 911 (Barshay); *see* JX 596.[6]

The Board informed Mr. Burkle of its decision not to allow Yucaipa to purchase additional shares and of the amendment to the definition of "Acquiring Person" in a letter dated February 17, 2010. JX 596.

J. The Independent Directors Meet with Burkle on March 29, 2010.

On February 25, 2010, Mr. Burkle sent another letter criticizing the Board for rejecting his request that Yucaipa be allowed to acquire up to 37% of the Company without triggering the Rights Plan. JX 615. The letter concluded with Mr. Burkle's request to meet with some independent directors. *See id.*

The Board discussed the February 25, 2010, letter at a meeting on March 8, 2010, and agreed that a meeting between Mr. Burkle and some of the independent directors should take place. JX 632. The Board decided that Mr. Del Giudice (as the Lead Director) and Ms. Higgins (as Chair of the Audit Committee) should attend the meeting on behalf of the independent directors. Mr. Del Giudice and Ms. Higgins met

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[6] As Mr. Riggio has testified, "I cannot buy a single share of stock, period. The rights plan caps me. To the question that counsel asked earlier about when I said the rights plan was about me and my family, the rights plan addressed me and my family was the context of that, that we're not allowed to buy stock, period. As far as I'm concerned, there's no ambiguity." Tr. 536-37; *see also* Tr. 226 (Higgins).

with Mr. Burkle in New York City on March 29, 2010. Counsel for both the Company and Yucaipa also attended. Tr. 811 (Daniels). At this meeting, Mr. Burkle questioned the Board's independence from Mr. Riggio and criticized the direction he believed Mr. Riggio was taking the Company. Tr. 811-14 (Daniels), 998 (Del Giudice). Mr. Del Giudice responded first by emphasizing that "the board has always acted independently" and then by outlining the Board's rationale for various decisions. Tr. 998-1000 (Del Giudice). Mr. Burkle made three requests at the meeting, the first of which was a reiteration of his prior demands that Yucaipa be allowed to acquire additional shares without triggering the rights plan. Tr. 812 (Daniels); JX 653; *see also* Tr. 45 (Burkle), 1000 (Del Giudice). Mr. Burkle also stated that he wanted "some corporate governance" – but refused to give specifics. Tr. 812 (Daniels); *see* JX 653 at BKS00050163. Finally, after stating (incorrectly) that the Board had only five, rather than six, independent directors (Tr. 812-13; JX 653 at BKS00050163), Mr. Burkle suggested the Company add three or four additional independent directors of his choosing to the Board. Tr. 45, 47 (Burkle); *see also* JX 653 at BKS00050163; Tr. 812 (Daniels), 261 (Higgins), 998-1000 (Del Giudice). Mr. Del Giudice and Ms. Higgins left the meeting still concerned about Mr. Burkle's intentions. Tr. 261-62 (Higgins) (while Burkle said he was not looking for a fight, they remained "concerned as to what his intent was" due to the letters). Following the meeting, Mr. Burkle and Mr. Del Giudice exchanged phone messages over the next month or so. Rather than respond to Mr. Del Giudice's most recent phone message and without ever speaking with Mr. Del Giudice again, Yucaipa filed this lawsuit on May 5, 2010. Tr. 1000-01 (Del Giudice); *see also* Tr. 262-63 (Higgins), 47-48 (Burkle).

K. Barnes & Noble Amends the Rights Plan on June 23, 2010.

On June 23, 2010, in response to the newly-raised issue by Yucaipa that it believed the Rights Plan's language in subclause (ii) of clause (c) in the definition of Beneficial Ownership prevented it from engaging in any communications with other Barnes & Noble stockholders in advance of a proxy contest, the Board approved a second amendment to the Rights Plan, as recommended by counsel, to remove any possible ambiguity (the "June 23 Amendment"). JX 778. The June 23 Amendment simply deleted clause (c)(ii), making the attribution provisions of the definition of Beneficial Ownership in the Rights Plan entirely consistent with the provisions of rights plans that have been upheld by this Court since 1985 and also consistent with the terms of Section 203 of the Delaware General Corporation Law ("DGCL"). Moreover, Barnes & Noble offered as a binding judicial admission during trial on July 9, 2010, what it had already stated, 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". Tr. 435.

ARGUMENT

I. THE BOARD'S ADOPTION AND AMENDMENT OF THE RIGHTS PLAN WERE APPROPRIATE EXERCISES OF DIRECTORIAL DISCRETION UNDER *UNOCAL*.

Adoption of a defensive measure will be protected by the business judgment rule so long as: 1) the board that adopts the measure in question had "reasonable grounds for believing that a danger to corporate policy and effectiveness existed"; and 2) the "defensive response was reasonable in relation to the threat posed". *Unitrin, Inc. v. Am. Gen. Corp.*, 651 A.2d 1361, 1373 (Del. 1995) (citing and summarizing *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 955 (Del. 1985)); *see also Mercier v. Inter-Tel (Del.), Inc.*, 929 A.2d 786, 810-11 (Del. Ch. 2007) (*Unocal* requires that directors "identify a legitimate corporate objective served by [their] decision" and "show that their actions were reasonable in relation to their legitimate objective, and did not preclude the stockholders from exercising their right to vote or coerce them into voting a particular way"). The evidence at trial has established that the Board's actions with respect to the Rights Plan satisfy the *Unocal* standard.

A. The Board Adopted and Maintained the Rights Plan in Response to a Reasonably Perceived Threat that Yucaipa Might Obtain Effective Control Without Payment of an Adequate Premium.

Plaintiffs stated in their Answering Pre-Trial Brief that whether there was "a need for a Rights Plan … has never been the issue in this litigation" (Pls.' Ans. Pre-Trial Br. at 11) – a substantial departure from the allegations in their complaint that "[t]he poison pill was not adopted in response to any legitimate threat to corporate policy". Compl. ¶ 82. In any event, Defendants have shown that the Rights Plan was adopted in response to the Board's reasonable perception that Yucaipa's rapid accumulation of shares threatened an acquisition of effective control without payment of an adequate premium to Barnes & Noble's stockholders.

As set forth in Defendants' pre-trial briefs, Delaware case law has repeatedly emphasized that the prospect of a creeping acquisition of control justifies adoption of appropriate defensive measures.[7] In emphasizing that Yucaipa never made a tender offer to acquire the Company, Plaintiffs miss the point. Had an offer been presented to the Board, the Board could have considered (and would have been required to consider) that offer and determined whether the price offered was in the best interests of the stockholders. It was the *absence* of any such offer, coupled with Yucaipa's rapid accumulation of shares, that threatened the acquisition of control without payment of an adequate premium. Indeed, even Plaintiffs' expert Gregory Taxin acknowledged at trial that he "might even understand why a pill would be put in place for fear of a creeping tender offer". Tr. 364. That is precisely what Defendants did here.

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[7] *See* Defs.' Op. Pre-Trial Br. at 43-44; Defs.' Ans. Pre-Trial Br. at 11-13; *see also Stahl v. Apple Bancorp, Inc.*, 1990 WL 114222, at *1 (Del. Ch.) (upholding poison pill enacted by board "[m]indful of the threats posed by a creeping acquisition of a control block"); *NACCO Indus., Inc. v. Applica Inc.*, __A.2d __, 2009 WL 4981577, at *26 (Del. Ch.) (describing adoption of poison pill as "an action that [a company] logically would have taken in response to the threat of a creeping takeover"); *Cheff v. Mathes*, 199 A.2d 548, 556 (Del. 1964) (upholding defensive share repurchase where Board perceived "a reasonable threat to the continued existence of [issuer], or at least existence in its present form, by the plan of [plaintiff stockholder] to continue building up his stock holdings"); *La. Mun. Police Employees' Ret. Sys. v. Fertitta*, 2009 WL 2263406, at *7, *8 n.34 (Del. Ch.) (denying motion to dismiss action for breach of fiduciary duty premised upon, among other things, a board's failure to implement a poison pill in the face of an "obvious intention to engage in a creeping takeover").

