**IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE**

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| THIRD POINT LLC, a Delaware limited liability company,<br><br>Plaintiff,<br><br>v.<br><br>WILLIAM F. RUPRECHT, *et al.*,<br><br>Defendants,<br><br>and<br><br>SOTHEBY'S, a Delaware corporation,<br><br>Nominal Defendant. | C.A. No. 9469-VCP |
| THE EMPLOYEES RETIREMENT SYSTEM OF THE CITY OF ST. LOUIS on behalf of itself and all other similarly situated shareholders of SOTHEBY'S,<br><br>Plaintiffs,<br><br>v.<br><br>WILLIAM F. RUPRECHT, *et al.*,<br><br>Defendants,<br><br>and<br><br>SOTHEBY'S, a Delaware corporation,<br><br>Nominal Defendant. | C.A. No. 9497-VCP |

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| LOUISIANA MUNICIPAL EMPLOYEES RETIREMENT SYSTEM on behalf of itself and all other similarly situated shareholders of SOTHEBY'S, | ) | |
| Plaintiffs, | ) | |
| v. | ) | C.A. No. 9508-VCP |
| WILLIAM F. RUPRECHT, *et al.*, | ) | |
| Defendants, | ) | |
| and | ) | |
| SOTHEBY'S, a Delaware corporation, | ) | |
| Nominal Defendant. | ) | |

**MEMORANDUM OPINION**

Submitted: April 29, 2014
Decided: May 2, 2014

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**PARSONS, Vice Chancellor.**

This action arises from a corporation's alleged misuse of a stockholder rights plan. In response to an apparent threat posed by increasing hedge fund activity in its stock, the corporation adopted a rights plan that would be triggered at a lower percentage of ownership for those stockholders who file a Schedule 13D with the U.S. Securities and Exchange Commission ("SEC") than those stockholders who file a Schedule 13G. The rights plan has remained in full force since its adoption despite at least one entity, the primary plaintiff in this litigation, having sought a waiver from certain of its requirements.

The primary plaintiff is an activist hedge fund and stockholder of the corporation. According to the hedge fund, the corporation's board violated their fiduciary duties by adopting the rights plan and refusing to provide it with a waiver from the rights plan's terms, so that the Board could obtain an impermissible advantage in an ongoing proxy contest with the hedge fund. The hedge fund avers further that, regardless of the board's intent in adopting and refusing to waive certain features of the rights plan, the fund does not pose a legally cognizable threat to the corporation and that, in any event, the rights plan is not a proportionate response to any threat the board might have perceived. The other plaintiffs in this litigation are institutional stockholders who purport to represent the interests of the corporation's stockholders other than the hedge funds. The stockholder plaintiffs largely join in the arguments made by the hedge fund with a particular emphasis on the effect the rights plan is likely to have on the stockholder franchise both for the near and long term.

In response, the defendant directors, who comprise the corporation's board, assert that, at all relevant times, the hedge fund posed a number of different legally cognizable threats to the corporation, and that the board responded proportionately to those threats in both adopting the rights plan and refusing to grant the hedge fund a waiver from certain of its provisions. The defendants also argue that the rights plan's two-tiered structure is reasonable based on the source of the threats to the corporation.

This matter is before me on the plaintiffs' motion for a preliminary injunction. The plaintiffs seek to enjoin the corporation's annual meeting, which is scheduled to take place on May 6, 2014, until an expedited trial can be conducted to determine the merits of the challenged board actions. The substantive issue on the plaintiffs' motion is not whether the defendants have breached their fiduciary duties or whether the corporation's rights plan is invalid. Rather, the question is whether the plaintiffs have made a sufficient showing to warrant my granting a preliminary injunction. Having considered the parties' briefs, the voluminous documents and depositions referenced therein, and the arguments made before me on April 29, 2014, I conclude that the plaintiffs have not satisfied their burden of demonstrating that they are entitled to the preliminary injunctive relief they seek. Specifically, I find that the plaintiffs have not demonstrated that they have a reasonable probability of success on the merits of their claims. Therefore, I deny plaintiffs' motions for a preliminary injunction.