1. The Board Reasonably Perceived a Threat in November 2009.

When Yucaipa first disclosed that it had purchased approximately 8% of the Company's stock in January 2009, the Board did not react reflexively by implementing a Rights Plan. That is because, as both Ms. Higgins and Mr. Del Giudice testified, the Board did not perceive Yucaipa's investments as a threat. Tr. 236-37 (Higgins); Tr. 976-77 (Del Giudice). When Mr. Burkle subsequently sent a critical letter to Mr. Riggio and the other Board members, the Board once again did not implement a Rights Plan, because there still was not a perceived threat of a creeping acquisition. *See* Tr. 172-73 (Higgins) ("I did not feel [Burkle's August 2009 letter] was inappropriate.").

It was on November 13, 2009, that the threat to the Company's stockholders became apparent. As Yucaipa's public filings disclosed, Yucaipa doubled its position with stock purchases spanning primarily four days, taking its total stake in the Company to nearly 17%. JX 308; JX 320; JX 321. Yucaipa further indicated its intent to acquire additional shares – up to a majority of the Company's stock – in its HSR filings. JX 321 at BKS00002770-73. The uncontroverted trial record establishes that these actions led the Board reasonably to fear an imminent acquisition of effective control without payment of an appropriate premium. The Board also reasonably feared that, to the detriment of the Company's other stockholders, Yucaipa and Mr. Riggio might engage in a share-buying "arms race" in the absence of a rights plan. JX 356 at BKS00051982; JX 355 at BKS00008628; Tr. 555 (Riggio), 990-91 (Del Giudice).

As Ms. Daniels, the Company's General Counsel at the time, testified, she immediately contacted Cravath to discuss possible responses to Mr. Burkle's disclosures.

Tr. 766. During a conversation that evening, Mr. Barshay suggested to Ms. Daniels that one possibility might be the implementation of a poison pill. Tr. 767-68 (Daniels), 878-79 (Barshay). Mr. Barshay had never met Len Riggio at the time of this discussion – and indeed would not meet him for the first time until five minutes before the November 17, 2009, Board meeting. Tr. 534 (Riggio), 916 (Barshay). Following Mr. Barshay's conversation with Ms. Daniels, Cravath immediately began drafting a poison pill that could be presented to the Board as soon as possible. Tr. 882-83. Both Mr. Barshay and Ms. Daniels feared that Yucaipa would continue buying shares in the marketplace to effect an acquisition of effective control. Tr. 775-76 (Daniels), 899 (Barshay). That concern was borne out on Monday, November 16, 2009, when Yucaipa announced the purchase of nearly half a million additional shares. JX 320.

The fear that Yucaipa would acquire control without paying an adequate premium was again articulated by Mr. Barshay during a meeting with the Company's internal lawyers and members of management on Monday. As Ms. Moayery's notes indicate,[8] Mr. Barshay discussed the concerns that "Yucaipa . . . could be buying shares now", that "we don't know what Burkle wants", and that "we have zero leverage" without a rights plan in place. DX 342 at BKS00009519-20; *see* Tr. 884 (Barshay). There also was a discussion at the meeting about the possibility that other investors (and specifically hedge funds) would follow Mr. Burkle. *Id.* at BKS00009520-21.

[8] The parties have stipulated to the admission of Ms. Moayery's notes.

After being presented with detailed explanatory materials before the meeting (*see* JX 368; JX 351), the Board took up the issue of Mr. Burkle's actions and the appropriate response. Ms. Higgins, an independent director and the Chair of the Audit Committee, testified that the Board's adoption of the Rights Plan was based on its concern that "Yucaipa would in fact continue to acquire additional shares and gain control of the company without paying a premium to our share owners". Tr. 244; *see also* Tr. 182-83, 199-201, 239, 243, 250. Similarly, Mr. Del Giudice, an independent director and the Board's Lead Director and Chair of the Compensation Committee, testified that "our purpose was to prevent [Mr. Burkle] or any other person from taking control by acquiring shares without paying a control premium and, since he was doing it, we wanted to stop it". Tr. 980; *see also* Tr. 990, 992. Mr. Riggio testified unequivocally that the Board adopted the pill "because it was very, very concerned with the roll-up of stock of Yucaipa, in the first place, that they can gain control of the company by just continuing to buy shares in the open market, that they could get de facto control of the company". Tr. 535-36.[9] As Mr. Barshay testified, the "board needed certainty and they needed to do something quickly because, without that, there was a risk that Mr. Burkle could have bought control". Tr. 899.

[9] "And there was a lot of talk at the meeting – and it seemed like every one of the board members knew, were fairly astute on this – that you can't allow an environment to exist where the minority shareholders are threatened, that if someone wants to go in and buy control of a company, they have to pay a premium. They can't just take control." Tr. 535-36 (Riggio); *see also* Tr. 793 (Daniels) ("[T]he board adopted the rights plan because they wanted to ensure that no one purchased control of the company without paying a control premium to our stockholders.").

The official minutes of the November 17, 2009, Board meeting and the contemporaneous notes from that meeting are in accord with the undisputed trial testimony. The minutes report that "[t]he Board noted the rapid accumulation of the Company's common stock" by Yucaipa and that Mr. Barshay "generally discussed with the Board how the rights plan was likely to limit the ability of anyone to acquire a controlling position in the Company's stock without Board approval". JX 354 at BKS00004278-79. Ms. Daniels's notes record Mr. Barshay's advice to the Board about the risk of "creeping control". JX 356 at BKS00051977-78; *see also* Tr. 786. Ms. Moayery's notes are in accord. JX 355 at BKS00008625-26 (reflecting Mr. Barshay's counsel that in absence of rights plan "Burkle can come in + control w/o a pr[emium]").

The trial record also establishes that the Board was specifically concerned about the possibility that Mr. Burkle could form a group with other stockholders to acquire control of the Company. As Mr. Riggio explained, "another strong discussion – and we turned out to be prescient – the idea of people assembling groups, that someone could buy up to a certain percentage and then have someone else buy shares". Tr. 536. Mr. Del Giudice also testified that the Board was concerned about the possibility of group conduct. Tr. 992 (noting Board concern "that we had a big investor suddenly acquiring shares, indicating he was going to continue to buy shares, indicating he was going to talk to others about it"). Finally, Ms. Daniels's notes establish that the Board discussed the possibility that "Burkle could partner up" (JX 356 at BKS00051977), which she has explained referred to "a concern expressed that Yucaipa could act with another investor". Tr. 784-85; *see also* Tr. 852-53 ("[W]e were mindful of the idea . . . that Yucaipa could be acting with someone else.").

2. <u>The Board Reasonably Perceived a Continued, and Indeed Increased, Threat in February 2010.</u>

The trial record also establishes that the Board confronted similar concerns on February 16, 2010, when it considered Mr. Burkle's request to amend the Rights Plan to permit Yucaipa to buy up to 37% of the Company. This time, however, the Board's concerns about group conduct were amplified by the additional purchases made by Yucaipa and the rapid accumulation of shares by Aletheia. Although Aletheia had purchased Company stock prior to the adoption of the Rights Plan, its previous holdings had been below 7% and reported on a Schedule 13G. After the Rights Plan was implemented and Mr. Burkle's ability to continue acquiring shares was restricted, Aletheia began making significant purchases that were now disclosed on Schedule 13Ds in which Aletheia reserved the right to, among other things, work with other Company stockholders. DX 453; DX 478; DX 511; DX 561; *see also* DX 803.

The official minutes of the February 16, 2010, Board meeting reflect that Mr. Barshay advised the Board that "Yucaipa had increased its ownership to approximately 18.7% of the Company's common stock and . . . another entity, Aletheia Research and Management, Inc., had increased its ownership to . . . approximately 17.4% of the Company's common stock". JX 587 at BKS00004286. Mr. Barshay then explicitly described for the Board the interplay between the 20% trigger in the Rights Plan and the Riggios' holdings. Mr. Barshay noted the 31% stake held by Mr. Riggio and his brother, and then compared that stake to the 19% held by Yucaipa and stated that, if you "add Aletheia", Yucaipa had "more than what all directors and officers" have. JX 589 at BKS00051835; Tr. 807-08 (Daniels). Mr. Barshay then advised the Board that "in Cravath's opinion, it was reasonable for the Board to perceive a threat to the Company". JX 587 at BKS00004286. Ms. Daniels's notes of the meeting also reflect that, after providing an update about Yucaipa's and Aletheia's holdings, Mr. Barshay advised the Board that there was "ample evidence that Aletheia follows Yucaipa" into investments and, although there was no evidence that Yucaipa and Aletheia were working together with respect to Barnes & Noble, there was "every reason to believe" they might act together. JX 589 at BKS00051834-35; *see also* Tr. 806-08.