# I. BACKGROUND

## A. The Parties

Plaintiff Third Point LLC ("Third Point") is the investment manager for a series of investment funds that, collectively, manage approximately $14.5 billion in assets. Daniel Loeb is Third Point's CEO. The firm, which often seeks to cause changes in the business policies or capital structure of the companies it invests in, can be characterized fairly as an activist hedge fund. Currently, Third Point is Nominal Defendant's, Sotheby's, largest stockholder, beneficially owning approximately 9.6% of Sotheby's common stock.

Plaintiffs the Employees Retirement System of the City of St. Louis and Louisiana Municipal Employees Retirement System (together, the "Stockholder Plaintiffs," and with Third Point, "Plaintiffs") are and have been stockholders of Sotheby's at all times relevant to this litigation.

Nominal Defendant, Sotheby's (or, the "Company"), operates the oldest auction house in the world. Until 2005, the Taubman family controlled 62.4% of Sotheby's voting power through a dual-class stock arrangement. Sotheby's shares trade on the New York Stock Exchange ("NYSE") under the symbol BID.

Defendant William F. Ruprecht is the Chairman of the Board of Directors, President, and CEO of Sotheby's. Ruprecht has served as a director and the President and CEO of the Company since February 2000, and was elected Chairman in December 2012. Ruprecht is the only Sotheby's employee currently serving as a director of the Company.

Defendant Peregrine A.M. Cavendish, the Duke of Devonshire, has been a director of the Company since September 1994 and has served as the Deputy Chairman since April 1996. Of the eleven directors of the Company, other than Ruprecht, the Duke of Devonshire is the only director who does not satisfy the definition of an "independent" director under the NYSE's listing rules.

Defendant Dominico De Sole has been a director of Sotheby's since December 1, 2013 and has served as the Company's Lead Director since December 13, 2013.

Defendant John M. Angelo has been a director of Sotheby's since April 2007.

Defendant Steven B. Dodge has been a director of the Company since May 2012, and previously served as a director from 2000 to 2007. Dodge, who will be leaving the Board after the upcoming director election, was the Lead Director immediately before De Sole's assumption of that role.

Defendant Daniel H. Meyer has been a director of Sotheby's since May 2011.

Defendant Allen I. Questrom has been a director of Sotheby's since December 2004.

Defendant Marsha E. Simms has been a director of Sotheby's since May 2011.

Defendant Michael I. Sovern has been a director of Sotheby's since February 2000, and served as Chairman from February 2000 until December 2012.

Defendant Robert S. Taubman has been a director of Sotheby's since August 2000. Taubman replaced his father, A. Alfred Taubman, on the Board after the latter stepped down as Chairman of the Company in February 2000.

Defendant Diana L. Taylor has been a director of Sotheby's since April 2007.

Defendant Dennis M. Weibling (and together with Ruprecht, the Duke of Devonshire, De Sole, Angelo, Dodge, Meyer, Questrom, Simms, Sovern, Taubman, and Taylor, the "Defendants") has been a director of Sotheby's since May 2006.

### B. Facts

Based on the documentary evidence and deposition testimony provided by both parties in conjunction with this motion, these are the facts as I preliminarily find them for purposes of Plaintiffs' preliminary injunction motions.

#### 1. Sotheby's and its business

Sotheby's is a global art business and primarily focuses on acting as an agent for high-end art sales. The Company operates in an essentially duopolistic market with Christie's, a privately-held enterprise, as its predominant competitor. Thus, when it comes to attracting business or key employees, the Company and Christie's largely are enmeshed in a "zero sum" game, in which a loss for one often translates into a gain for the other.

There are three key factors that drive Sotheby's business: (1) relationships with owners of fine art and their heirs; (2) financial discipline that allows the Company to offer sufficiently attractive price and marketing guarantees to potential sellers when important lots become available; and (3) the ability to attract and retain sought after art world experts and relationship specialists who work to obtain consignments of important collections and to interest potential buyers. Struggles in any of these areas potentially could pose serious problems for the Company's successful operation.

### 2. The Sotheby's Board

Sotheby's is led by an unstaggered board consisting of twelve directors. Ruprecht is the lone management representative on the Board, and ten of the eleven other directors are "independent" within the meaning of the NYSE listing standards. Together, the directors own approximately 0.87% of the Company's outstanding shares.[1] In addition, the composition of the Board turns over more frequently than the average publicly traded company. On average, the Company's directors have served as directors for 7.1 years, compared to an average of 10.1 years for the S&P 500 and 10.8 years for the S&P 1500.