As Ms. Higgins testified: "It was decided that we would not provide that ability for Mr. Burkle to acquire additional shares, particularly in light of Aletheia's accumulation." Tr. 257. Similarly, Mr. Del Giudice explained that "[t]here was no change in the rationale to the rights plan. And, in fact, by that time Aletheia . . . had acquired . . . additional shares, another 16 percent or so. . . . And the fact that what we were concerned about, which is sort of creeping control by one or two investors of the company without paying a premium, might, in fact, be playing out." Tr. 993-94.[10]

[10] Mr. Barshay testified that he "described for [the Board] sort of what the state of play was, what had changed since the board had the meeting when it adopted the pill. The main thing that had changed . . . was the emergence of Aletheia as a much larger stockholder. The board talked about it, asked questions, and that's what they talked about on that issue." Tr. 909-10.

B. **<u>The Rights Plan Was Reasonable and Proportionate to the Threat Posed by Yucaipa's (and Subsequently Aletheia's) Rapid Accumulation of Company Stock.</u>**

The Rights Plan was (and is) a proportionate response to the threat posed by Yucaipa's threatened accumulation of effective control because it protects against a non-negotiated, zero-premium acquisition of effective control by one or more large stockholders and because – by design, and in the opinion of all three experts in this case – it preserves Yucaipa's prospects for a successful proxy contest. Moreover, the Rights Plan's language governing the attribution of beneficial ownership and the "grandfathering" of Mr. Riggio are customary and reasonable. Plaintiffs' inability to predict with certainty whether they will actually *win* a proxy contest – in advance of even selecting candidates, formulating a platform, or announcing their unambiguous intent to do so – does not render the Rights Plan unreasonable.

1. <u>The Rights Plan Is Not Preclusive.</u>

Despite alleging in their Complaint that "a successful proxy contest [by Yucaipa] is realistically unattainable" (Compl. ¶ 86), Plaintiffs now insist that "the issue here is not whether the Rights Plan is preclusive". Pls.' Ans. Pre-Trial Br. at 12. This change in position has obviously been compelled by the facts. The overwhelming and undisputed evidence at trial – including the testimony of Plaintiffs' own experts – confirms that the Rights Plan is *not* preclusive. *See Unitrin*, 651 A.2d at 1388-89 (a defensive measure is "preclusive" only if it renders a proxy contest by an outside stockholder "mathematically impossible or realistically unattainable"). Indeed, there is good reason to think that Yucaipa may be more likely than not to succeed in a proxy contest if it assembles a platform and a slate of candidates that conform with the standard recommendations of institutional proxy advisor RiskMetrics. Tr. 720 (Harkins) ("I think they have got better than a 50-50 chance"); Tr. 585-86 (Burch) ("You know, barring unforeseen things, I think, you know, we have a better shot at winning than not; but all those other scenarios can happen.").

Plaintiffs' expert Daniel Burch's testimony concerning preclusiveness was unequivocal.

> Q. You don't believe that Barnes & Noble's rights plan, as now amended, makes a successful proxy contest by Yucaipa a mathematical [im]possibility, do you?
>
> A. No, I don't believe it makes it a mathematical [im]possibility.
>
> Q. You don't believe that Barnes & Noble's rights plan, as now amended, makes a successful proxy contest by Yucaipa realistically unattainable, do you?
>
> A. No, I don't.

Tr. 681-82.[11]

Defendants' expert, Peter Harkins, agrees with Mr. Burch's conclusions on this front:

> Q. Mr. Harkins, in your opinion, is it mathematically possible for Yucaipa to win in a proxy contest for the election of directors to Barnes & Noble's board this fall?
>
> A. Yes, I think it is and I think everyone agrees that it is.

[11] This portion of the trial transcript contains two stenographic errors (using the term "possibility" instead of "impossibility" in two places). Defendants intend to file an appropriate application to have the trial transcript corrected, and are working with Plaintiffs to reach agreement on this and other corrections.

> Q. In your opinion, is it also realistically attainable?
>
> A. Yes, I believe it is realistically attainable and I think I've demonstrated that fact in my report – in the rebuttal report. I think the plaintiffs' experts and I are in agreement with respect to at least two scenarios where they would win.

Tr. 720-21.

The expert testimony concerning the probable outcome of a proxy contest by Yucaipa is even more striking than this congruence in Mr. Harkins' and Mr. Burch's summary opinions would suggest. Mr. Taxin has opined that the recommendation of proxy advisory service RiskMetrics will be critical to the outcome of any contest – and that RiskMetrics is as much as three times more likely to endorse Yucaipa than to endorse a management slate. Tr. 405-06. Messrs. Burch and Harkins agree that RiskMetrics is most likely to support Yucaipa's slate. Tr. 656-58 (Burch); Tr. 711-13 (Harkins) (opining that, based on RiskMetrics' published guidelines, RiskMetrics would likely support a Yucaipa slate). In fact, Mr. Burkle met with representatives of RiskMetrics earlier this year, and testified at trial that he believes RiskMetrics will support his slate. Tr. 133. Mr. Taxin has also enumerated several reasons why institutional stockholders (which by all accounts comprise the overwhelming majority of the unaffiliated vote) are likely to support a dissident slate under the present circumstances. JX 764 at 5-7 (Taxin Report).[12]

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[12] Mr. Taxin has also offered the opinion that, in general, dissident slates win board elections at a somewhat lower rate than management slates. These opinions are as unsurprising as they are irrelevant here. The question here is not whether dissidents in general have a tough time winning elections. It is whether, under current circumstances

Consistent with Mr. Taxin's expectation that RiskMetrics will most likely endorse a dissident slate, Mr. Burch testified that, of the eight scenarios in which he projected the results of a proxy contest, the four scenarios in which RiskMetrics endorses Yucaipa are significantly more likely to occur. Tr. 656-57; *see also* Tr. 711-13. Thus, once the scenarios premised on the unlikely assumption that RiskMetrics endorses the management slate are removed, Mr. Burch's analysis contains the following four scenarios:

SCENARIO SUMMARY	% of Total Votes Cast Voting with Board	% of Total Votes Cast Voting with Yucaipa
Scenario 1 = RMG FOR YUCAIPA WITH ALETHEIA VOTING FOR YUCAIPA	45.98%	54.02%
Scenario 3 = RMG FOR YUCAIPA WITH ALETHEIA VOTING FOR BOARD	63.38%	36.62%
Scenario 5 = RMG FOR YUCAIPA, ALETHEIA DOES NOT VOTE	55.66%	44.34%
Scenario 7 = RMG FOR YUCAIPA, ALETHEIA PASSES THROUGH VOTE	49.49%	50.51%

JX 783 (Burch Rebuttal Report).

Mr. Burch's Scenario 3 assumes that Aletheia's shares will be voted as a block for a Barnes & Noble management slate. While this is theoretically possible, the evidence at trial makes such a scenario exceedingly unlikely. (*See* Statement of Facts Section G, *supra*.) As noted above (and numerous times at trial), Aletheia's CEO, Mr.

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and with the Rights Plan in place, Yucaipa can realistically prevail in a proxy contest to elect directors to the Barnes & Noble Board – to which the answer is emphatically yes.

Eichler, has been candid in his admiration for Mr. Burkle – and very frank in his acknowledgement that he would likely support Mr. Burkle himself as a candidate to sit on almost any board. Eichler Dep. 200:7-9; *see also* Tr. 414-20 (Taxin), 616-17 (Burch). Moreover, Aletheia's pattern of following Yucaipa's investments – and especially the close correlation in time between Aletheia's and Yucaipa's purchases of Barnes & Noble shares – makes it hard to believe that Aletheia would abandon its stated historical practice of passing through its shares in order to unequivocally support a *management* slate, especially in view of the high probability that RiskMetrics will endorse an insurgent's slate. (*See* Statement of Facts Section G, *supra*.)

Mr. Burch's scenario number 5 is equally implausible. Although Mr. Burch stated at trial that he believed it was likely that none of the shares held by Aletheia would be voted at all (Tr. 660-62), Plaintiffs themselves have disclaimed that outcome in their pre-trial briefing. Pls.' Ans. Pre-Trial Br. at 13 ("[A]s Aletheia testified, its policy and practice is that it does not vote and, instead, institutional investors in its fund decide how to vote their own shares, except in the rare circumstance that they request Aletheia do so, in which case it simply contracts with ISS to do the voting."). Mr. Eichler also clearly testified that, putting aside who votes the shares, the Barnes & Noble stock owned and reported by Aletheia "probably will be voted". Eichler Dep. 154:22-155:5.

Removing Scenarios 3 and 5 from Mr. Burch's chart thus yields the two most likely scenarios – each of which predicts a Yucaipa victory:

SCENARIO SUMMARY	% of Total Votes Cast Voting with Board	% of Total Votes Cast Voting with Yucaipa
Scenario 1 = RMG FOR YUCAIPA WITH ALETHEIA VOTING FOR YUCAIPA	45.98%	54.02%
Scenario 7 = RMG FOR YUCAIPA, ALETHEIA PASSES THROUGH VOTE	49.49%	50.51%

According to Mr. Burkle, it is only if he is "likely" to prevail that he "might be willing to pay the whole bill" and go through a proxy contest. *Tr.* 111. While that is telling of Mr. Burkle's true intentions, it is not, of course, the legal standard under *Unocal*. Defendants need not establish that Yucaipa would be more *likely* than not to win a proxy contest (though Mr. Burch's report and trial testimony do indeed appear to establish exactly that). Instead, Defendants need only show that success by Yucaipa is neither "mathematically impossible" nor "realistically unattainable". *Unitrin*, 651 A.2d at 1388-89. Defendants have carried this burden.

2. The 20% Trigger Was (and Is) Within the Range of Reasonableness.

Even after the conclusion of trial in this action, Plaintiffs have failed to identify any factual or legal basis for their claim that the use of a 20% trigger was outside the range of reasonableness. Plaintiffs press this claim even though all experts agree that, even with the 20% trigger, Yucaipa is *more likely than not* to prevail in a proxy contest. In their pre-trial answering brief, the best argument that Plaintiffs could muster was that the 20% trigger was not "necessary", suggesting that a higher trigger would have accomplished the Board's goals. Pls.' Ans. Pre-Trial Br. at 4. But that is not the standard; a "necessary" standard was explicitly rejected by the Supreme Court in *Unitrin*.

As the Supreme Court explained, a defensive measure need not be the product of a "perfect" decision:

> If a board selected one of several reasonable alternatives, a court should not second guess that choice even though it might have decided otherwise or subsequent events may have cast doubt on the board's determination. Thus, courts will not substitute their business judgment for that of the directors, but will determine if the directors' decision was, on balance, within a range of reasonableness.

Unitrin, Inc., 651 A.2d at 1385-86 (citing *Unocal*, 493 A.2d at 955-56). Thus, the only issue with respect to the trigger is whether it was *outside the range of reasonableness* to set the trigger at 20% given the Riggios' existing stake. As set forth below and in Defendants' pre-trial briefs, the answer is no.

First, Plaintiffs' constant refrain that the Riggios control an "Insider Block" of 38% of the Company has no basis in the evidence. Leonard and Stephen Riggio together hold a total of 28.91% of the Company's voting stock. Tr. 698-99 (Harkins); JX 763 at 5 (Harkins report); JX 714 at cell I21 ("Summary of Beneficial Ownership" spreadsheet). Including Leonard and Stephen Riggio's shares, Barnes & Noble's directors and officers collectively hold 32.17%. JX 763 at 5 (Harkins Report); Tr. 563-64, 638 (Burch), 698-99 (Harkins); *see also* JX 714 at cell I36. As explained by both Messrs. Burch and Harkins, higher figures cited by Plaintiffs do *not* reflect an accurate total of the combined holdings of the Company's directors and officers, but rather include shares held by thousands of non-officer Company employees.[13]

[13] None of the experts believes that such shares would be uniformly voted for a management slate. *See* Tr. 699 (Harkins explaining difference between 32.17% figure

The differential between the Riggio's holdings and the 20% trigger is no more significant than the differential that existed in other cases where defensive measures have been upheld by Delaware courts. *See, e.g.*, *Unitrin*, 651 A.2d at 1382-83 (upholding repurchase program anticipated to give directors 28% voting control, in the context of a pill with a 14.99% trigger); *Selectica, Inc. v. Versata Enters., Inc.*, 2010 WL 703062, at *3, *25 (Del. Ch.) (upholding pill with a 4.99% trigger with a grandfathered 14.9% stockholder).

Second, Plaintiffs ignore the fact that *this* poison pill, under the present circumstances, is conceded by all sides to permit Yucaipa to succeed in a proxy contest. (*See* Section I.B.1 *supra*.) Indeed, it appears that Yucaipa has a better than even chance of winning such a contest. Tr. 720 (Harkins) ("In this particular case, I think they have already got a 50-50 chance. I think they have got better than a 50-50 chance."); *see also* Tr. 441 (Taxin) (admitting that in absence of alleged "chilling effect, even if [Yucaipa] didn't buy more shares, they'd have an excellent chance to win"), 585-86 (Burch) (testifying that in the absence of unforeseen events, "we have a better shot of winning than not"). It is true, of course, that it would be easier for Yucaipa to win if, in advance of mounting a proxy contest, it could lock in a greater percentage of the vote by purchasing additional shares in the marketplace. However, it is emphatically *not* the law of Delaware that a defensive measure is unreasonable if it has *any* impact on the

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and 35.24% figure); Tr. 638-39 (Burch admitting that his 35.74% figure includes employee shares); *see also* JX762 (Burch report).

likelihood of a dissident's success in a proxy contest. *See* Defs.' Op. Pre-Trial Br. at 60; *see also Selectica*, 2010 WL 703062, at *21 (Del. Ch.) (noting that in order to be found preclusive, "[i]t is not enough that a defensive measure would make proxy contests more difficult – even considerably more difficult").

Third, Plaintiffs' request ignores a significant aspect of the threat perceived by the Board in adopting and declining to amend the Rights Plan to permit Yucaipa to acquire shares above the 20% threshold: that Yucaipa, in tacit coordination with just one other stockholder, could acquire effective control of the company without payment of any control premium. *See* Statement of Facts Section G, *supra*. A trigger of even five percent greater than the current threshold would permit two stockholders acting in concert (even without an express agreement) to exert control over the Company. As Mr. Barshay explained:

> The reason you have pills almost always at no higher than 20 percent is because . . . what we're concerned about when we advise boards is the concern that you can have two stockholders who each have – if you have a 25 percent pill – you have two stockholders who each have 25 percent. They're not going to – they can't form a group under 13D. As I was just talking about, they absolutely can form a block in some way.
>
> And you can say, okay. Three stockholders can do that [even with a pill trigger set at 20%]. But you're sort of playing the odds. In public companies, you generally – it's more often that you'll get two stockholders [at] those kinds of levels [than] three stockholders at those kinds of levels who are willing to play that game. And so you play the odds.
>
> If we had let Mr. Burkle buy up to 37 percent, or even 30 percent, the fear that he would team up with somebody else – and at that point you're talking about Aletheia was in the mix – I think the fear of that was so great that I think, absent anything else that would change the situation, I think it would have been a giant mistake for the board to have put the company in the

> situation where Mr. Burkle was at 37, or even 30 percent, and Aletheia could buy up a couple more percent to get to 20. That's the answer.

Tr. 956-57.

The uncontroverted trial testimony shows that Mr. Barshay considered this very issue in November 2009, when the Rights Plan was adopted, and that there was discussion among the Board members during the November 17, 2009, meeting about the facts that: (1) the Rights Plan would include a 20% trigger; (2) the Riggios owned approximately 30% of the Company at that time; and (3) there was a fear that Yucaipa might partner with other investors. Tr. 211-12, 245-46 (Higgins), 888-89 (Barshay), 979, 987-89 (Del Giudice); JX 355 at BKS00008627; JX 356 at BKS00051979-80.