### 3. Hedge funds, including Third Point, begin to purchase Sotheby's stock

On May 15, 2013, in a Form 13F filed with the SEC, Third Point disclosed that it had acquired 500,000 shares of Sotheby's stock. On June 11, 2013, Morrow & Company ("Morrow"), the Company's proxy solicitor, notified Jennifer Park, Sotheby's Investor Relations director, that Trian Fund Management, L.P. ("Trian"), an activist hedge fund with ties to Nelson Peltz, had acquired 250,000 shares in the Company. Park, in turn, notified Ruprecht, William Sheridan, the Company's CFO at the time, and Gilbert Klemann, the Company's General Counsel, of the development and stated that "[Trian's] usual MO is to buy 4.9% and then call us and make a lot of noise." In response, Sheridan stated he saw "no need to update the full Board at this point," but asked Klemann to update the Company's outside counsel, Wachtell, Lipton, Rosen & Katz ("Wachtell"),

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[1] Compl. ¶ 21. According to Third Point, this "miniscule number" is a "fraction" of Third Point's holdings in the Company. *Id.*

and asked Park to "recirculate" a presentation the Company's financial advisor, Goldman Sachs Group, Inc. ("Goldman"), had prepared for the Company regarding Loeb and Peltz.

On July 19, 2013, Ruprecht informed the Board that "there is an increasing probability that we are going to be subject to an imminent activist effort to shift our management agenda." In support of his assertion, Ruprecht noted that Morgan Stanley recently had announced a "passive" 5.1% stake in Sotheby's, but that such a stake might be a front for one or more funds, including Third Point and those associated with Peltz or Bill Ackman, another well-known activist investor, wishing to obtain as large an interest as possible in the Company "before announcing their intentions, probably through a 13D filing." Ruprecht pointed out that the Board already was scheduled to discuss activist stockholders with Goldman and Wachtell at a Board meeting scheduled for early August, and also stated that he would be working with Goldman and Wachtell before then "anticipating an activist approach and any immediate response required." According to a banker at Goldman, when Ruprecht communicated with the Board on July 19, "the company [was] very concerned about the possibility of an imminent 13D filing, given [the] presence of Third Point and Trian in [its] shares."

On July 30, 2013, another activist fund, Marcato Capital Management LLC ("Marcato"), filed a Schedule 13D disclosing its acquisition of 6.61% of Sotheby's common stock. Marcato's filing stated that it may enter into discussions with the Board, the Company's management, or other stockholders about "various strategic alternatives," including "M&A." Marcato also reserved the right to acquire additional shares in the

Company and to pursue "[a]n extraordinary corporate transaction, such as a merger, reorganization or liquidation, involving the issuer or any of its subsidiaries."

At some point shortly after Marcato filed its Schedule 13D, Third Point held an internal meeting to discuss Sotheby's. The first page of the materials circulated for that meeting, entitled "One-pager," contained a "Summary of activist case," which included a bullet point asking "Why is [Sotheby's] even a public company?" Under the "Alternative playbook" heading on the same page, a single bullet point stated: "Push mgmt. to explore strategic alternatives and let an art loving billionaire [*i.e.*, Loeb] (or the Qataris) take [Sotheby's] private." The following page of the presentation, entitled "Investment thesis," listed a number of different approaches Third Point might consider taking as to the Company. The last line states, "[o]therwise, most intriguing trade here is for [Loeb] (or someone like [Loeb]) to take this private and monetize the real estate."[2]

### 4. Third Point contacts Sotheby's

On August 1, 2013, Matthew Cohen of Third Point emailed Park to inform her that Third Point owned over 500,000 shares in the Company and to ask for a meeting with Ruprecht "as part of [Third Point's] efforts to better understand the company and strategic plans." Park promptly arranged a date and time for a meeting. Loeb proposed

[2] In addition, one of Third Point's nominees in the later-commenced and ongoing proxy contest, Olivier Reza, on more than one occasion suggested that Loeb consider taking Sotheby's private. On the record before me, however, Loeb's receptiveness to those suggestions is, at best, unclear. I also note that there is no evidence to date that the Sotheby's Board was aware of either the Third Point internal presentation or of Reza's perspective until they obtained discovery in this litigation.

hosting the meeting at Third Point's offices, to which Ruprecht was "agnostic" and Sheridan responded internally that "we should go see them to get things off on a positive note."