The record also demonstrates that the Board discussed this exact threat of collective action at the February meeting when it considered Mr. Burkle's request that the Rights Plan's threshold be increased. Tr. 909-10 (Barshay) (explaining that "the main thing in the world that had changed at that point was the emergence of Aletheia as a much larger stockholder"), 257 (Higgins) (noting Board decision "that we would not provide that ability for Mr. Burkle to acquire additional shares, particularly in light of Aletheia's accumulation"), 993-94, 1001 (Del Giudice) (testifying that he did not believe Yucaipa should have been allowed to purchase 30 percent of Barnes & Noble because "if you were allowed to buy 30 percent and someone else were allowed to buy 30 percent, essentially it's game over as far as control of the company is concerned"), 806-08 (Daniels) (describing discussion of Aletheia purchases and the "[a]mple evidence [that] Aletheia follows Yucaipa"). *See also* Statement of Facts Section G, *supra*. In fact, that was *the* issue in February, *i.e.*, whether, given the Riggios' holdings, the Board should allow Mr. Burkle to purchase more stock than the 20% trigger permitted.

In February 2010, the Board reasonably perceived a threat of possible coordinated action between Yucaipa and Aletheia based on their prior investment parallelism and the facts specific to Barnes & Noble. It was, at the very least, suspicious that Aletheia suddenly increased its ownership *and* switched from a Schedule 13G to a Schedule 13D almost immediately after the Rights Plan restricted Mr. Burkle's ability to buy shares himself. Tr. 254-55 (Higgins), 899-900 (Barshay). Similarly, it appears to be more than a coincidence that Mr. Burkle met with Mr. Eichler less than a month later and, within days of that meeting, Mr. Burkle had his assistant forward an article concerning Borders to Mr. Eichler. Tr. 83-84, 94-95 (Burkle); DX 488.

However, even assuming that Aletheia were not in the mix, the 20% trigger would nonetheless be reasonable here. The key point in November 2009, February 2010 and today is the concern that there is an etiquette that has arisen amongst investors, particularly activist investors, to work in concert without actually triggering poison pills or Rule 13d disclosure obligations. This elaborate system of "nods and winks" is a very real dynamic (Tr. 354 (Taxin)) and was of paramount importance to Mr. Barshay in formulating the advice that he provided to the Board (Tr. 954-57). The formulation of viable and valid defensive measures requires a careful balancing of competing concerns and interests, including the need to thwart a non-premium creeping acquisition while not precluding a proxy contest. A 20% trigger, while not ideal because it still may permit two stockholders effectively to control 40% of the Company, increases the impediments to such a non-premium acquisition of control. Thus, a 20% trigger generally provides that balance and, even with Mr. Riggio grandfathered at approximately 30%, the evidence in the record is undisputed that a 20% trigger does so here. Tr. 441 (Taxin), 585-86 (Burch), 720 (Harkins). A higher trigger, such as the 30% trigger sought by Mr. Burkle, provides far too great a risk that two large investors, working together tacitly, could seize control of the Company. That would fundamentally undermine the purposes of implementing a Rights Plan where, as here, the board is concerned about creeping acquisitions. Thus, in November 2009, Mr. Barshay analyzed Mr. Riggio's stake of approximately 30% under the *Unocal* standard to ensure that a 20% trigger would not be preclusive. Tr. 888-89. Mr. Barshay determined that it would not be preclusive and, as a result, advised the Board to adopt a Rights Plan with a 20% trigger. *Id.*; JX 356 at BKS00051979.

Poison pills today serve a variety of functions. *See, e.g.*, *Selectica*, 2010 WL 703062, at *25 (approving use of poison pill with 5% trigger to protect federal tax assets threatened by transactions by holders of 5% or more of the company's stock). Their classic purpose, however, remains the preservation of the power of a public company's board to negotiate on behalf of all stockholders to extract a control premium from any would-be acquirer. *Moran v. Household Int'l, Inc.*, 490 A.2d 1059, 1078 (Del. Ch.), *aff'd*, 500 A.2d 1346 (Del. 1985); *In re Gaylord Container Corp. S'holders Litig.*, 753 A.2d 462, 478 (Del. Ch. 2000). The Barnes & Noble Rights Plan does exactly this. A pill with a higher threshold would not accomplish the same ends, for the reasons highlighted above.

* * * * *

During trial, the Court raised the possibility of a rights plan with a "dual trigger" that would limit outright ownership to 20% while permitting the formation of voting groups with a collective ownership of greater than 20% but less than 30%, where such voting groups would possibly include only one stockholder larger than a certain level of ownership. Tr. 957-58. The Barnes & Noble Board did not consider this alternative in either November 2009 or February 2010 – indeed, to Defendants' knowledge, a "dual-trigger" rights plan of that sort has not been adopted by other corporations; nor has such a plan been tested in a Delaware court.

Even if a "second trigger" could be set low enough to avoid the threat of a coercive bid for irrevocable proxies, it is not clear that the ability to form binding agreements with a small number of stockholders would provide any meaningful benefit to a large minority stockholder such as Yucaipa. An agreement to share costs of a proxy contest or advance a joint slate of nominees would create a group for purposes of Section 13(d) of the Securities Exchange Act. But Mr. Burkle has already admitted that Yucaipa would *not* take any actions that would result in the formation of a Section 13 group. Tr. 75. Plaintiffs' expert Mr. Burch has also observed that non-activist investors generally take pains to avoid participation in such groups – and that none of the significant stockholders in Barnes & Noble's stock is an activist. Tr. 651-54. Hence, it is unlikely in the present circumstances that Yucaipa would even be interested in making use of a "second trigger" and, if it was, whether any Company stockholders would even be willing to form a group with Yucaipa.

In any event, while the possibility of a "dual trigger" pill raised by the Court is indeed intriguing, Defendants respectfully submit that the existence of another potentially reasonable alternative does not mean it was outside the range of reasonableness for them to have adopted a rights plan with a customary 20% trigger. *See Paramount Commc'ns v. QVC Network, Inc.*, 637 A.2d 34, 45-46 (Del. 1994) (explaining that the Court should ascertain "whether the directors made a reasonable decision, not a perfect decision. If a board selected one of several reasonable alternatives, a Court shall not second guess that choice even though it might have decided otherwise . . . . Thus courts will not substitute their business judgment for that of the directors, but will determine if the directors' decision was, on balance, within a range of reasonableness."). While a "dual trigger" option may well be within the range of reasonableness, so too is the poison pill adopted by the Barnes & Noble Board.

3. <u>The Rights Plan Does Not Unreasonably "Chill" Proxy Conduct.</u>

Plaintiffs have invested a great deal of energy – in discovery, pre-trial briefing and at trial – in the theory that the Rights Plan represents an unreasonable response to the threat of a creeping acquisition of effective control by Yucaipa by virtue of a "chilling" or "*in terrorem*" effect upon potential Yucaipa allies. This theory is wrong for two closely related reasons.

First, as set forth in Defendants' Opening and Answering Pre-Trial Briefs, the definition of Beneficial Ownership set forth in the Rights Plan, as amended, is identical to that found in nearly every poison pill since the pill's invention – as well as to the language relating to group formation in Section 203 of the DGCL and Rules 13d-3 and 13d-5 promulgated by the SEC under the Securities Exchange Act of 1934.[14] Defs.' Op. Pre-Trial Br. at 54-55; Defs.' Ans. Pre-Trial Br. at 5-11; *see also* DX 1 at Ex. 1, pp. 2-3 (Household Bank Rights Plan); DX 2 at Ex. 2, p. 3 (Apple Bancorp Rights Plan); DX 39 at 2-3 (Hilton Hotels Rights Plan). Plaintiffs' experts have admitted as much. Tr. 426 (Taxin) (admitting that the Rights Plan's definition of beneficial ownership "appears in hundreds of other rights plans"), 648-49 (Burch) (admitting that Rights Plan's beneficial ownership definition is "not unusual in any way").

Neither the customary definition of Beneficial Ownership in other rights plans nor the similar definition of Owner in Section 203 preclude stockholders from soliciting proxies in a public proxy contest or from engaging in the ordinary types of communications needed to carry out a proxy contest (Tr. 428-29 (Taxin)), nor has that language been construed by a court to do so. The Barnes & Noble Rights Plan should be construed no differently, as Defendants have repeatedly assured Yucaipa – most recently in a binding judicial admission in open court on Friday, July 9. JX 780; Tr. 434-45 (open court admission enunciated by Kenneth Nachbar). Plaintiffs' expert Mr. Taxin has concluded that this admission would resolve "all the problems" relating to "the ambiguity of the definition" of beneficial ownership. Tr. 434-35.

Second, as illustrated by the trial testimony, there is a well-understood "etiquette" by which experienced institutional investors communicate about the subject

[14] Indeed, as Plaintiffs point out in their Answering Pre-Trial Brief, the group formation rules under Section 13 are in some respects actually *broader* than those contained in the Rights Plan. Pls.' Ans. Pre-Trial Br. at 25-26.

matter of actual and potential stockholder votes while avoiding the mutual attribution of beneficial ownership for purposes of the federal disclosure regime under Section 13 of the Securities Exchange Act. Tr. 334 (Taxin) ("Section 13D is very well understood by institutional investors"), 335 ("[I]nstitutional investors do worry about 13D. They don't like, you know, the prospect of being potentially liable for someone else's stake and for disclosure obligations."), 630 (Burch) (admitting that institutional investors would understand that any agreement between them in the context of proxy contest discussions would be implicitly "footnoted" by the understanding that such agreement was unenforceable).

In fact, Yucaipa's actual conduct since the Rights Plan was adopted fundamentally undermines its "chilling" argument. For example, Mr. Burkle has admitted that – notwithstanding the Rights Plan's existence – he met with Aletheia's Mr. Eichler and discussed their respective investments in Barnes & Noble on January 8, 2010. Tr. 83-84. To be sure, Mr. Burkle's testimony concerning the level of detail in that conversation differs considerably from Mr. Eichler's, but it is evident that the Rights Plan did not prevent them from meeting and talking about Barnes & Noble. *See* Tr. 87-91 (Burkle) (insisting that Mr. Burkle and Mr. Eichler have merely "different recollections" of their two meetings at the Beverly Hills Hotel). Mr. Burkle also conceded that he has received many calls from other Company stockholders to discuss the Company. *See* Tr. 61 (claiming Yucaipa has not returned any phone calls since the pill was enacted).

Similarly, Yucaipa's contention that the pill exerts an "*in terrorem*" effect on stockholders is simply not credible in view of Mr. Burkle's obviously relaxed reaction to the report (conveyed to him by banker and sometime intermediary Ken Moelis) that Mr. Riggio believed he and Aletheia had formed a beneficial ownership group:

> Q. So you laughed when you learned that Mr. Riggio was telling a banker, "Look, I believe Aletheia and Yucaipa have an agreement and I'm upset about it, I think they should be sued"? You thought that was funny?
>
> A. I thought it was funny that Len thought we had an agreement.

Tr. 98. Mr. Burkle did sprinkle his trial testimony with assertions of concern that the Company might spring the Rights Plan's trigger on him in response to some innocuous discussion. However, these self-serving assertions are inconsistent with his candid admission of humor at the report of Mr. Riggio's belief that Yucaipa and Aletheia had formed a group and his admission that he is free to "call any other stockholder just like Aletheia and discuss Barnes & Noble without fear of triggering the pill". Tr. 77. They are also inconsistent with Mr. Burkle's trial testimony that he is "not afraid" of the Company taking the position that Yucaipa has reached an agreement, arrangement or understanding with another stockholder as long as he knows there is no truth to the allegation. Tr. 99. Taken together, this testimony establishes that Mr. Burkle knows he is fully capable of seeking and receiving input from other stockholders without reaching agreements, and the claim of an *in terrorem* effect is illusory.

Third, it is well-established under Delaware law that it is within the range of reasonableness for a poison pill to restrict the formation of joint slates or the sharing of expenses. Defs.' Op. Pre-Trial Br. at 56-57; *Moran*, 490 A.2d at 1080; *Stahl*, 1990 WL 114222, at *2, *4. The Delaware courts have struck an important balance between allowing free communications between stockholders before and during proxy contests and restricting group conduct, such as the formation of voting agreements like joint slates, that can materially undermine the protections afforded by a poison pill. The Rights Plan adopted by the Barnes & Noble Board strikes that same balance.

4. Plaintiffs Are Not Entitled To Predict, With Certainty, the Outcome of a Proxy Contest.

In their briefing and through Mr. Burkle's testimony at trial, Plaintiffs complain that the outcome of a proxy contest remains uncertain. Pls.' Op. Pre-Trial Br. at 48-49; Pls.' Ans. Pre-Trial Br. at 22-23; Tr. 56-57, 110. Similarly, Mr. Burch points out that the victories he predicts for Yucaipa in the two likeliest scenarios he has analyzed have relatively narrow margins. JX 783 (Burch Rebuttal Report); Tr. 568-69 (testifying that in his corrected Rebuttal Report, Yucaipa was projected to win Scenarios 1 and 7 "by a small margin").

Defendants concede that the outcome of a proxy contest mounted by Yucaipa remains uncertain. This is especially so given that Yucaipa has yet to articulate a platform or slate for such a contest. Tr. 111-12 (Burkle) (testifying that he had not even reviewed a list of candidates for a prospective slate). In fact, despite their prior representations to this Court, Plaintiffs refuse to say definitively whether they in fact intend to mount such a contest. Pls.' Ans. Pre-Trial Br. at 22-23; *see also* Tr. 110-12 (Burkle) (enumerating reasons why Yucaipa might be unwilling to run a contest).

However, uncertainty about the outcome of a proxy contest is not grounds to find a poison pill unreasonable. In fact, the hallmark of a defensive measure that is *not* preclusive is when the "[t]he key variable in a proxy contest would be the merit of [a dissident stockholder's] issues, not the size of its stockholdings". *Unitrin,* 651 A.2d 1361, 1383 (citing *Moran*, 500 A.2d at 1355); *see also* JX 763 at 5 (Harkins Report) (noting that, "as is usually the case, much would depend on the platform of Yucaipa's nominees versus the platform of the Board's nominees"). Here, as always, the determination whether or not to commence a proxy contest is a cost-benefit analysis in which the contributing factors are the cost of a contest, the prospects for success, and the financial upside expected by the putative insurgent. Tr. 681-82 (Burch); 719-20 (Harkins). The Rights Plan is not outside the range of reasonableness simply because Yucaipa must engage in the same cost-benefit analysis that attends upon every decision – with respect to any company – to put forward a dissident slate. Mr. Burkle has already invested hundreds of millions of dollars in his Barnes & Noble investments (and likely many millions more in this litigation). Although an argument could perhaps be made to permit small stockholders to form alliances in advance of a proxy contest where those stockholders acting alone would not have the economic incentive to mount a proxy challenge, no such argument can credibly be advanced here.

More importantly, any lack of certainty as to the outcome of a potential proxy contest has nothing to do with the Rights Plan. As Mr. Burkle testified, and as Defendants have represented multiple times, Mr. Burkle can communicate fully and freely with Company stockholders regarding any potential proxy contest. In fact, he is no more limited here than any investor ever is pursuant to Section 13(d) or Section 203 of the DGCL.

5. <u>The Rights Plan Does Not Accord Special Treatment to the Riggios.</u>

Plaintiffs also distort or misapprehend certain details of the Rights Plan in an effort to suggest special treatment for Mr. Riggio and his family.

First, Plaintiffs note that an "Excluded Person" – *i.e.*, a person whose shareholdings are frozen by the grandfather clause – may acquire additional shares "with Board approval". Pls.' Op. Pre-Trial Br. at 46, 53-54. This is true. However, as noted in Defendants' pre-trial briefing, Section 26 of the Rights Plan permits the Board to approve additional purchases by *any* stockholder by amending the Rights Plan. Pls.' Ans. Pre-Trial Br. at 18-19. The purported distinction between "approval" and "amendment" is one without a difference, in view of the fact that either action would require a majority vote of the Board, and either could be taken at any time so long as it is consistent with the directors' fiduciary duties. Tr. 212-13 (Higgins).