On August 3, Ruprecht emailed De Sole informing him that he had upcoming meetings with "activists" Third Point and Marcato which should give him a "bead on their approach[es]." In addition to expecting "a fair amount of noise and acrimony" from the activists, Ruprecht expressed concern that they would want Sotheby's to "lever up" the business and stop using on-balance sheet lending, which "would have [] dramatic consequences on our P&L" and force management and the Board "to run the business without a robust balance sheet."

Ruprecht also observed that the "activists" were likely to want to have the Company pursue a strategy emblematic of the "classic tension [of] short term vs long term thinking and strategies." According to him, the "activists'" likely plan of "stripping capital from the company and increasing our annual P&L costs" based on "our very volatile business, with intense competitive and margin pressures" was "nuts." Nevertheless, Ruprecht acknowledged "that if you are an activist, and if you are clever, you can make quite a lot of money agitating for this, and they have already been successful, our equity up over 30% YTD, and 55% in 12 months."

Two days later, on August 5, Dodge asked Ruprecht if he had any information about the activist positions in the Company. Ruprecht responded that the Company was focusing on Third Point and Marcato, and he had meetings scheduled with

representatives from both later in the week. Regarding those upcoming meetings, Ruprecht wrote:

> Suspect that they agitate for real estate sales, syndication of our loan book, and return of capital to shareholders. They will bitterly condemn me, as a power hungry despot having insisted on assuming Chairmanship etc. and that all [C]EO's are wildly overpaid, and that they want multiple board seats. While none of their ideas will likely bear material fruit, they raise money on the basis that they activate management teams.

**5. The August 6 Board meeting**

On August 6, 2013, the Board held a regularly scheduled meeting at which Goldman and Wachtell were invited to provide "an update on shareholder activism, a vulnerability assessment, [and] a discussion of the key roles of directors and preparation considerations." The Board received information in a presentation jointly prepared by Wachtell and Goldman describing the stockholder activism market generally and stockholder activism issues specific to Sotheby's. Regarding activism in general, the Board was informed that stockholder activism levels were "high," at least in part because of activists' prior successes in waging proxy contests. The presentation also contained a slide titled "Activist Investor Tactics Typically Follow a Familiar Pattern." According to the presentation, this pattern usually consists of activists building a stake in an entity, individually or by teaming up with other institutional or activist stockholders to form a "wolf pack," applying pressure on the entity, including threatening to agitate against a board's preferred strategic alternatives, and finally taking action against the board by

threatening "withhold the vote" campaigns, demanding board seats, launching a short-slate proxy contest, or making aggressive use of derivatives.

As to the activism issues facing Sotheby's, the presentation contained an overview of each of Trian, Marcato, and Third Point. For Third Point, the overview noted Loeb's penchant for authoring "poison-pen" letters and the fund's focus on "event-driven situations such as mergers, acquisitions, tender offers, recapitalizations, spin-offs, exchange offers and liquidations." On a slide comparing the "agendas" Trian, Marcato, and Third Point had pursued in previous activist campaigns, Goldman and Wachtell reported that Third Point had, among other things, bid for a company in which it had invested. The Board's financial and legal advisors also discussed with them Third Point's previous successes in negotiating a transaction with entities it had invested in that arguably allowed it to obtain a benefit that was not available to the entity's other stockholders. An example was the repurchase by Yahoo! of 40 million of its shares from Third Point. The unredacted official minutes from the August 6 Board meeting state only that "[t]here was an extensive discussion among the directors about the presentations that were made."

### 6. Sotheby's Meets with Third Point and Marcato

On August 9, 2013, Sotheby's management met separately with both Marcato and Third Point. At the Marcato meeting, Richard "Mick" McGuire, Marcato's CEO, urged the Company to return much of its cash-on-hand to investors and showed the Sotheby's delegates materials he had prepared before the meeting to that effect.

During the meeting with Third Point, Ruprecht and Loeb exchanged opinions about Sotheby's and its business. This included Loeb questioning the Company's management about the differences between Sotheby's and Christie's. Loeb's notes suggest that he intended to ask Ruprecht and others during the meeting: "[w]hat would you do different if Sotheby's was a private company? Do you think that would change the industry competitive dynamic?" The notes also included the "bonus topic" of Marcato; Loeb apparently was curious as to whether Sotheby's planned to hire external advisors, such as bankers and lawyers, in response to Marcato's 13D filing.