Second, Plaintiffs continue to suggest that the "family transfer" provision in the Rights Plan implies preferential treatment for Mr. Riggio. This is wrong. The family transfer language in the definition of Acquiring Person was designed merely to facilitate estate planning by allowing an Excluded Person to transfer shares to an immediate family member (or a trust for that person's benefit) without triggering the Rights Plan. This would never have allowed a beneficial ownership group including Mr. Riggio to hold more shares than it held when the Rights Plan was adopted. Tr. 943-47 (Barshay). Moreover, as amended in February 2010, any single person who receives shares from an Excluded Person under the family transfer provisions must immediately sell his or her holdings down to – at most – the same level that the transferor (presumably Mr. Riggio) held when the Rights Plan was adopted. JX597; *see also* Tr. 910-11 (Barshay).

Third, although the Rights Plan does permit Leonard and Stephen Riggio to receive additional Company shares as a result of the Company's equity compensation programs, Mr. Del Giudice – Chair of the Compensation Committee – testified that any such grants "would be totally against the spirit of the rights plan". Tr. 992-93. Mr. Del Giudice further explained that "it's not my intention, our intention to grant additional shares to either Steve or Len. That's – it would go against the entire purpose of what we're trying to do." Tr. 993.

Put simply, Mr. Riggio is not allowed to buy any more shares, and he knows it. Tr. 536-37 (Riggio) ("I cannot buy a single share of stock, period. The rights plan caps me."). Plaintiffs' efforts to suggest otherwise fail.

C. **<u>The Board Properly Relied Upon the Advice of its Outside Advisors in Adopting and Amending the Rights Plan.</u>**

Under Delaware law, directors are permitted to rely on the opinions of advisors who are chosen with reasonable care. 8 Del. C. § 141(e). There is no argument that the Board could not properly rely on the advice of Cravath: Cravath had no prior relationship with the Riggio family (indeed, Mr. Barshay first met Len Riggio five minutes before the November 17 Board meeting (Tr. 895)), and in fact was chosen by Ms. Daniels because she knew and respected Cravath from her contact with Cravath in her prior position as assistant general counsel at IBM. Tr. 766-67 (Daniels); *see Gaylord*, 752 A.2d at 479 n.57 (rejecting contention that long-time outside counsel to issuer was beholden to issuer's founder and largest shareholder). Plaintiffs will no doubt attack Morgan Stanley and Bryan Cave as having been advisors to Mr. Riggio, but the record is clear, and undisputed, that the primary advice concerning both the decision to adopt the Rights Plan, and as to its structure, came from Cravath. JX 355; JX 356. Moreover, at the critical February 16, 2010, meeting - when the board considered Mr. Burkle's request to increase the rights plan trigger - Cravath was *the* only advisor; neither Morgan Stanley nor Bryan Cave even attended that meeting. JX 587.

D. **The Evidence of Defendants' Conduct in Adopting and Amending the Rights Plan Is Entitled to "Material Enhancement".**

The evidence at trial has shown that all decisions concerning the Rights Plan were carefully reviewed and approved by the Company's fully-informed directors – a majority of whom are independent outside directors, such that the reasonableness of the Board's actions is "materially enhance[d]". *See Unitrin*, 651 A.2d at 1375; *Gaylord*, 753 A.2d at 465, 478 (majority independent "composition of the [company's] board bolster[ed] the reasonableness of its threat analysis"). While material enhancement has universally been applied to the first prong of the *Unocal* test, it is also relevant to the second prong in the sense that the presence of an outside independent majority weighs in favor of a finding that "particular defensive options were selected in good or bad faith". *Chesapeake Corp. v. Shore*, 771 A.2d 293, 330 n.86 (Del. Ch. 2000); *see also Selectica, Inc.*, 2010 WL 703062, at *14. Moreover, Defendants have made "a *prima facie* showing of good faith and reasonable investigation" based on the fact that "the presence of a majority of outside directors [is] coupled with a showing of reliance on advice by legal and financial advisors". *Selectica*, 2010 WL 703062, at *12 (citations omitted).

Six of the nine Board members are "outside directors" who have been certified as independent pursuant to NYSE Corporate Governance Rule 303A.02. JX 234 at 4 (2009 Proxy); Tr. 763 (Daniels); *see also* Defs.' Op. Pre-Trial Br. at Section I.A.2. Plaintiffs continue to rely on conclusory allegations that fail to refute the independence of these directors. *See In re J.P. Morgan Chase & Co. S'holder Litig.*, 906 A.2d 808, 822-23 n.48 (Del. Ch. 2005) (criticizing plaintiffs' reliance on conclusory allegations in light of failure to investigate the decision-making process behind the qualification of the directors as independent under the NYSE Corporate Governance rules), *aff'd*, 906 A.2d 766 (Del. 2006). No evidence was adduced at trial to even suggest that any of these directors were "beholden" to Mr. Riggio or were so "under [Mr. Riggio's] influence that their discretion would be sterilized". *See Selectica*, 2010 WL 703062, at *13 (citations omitted); *see also Gaylord*, 753 A.2d at 465. Nor was there any evidence at trial that any director has received compensation from the Company that was "sufficiently material" to impair that director's independence. *See Selectica*, 2010 WL 703062, at *14; *Gaylord*, 753 A.2d at 465. As demonstrated by the "individualized facts about the specific directors" and the evidence concerning the "circumstances" and "situation at issue", each of these directors is independent in the sense that his or her decisions respecting the Rights Plan were "based on the corporate merits of the subject before the board rather than extraneous considerations or influences". *Selectica*, 2010 WL 703062, at *13 (internal quotation marks and citations omitted); *see also Unitrin*, 651 A.2d at 1375; JX 748; Tr. 510-19 (Riggio).

1. Dr. Campbell

George Campbell Jr. was recommended to serve on the Board by Mr. Del Giudice and joined the Board in 2008. Tr. 517; JX 234 at 4. He is the president of Cooper Union University. Tr. 517. Dr. Campbell and Mr. Riggio have no significant social or professional connections outside of their service on the Board. *Id.* Plaintiffs have not questioned Dr. Campbell's independence.

2. Mr. Del Giudice

Michael J. Del Giudice is a former Lazard banker who now sits on several boards and manages funds that invest in the energy sector. JX 50 at 3. Mr. Del Giudice is the Lead Independent Director and has served on the Board since 1999. He currently is the Chair of the Compensation Committee and a member of the Audit Committee. JX 234 at 4. He has never been employed by the Company. JX 748.

While Plaintiffs claim that Mr. Del Giudice's independence is compromised by his purported "personal relationship, as well as political alliances, with Leonard Riggio" (Pls.' Ans. Pre Trial Br. at 7), Mr. Riggio and Mr. Del Giudice are acquaintances who have simply attended some of the same political and not-for-profit fundraisers. Tr. 515 (Riggio), 1008 (Del Giudice). Moreover, Mr. Del Giudice's independence is not compromised by the fact that Mr. Del Giudice and Mr. Riggio have both served on another board together. *See Langner v. Brown*, 913 F. Supp. 260, 266 (S.D.N.Y. 1996) ("The fact that several director defendants sat on the same boards of directors of other companies does not in itself establish lack of independence.") (applying Delaware law) (citation omitted). Finally, Mr. Riggio's investment in enterprises in which Mr. Del Giudice is involved does not affect Mr. Del Giudice's independence because, as Mr. Del Giudice has testified twice, he has signed agreements stating he does "not participate in any way in any fees or profits associated with monies attributable to Mr. Riggio's portion of that investment". Tr. 972-73 ("I don't get any financial – personal financial benefit out of it. It's simply an investment that each of us has in these projects."); Del Giudice Dep. 39:13-22; *see also* Tr. 449-50 (Riggio); JX 748 at 8.

3. <u>Mr. Dillard</u>

William Dillard, II was a Vendex appointee who brought his retail real estate expertise to the Board, on which he has served since the Company's public offering in 1993. Tr. 510-11 (Riggio). He serves as Chair of the Corporate Governance and Nominating Committee and as a member of the Compensation Committee. JX 234 at 3. He has never been employed by the Company and does not have any personal or professional relationship with Mr. Riggio outside of his service on the Board (other than two golf outings in the past fifteen years). Tr. 511-12 (Riggio); JX 748.

4. <u>Ms. Higgins</u>

Patricia Higgins was recruited to the board of Barnesandnoble.com by a headhunter retained by the CEO of that entity in 1999. She subsequently joined the Barnes & Noble Board in 2006. Tr. 234-35, 513-14; JX 234 at 3. She was formerly the Chief Technology Officer for Alcoa and had served on the boards of several technology companies prior to joining the Barnesandnoble.com board. Tr. 513-14. Ms. Higgins has no other social or professional connections with Mr. Riggio. Tr. 236, 514. Plaintiffs do not attempt to impugn her independence.

5. Ms. Miller

Irene Miller was employed as the Company's CFO from 1993 to 1997 and the Company's Vice Chairman from 1995 to 1997, and she has been sharing her financial expertise with the Board since joining in 1995. JX 234 at 3; JX 748 at 8. Prior to joining the Company, Ms. Miller was a Managing Director at Morgan Stanley. Tr. 514. She currently serves on the Corporate Governance and Nominating Committee. JX 234 at 3. She does not have any significant personal relationship or any professional relationship with Mr. Riggio outside of her service on the Board. Tr. 515; *see also* JX 748 at 8-9. The alleged "longstanding and close relationship" between Ms. Miller and Mr. Riggio that Plaintiffs allege in their Complaint and pre-trial briefing appears to be based entirely on Ms. Miller's previous employment by the Company – no such relationship is suggested by any evidence introduced at trial. *See* Pls.' Ans. Pre-Trial Br. at 10. However, Ms. Miller's former employment by the Company, which ended 13 years ago, has no bearing on her independence. *See, e.g., Gaylord*, 753 A.2d at 465 (none of the disinterested and independent directors "was a member of Gaylord's management at any relevant time"); *Odyssey Partners, L.P. v. Fleming Cos., Inc.*, 735 A.2d 386, 408 (Del. Ch. 1999).[15]

[15] The NYSE Corporate Governance Rules, which have been used by this Court as guidance in this area, state that former employment by a company stops affecting a director's independence "three years after the end of such employment relationship". *See*

6. Ms. Monaco

Margaret Monaco was recommended to the Board by one of the Company's bankers because of her retail financial expertise. Tr. 512. She joined the Board in 1995. *Id.* She is currently a member of the Audit Committee. JX 234 at 4. Ms. Monaco has never been employed by the Company and does not have any personal or professional relationship with Mr. Riggio. Tr. 512; JX 748 at 9.[16]

E. **Defendants' Adoption and Maintenance of the Rights Plan Was A Valid Corporate Action Under the Business Judgment Rule.**

Having satisfied *Unocal*, the Board is entitled to the protection of the business judgment rule, *i.e.*, the presumption that it acted on an informed basis, in good faith and in the honest belief that it was acting in the Company's best interest. *See Unocal*, 493 A.2d at 958; *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984). Plaintiffs have failed to overcome that presumption, because they did not prove that the Board's

NYSE Corp. Gov. R. 303A.02(b)(i); *J.P. Morgan*, 906 A.2d at 823 (citing NYSE Corp. Gov. R. 303A.02(b)(i)).

[16] In their pre-trial briefs, Plaintiffs argued that Ms. Monaco's independence was impaired by her position as the Chair of Compensation Committee at a time when it subsequently was determined that certain option grants had been improperly dated. However, there was no evidence at trial suggesting any wrongdoing by Ms. Monaco in connection with certain improperly accounted-for options granted during her tenure on the Compensation Committee – or that any such options were ever granted to Mr. Riggio. *See* Tr. 248-49 (Higgins). Instead, as the Company has reported in public filings, and as Ms. Higgins (the head of the Special Committee) testified at trial, the Special Committee that investigated Barnes & Noble's options-accounting practices between 1996 and 2006 "did not find any intent to defraud or fraudulent misconduct by any individual or group of individuals" and determined the Company's dating and pricing practice for stock options "was not used selectively to benefit any one group or individual within the Company". JX 107 at F-6; Tr. 248-49 (Higgins).

actions "were *primarily* based on (1) perpetuating themselves in office, or (2) some other breach of fiduciary duty such as fraud, overreaching, lack of good faith, or (3) being uninformed". *Unitrin*, 651 A.2d at 1390 (quoting *Unocal*, 493 A.2d at 958).

Rather, as shown above in Section I, the evidence establishes that the Board acted reasonably and proportionately in adopting and amending the Rights Plan – a far cry from the gross negligence or bad faith that would be required to overcome the business judgment rule. *See In re Walt Disney Co. Deriv. Litig*, 906 A.2d 27, 67 (Del. 2006) (director's bad faith constitutes "intentional[] fail[ure] to act in the face of a known duty to act, demonstrating a conscious disregard for his duties"); *McPadden v. Sidhu*, 964 A.2d 1262, 1274 (Del. Ch. 2008) ("Delaware's current understanding of gross negligence is conduct that constitutes reckless indifference or actions that are without the bounds of reason."); *see also Gaylord*, 735 A.2d at 475-76 (noting that "[i]t is not at all apparent how a plaintiff" could possibly overcome the business judgment rule "where the board met its burden under *Unocal*").

II. <u>ENTIRE FAIRNESS IS NOT AN APPROPRIATE STANDARD OF REVIEW HERE.</u>

Neither the record nor Delaware law support Plaintiffs' effort to shoehorn their claims into the "entire fairness" framework. Indeed, since *Moran*, Delaware courts have employed *Unocal*'s two-part test to evaluate poison pills and have explicitly rejected the invitation to apply entire fairness in this context:

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

> *intermediate standard of judicial scrutiny under Unocal was designed to deal with this potential conflict.*

In re Unitrin, Inc. S'holders Litig., 1994 WL 698483, at *4 (Del. Ch.) (emphasis added), *rev'd on other grounds*, 651 A.2d 1361 (Del. 1995).[17]

Plaintiffs' entire fairness theory depends on a strained characterization of the Rights Plan as "an economic transaction between the Company and its controlling stockholders". *See* Pls.' Op. Pre-Trial Br. at 54. However, Plaintiffs concede, as they must, that "[t]he declaration of a dividend is typically not subject to entire fairness scrutiny because *the dividend treats all stockholders the same*". *See id.* at 55 (emphasis added). Nothing in the evidence adduced at trial would suggest that this dividend is any different.

The Rights Plan "does not rise to the level of a self-dealing transaction that requires the board to demonstrate entire fairness" simply because it accounted for the circumstances existing at the time it was adopted by allowing Mr. Riggio to retain his then-current stock ownership instead of forcing him to sell down his shares. *See In re Unitrin*, 1994 WL 698483, at *4.[18] As discussed *supra* at Section I.B.5, no unique or

[17] In reversing on other grounds, the Delaware Supreme Court agreed that the Court of Chancery "properly concluded the facts before it required an application of *Unocal* and its progeny". *Unitrin*, 651 A.2d at 1372; *see also City Capital Assocs. Ltd. P'ship v. Interco Inc.*, 551 A.2d 787, 790 (Del. Ch. 1988) ("the Supreme Court in *Moran* has directed us specifically to its decision in *Unocal* . . . as supplying the appropriate legal framework [in the poison pill context]"), *criticized on other grounds, Paramount Commc'ns, Inc. v. Time Inc.*, 571 A.2d 1140, 1152-53 (Del. 1989).

[18] If this were not the case, any poison pill case involving grandfathered-in stockholders would have been subject to entire fairness review. *See, e.g.*, *In re infoUSA*,

special benefits were provided to Mr. Riggio; instead, he, like every other stockholder, has been capped. As Plaintiffs have conceded in their pre-trial answering brief, if the Board adopted a pill that triggered at a threshold lower than the Riggio's holdings, the Riggios had to be grandfathered. Pls.' Ans. Pre-Trial Br. at 1, 11-12. Moreover, all decisions concerning the Rights Plan were unanimously approved by all six of the independent directors – a disinterested majority of the Board. Even if the self-interestedness alleged by Plaintiffs were deemed to exist on the part of Leonard Riggio, the disinterestedness of the independent directors was not affected – they remained sufficiently independent to make impartial decisions regarding the Rights Plan. *See supra* Section I.D.

CONCLUSION

For the foregoing reasons, Defendants respectfully request that judgment be entered in their favor in all respects.

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