Later that day, Cohen of Third Point emailed Loeb and two others to express his take on the meeting. Cohen wrote that, "[a]t the end of the meeting, mgmt said they 'want our ideas,' so we could certainly go back to them with some." He also cautioned those on the email that it was "important to remember that 10% of [Sotheby's] is only about $300m, so [Loeb] needs to decide whether anything other than a strictly passive investment is the best use of your time." The following day, Loeb responded to Cohen's email. After criticizing Sotheby's management for lacking "sizzle or pizzazz," he observed that "I do think the marcato guys COULD force a sale and plan to get on the board and a proxy contest could revise activist premia . . . ."

On August 11, Sotheby's management sent the Board a written summary of both the Marcato and Third Point meetings. Dodge responded "my initial reaction is that they understand reasonably well what they are looking at and some of their thoughts are not far off the mark, including re: the Board." Dodge did not specify, however, whether he

was referring to Marcato's thoughts, Third Point's thoughts, or some combination thereof.

### 7. Activist funds continue to increase stakes in Sotheby's

On August 14, 2013, Trian filed a Form 13F, revealing that as of June 30, 2013, it had acquired over 2 million shares of Sotheby's, or approximately 3% of the Company's outstanding common stock. The same day, the Company also learned that Third Point had quintupled its stake in Sotheby's (from approximately 500,000 shares to 2.5 million shares), increasing its ownership in the Company to approximately 3.6%. Sheridan expressed concern about what he perceived to be "collusive" behavior between Trian and Third Point, to which Ruprecht responded in part "when, and if, we cannot defeat a hostile proxy fight, these [jerks] can run the business. I will not supervise the over leveraging of this business which leads to wholesale termination of staff and suffocating debt."

When informed of the new developments regarding Trian and Third Point, Dodge asked management for an update as to the combined holdings in the Company, in percentage terms, of Trian, Marcato, and Third Point. Dodge also inquired whether Blackrock, Sotheby's largest stockholder at the time, had weighed in on the activists' recent actions. Arguing that it was premature to engage Blackrock in the discussion, Ruprecht wrote Dodge "[m]y belief has been that engaging top shareholders with anything less than a specific plan of returning capital to shareholders this Autumn will hand the agenda to activists, who in turn will propose and win a proxy contest in March unless we take dynamic action before hand." He wrote further that "[s]hareholders will

accept and indeed enjoy activist agenda [] until we have specific actions announced publicly."

Less than two weeks later, on August 26, Third Point filed its initial Schedule 13D, disclosing it had acquired a 5.7% stake in the Company. According to the filing, Third Point intended to "engage in a dialogue with members of the Board or management," and also might pursue discussions with other stockholders or "knowledgeable industry or market observers (including art market participants)." Third Point stated that these discussions "may relate to potential changes of strategy and leadership at" Sotheby's. As Marcato had done in its Schedule 13D filing, Third Point also reserved the right to purchase additional Sotheby's shares and to pursue "[a]n extraordinary corporate transaction, such as a merger, reorganization or liquidation, involving the issuer or any of its subsidiaries."

That same day, Third Point's Schedule 13D was circulated to the Board. This prompted the Duke of Devonshire to inquire whether he should plan on attending the next Board meeting, scheduled for early September, in person. Ruprecht responded in the negative and stated "[e]arly next year we are likely to face a proxy contest with activists wanting to come on the Board. As our advisor Wachtell reminds me today, there is nothing they can do till [M]arch of 2014, unless we choose to work with one of these folks to blunt the others." Ruprecht continued "[e]ssentially as I see it tonight, I don't see this [September Board] meeting as more than directional. The endgame is either in 8 months or 20 months when the Board election cycle matures annually."

Two days later, on August 28, in an email exchange, Ruprecht's sister asked whether "all the news regarding hedgies [is] good or bad" for him personally. In response to his sister's question, Ruprecht wrote, "Hedges are fine, buying our stock at huge prices, not likely to have a happy ending. They may shove, early next year, a person [onto] our board….which won't kill anyone."

Shortly thereafter, on August 30, Marcato received clearance from the U.S. Federal Trade Commission ("FTC") to acquire over 50% of Sotheby's outstanding shares, if it so chose.

**8. Discussions about a return of capital**

On August 31, 2013, a memorandum was circulated to the Finance Committee of Sotheby's Board to outline what would be discussed during the committee's scheduled September 4, 2013 call. The Finance Committee was informed that Trian, Marcato, and Third Point had accumulated approximately 15% of the Company's outstanding shares, and that Third Point held derivative positions that, if exercised, would increase that figure to over 20%. In response, the Company was considering a two-step approach that essentially focused on conveying to stockholders its intent to return capital to them in both the near and long term time frames. The memorandum concluded that "[t]his approach positions us as nimble, on our front foot, and controlling the dialogue, all of which should bode well in any proxy contest on the horizon."

Two days later, Ruprecht wrote to Goldman and Wachtell to share his thoughts on Loeb's strategy. According to Ruprecht, Loeb's actions of attempting to stir up dissent among the Company's staff and experts suggested that his "endgame must be to either be

replacing management/board composition or simply to be so disruptive that we accommodate." Ruprecht also conveyed his belief that the Company could blunt Loeb's efforts if the Company could "get [the] mid September capital structure review announced before [Loeb] goes public" with his thoughts on Sotheby's.

On September 4, before the Finance Committee call, Ruprecht previewed his recommendation to that committee to Taubman. Ruprecht stated:

> We are going to be the target of a proxy fight with activist shareholders. The motivation for that fight is only peripherally about returning capital. It is about being on Sotheby's Board. Mick McGuire needs that as validation, and Loeb wants that for ego.
>
> Now, I do not have an appetite for significantly leveraging this business, our progress has been hard won, and our ability to operate and invest in deals, and potentially an art fund principal business has never been more exciting.
>
> My review of the situation however is this: if we make a gesture, that we can afford, of a couple of hundred million returned quickly to shareholders, we gain enormous tactical leverage in the process of persuading the 85% of shareholders who were not activists, that we are responsible stewards for their investment. If we do not act soon, my guess, no more than a guess, is that Loeb in particular sows very considerable disruption over the next several months. He is actively soliciting staff and clients for comment and support. Having lived with the reality of holding on to staff, and clients, in the face of a crisis or turbulence – it is not a simple exercise in this business. Our competitor will have great fun dissuading clients from giving us business, suggesting [already are doing so] we will be sold/off focus/unable to be strong advocates for their property.
>
> So this is about power, and political gamesmanship with shareholders, not about capital structure. In the event we do not act, my view is that a proxy fight is much harder to win, and a slate of 3-4 new directors would displace current

> directors. Who would they replace? Unknown. But the Board will not make those decisions. And in my view, the single most valuable thing the board can do is stay collaborative and speak with one voice, and control its future. If you do a modest buy back, and still feel like you are going to lose a proxy contest, then you would offer activists one or two seats and still be in control. But if you go for it in a full battle, without making a gesture to shareholders, Loeb and co have a pretty good shot at persuading shareholders that he is their advocate.

For his part, Taubman believed that "every suggestion [Third Point had] made [was] terrible – and not good for the business." He also expressed concern that by dealing with Third Point "I think we'll make a short term deal w the devils and it will hang over us forever," and that he was not "sure where this stops." In addition, Taubman was reluctant to reach a deal to appease Third Point because "[i]t will also surely reduce our competitiveness just as we're gaining a capital position to truly compete w all the changing forces in the art world."

On the morning of September 4, Ruprecht also emailed Goldman to give "his read" on the situation before the Finance Committee call. Ruprecht described the Board's decision on whether to return capital to stockholders as being:

> About power and the ability to persuade . . . . If we are going to fight any capital distribution and the entire discussion is about - this Autumn with shareholders - why we shouldn't distribute, and why we can deliver returns above the cost of capital - we will likely lose that argument. At which point we will have perhaps four new directors, who view their charge as the distribution of capital. The board is in the crosshairs, not management. The board not management gets elected by shareholders. So the decision to make a prudent distribution now allows us the greatest control over board composition and collegiality going forward. To bunker in ensures board disruption next spring.

> This isn't and never was about capital markets [for McGuire and Loeb]. It's about getting into a leadership position on Sotheby's board.

Patrick McClymont of Goldman "agreed" with Ruprecht and opined that an announcement of a return of capital to stockholders would be the "right catalyst" "for a real discussion with shareholders."

During the Finance Committee meeting, Goldman made a presentation recommending a $200-$250 million share repurchase as part of a two-step process to address "recent shareholder feedback." While Goldman noted that one of the "potential consequences of inaction" was that "vocal shareholders" would "[p]ropose a short slate of 2 to 3 alternative directors," it also described some of the "key risks" of engaging in a share buyback as adding "additional leverage to a highly cyclical business," and creating the "[p]otential for Marcato/Third Point to 'claim victory,'" and the "[p]otential loss of operational flexibility in the U.S."

On September 10, 2013, the Board held a regularly scheduled meeting. Ruprecht provided the Board "background information regarding [Marcato] and Third Point, the two activist hedge funds that had accumulated substantial positions in the Company's stock." He also "provided his assessment of the goals and motivations of Marcato and Third Point" based on his discussions with the principals of those funds.

The Board was advised that McGuire was expected to speak the following week at an investor conference in which it was "anticipated that he will air his views about Sotheby's." As such, Ruprecht said that management was "tactically anxious" to announce before the conference that the Company would be undertaking a

comprehensive capital allocation review and engaging with stockholders to take steps to enhance stockholder value. Ruprecht also noted that "the Board may be the subject of a proxy contest in the spring 2014" and asked the Wachtell and Goldman representatives in attendance to review for the Board "that prospect and related events they see unfolding in the months ahead."

The next day, September 11, the Company announced publicly that it was conducting a capital allocation review. By this time, the Company also had undertaken a review of its real estate portfolio. In the context of discussing the Company's real estate plans, Taubman emailed Ruprecht that "this all happened because of Loeb." Ruprecht responded with a single word: "scum."

**9. The October 2, 2013 letter**

On October 2, 2013, Third Point filed an amended Schedule 13D revealing that the fund had increased its stake in Sotheby's to 6.35 million shares, or approximately 9.4% of the Company. Attached to the Schedule 13D was a letter from Loeb to Ruprecht. In the letter, Loeb raised several concerns about Sotheby's, including "the Company's chronically weak operating margins and deteriorating competitive position relative to Christie's," "Management's lack of alignment with shareholders," Ruprecht's "generous package of cash, pay, perquisites, and other compensation," "a sleepy board and overpaid executive team," and "lack of expense discipline."

Loeb's "prescription for repairing Sotheby's" consisted of the Company bringing in "the right technicians," such as Loeb himself, several new directors recruited by Loeb, and "a designee from another large shareholder." According to the letter, "[o]nce

installed, these new directors would determine what other steps are necessary to ensure that the Company benefits from the rigor and direction that comes with having an 'owners perspective' in the boardroom." In addition, Loeb emphasized the need to replace Ruprecht as CEO. In that regard, his letter stated that Third Point already had identified potential CEO candidates, both internal and external to the Company, and had already commenced informal discussions with the external candidates.

Loeb apparently made several of the accusations in his letter without actual knowledge of their veracity. In addition, the record supports an inference that Loeb included the letter with the Schedule 13D as part of an "all out assault" meant to destabilize the Company. In contemporaneous emails, Loeb described his letter as both part of a "holy jihad" intended to "make sure all the Sotheby's infidels are made aware that there is only one true God," and part of a "Special Operation on Sotheby's," which was intended to "shock and awe" the Company and "undermine the credibility" of Ruprecht. Loeb acknowledged that the letter may have caused some "collateral damage" to the Board, but believed that was "an acceptable risk" to have taken.

### 10. The Board adopts a rights plan

On October 3, 2013, the Board held a special meeting, which included Goldman and Wachtell, to discuss Third Point's updated Schedule 13D and Loeb's letter. After leading the Board through a point-by-point discussion of Loeb's letter, Ruprecht "noted discussions that he and the Company's management had had with advisors from [Wachtell] and [Goldman] regarding possible responses to the letter from Mr. Loeb, including the possible adoption of a Shareholder Rights Plan (the 'Rights Plan')."

Andrew Brownstein of Wachtell reviewed the proposed Rights Plan with the Board. Brownstein referred to materials Wachtell and Goldman had distributed to the Board that Trian, Marcato, and Third Point had collective ownership of approximately 19% of the Company's outstanding shares. The advisor-produced materials stated "[i]n this and other cases, activists have acquired shares rapidly and used derivatives to accumulate positions without paying [a] control premium," and that "[r]ights plans have been adopted by companies facing activist situations . . . as well as companies facing takeovers." As to activist situations, the Rights Plan was described as an "[e]ffective device to ensure Board involvement in the timing and outcome of a takeover bid or creeping accumulation of control."

After Brownstein's review, "the Board engaged in an extensive discussion of the features of the proposed Rights Plan" and "whether the recent accumulations of stock and related items posed a threat to the Company to which adoption of a Rights Plan was an appropriate response." At Ruprecht's suggestion, the Rights Plan topic was tabled and slated to be addressed at the previously scheduled Board meeting to be held the following day.

On October 4, the Board held its regularly scheduled meeting. The first item of business was another "Activist Investor Update." After continuing the discussion from the previous day, the Board unanimously approved the adoption of the Rights Plan. In doing so, Marcato and Third Point were identified as Schedule 13D filers that "may each continue to accumulate Common Shares and/or derivative positions with respect to the Corporation." A "Summary of Terms of Rights Plan" enclosed with the meeting minutes

explained briefly how the Rights Plan provides "[p]rotection against creeping acquisition/open market purchases." At the October 4 meeting, the Board did not make any explicit findings regarding the existence of a threat. The Company's press release announcing the adoption of the plan, however, stated that the Rights Plan was "intended to protect Sotheby's and its shareholders from efforts to obtain control that are inconsistent with the best interests of the Company and its shareholders."

In an email to a Sotheby's employee on October 4, which appears to have been sent before the Board meeting, Ruprecht wrote, "[o]ur job is to be compelling with investors. We will have a big fight re the board composition next summer. Loeb wants to control our board. Our staff would hate that. He's a scumbag."

### 11. The terms of the Rights Plan

By its own terms, the Rights Plan expires in one year unless it is approved by a stockholder vote. Nothing in the Rights Plan, however, appears to prohibit the Board from re-adopting it in whole or in part after it expires. In addition, the Rights Plan contains a "qualifying offer" exception, in which the Rights Plan will not apply to an "any-and-all" shares offer for the Company that cashes out all Sotheby's stockholders and gives them at least 100 days to consider the offer.

Of greater relevance to the current litigation, however, is the Rights Plan's two-tiered structure. Under the Rights Plan's definition of "Acquiring Person," those who report their ownership in the Company pursuant to Schedule 13G may acquire up to a 20% interest in Sotheby's. A person is eligible to file a Schedule 13G only if, among other things, they have "not acquired the securities with any purpose, or with the effect

of, changing or influencing the control of the issuer, or in connection with or as a participant in any transaction having that purpose or effect" and they own less than 20% of the issuer's securities.[3] All other stockholders, including those who report their ownership pursuant to Schedule 13D, such as Third Point and Marcato, are limited to a 10% stake in the Company before triggering the Rights Plan or "poison pill."

**12. Third Point and Sotheby's continue to interact, Sotheby's continues its capital allocation review**

On October 10, 2013, McClymont, formerly of Goldman and now Sotheby's new CFO, met with Loeb. Among other things, Loeb and McClymont discussed "cost reductions," "Sotheby's work and corporate culture," "the perceived working and role of the [Board]," "a comparison of the leadership, talent, strategies, tactics and structure of Sotheby's versus Christie's," and areas for growth for the Sotheby's business and the ability of Mr. Loeb's spouse to assist Sotheby's with respect to certain potential initiatives and opportunities." McClymont reported his meeting with Loeb to the Board during an October 25 meeting. At the same meeting, Dodge also recounted to the Board the details of a meeting he had had with Loeb. Dodge mentioned, in particular, Loeb's comments to him regarding the Company's leadership and what he perceived "as the Company's shortcomings versus Christie's." In addition, according to Dodge, during their meeting, "Loeb had indicated that much of his information and conclusions were based on second-hand sources, rumors and commentary among friends and acquaintances in the art market, including at Sotheby's."

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[3] 17 C.F.R. § 240.13d-1(c).

On November 19, 2013, Third Point's COO Josh Targoff met with Marcato's General Counsel. The purpose of the meeting was to ensure that the funds "didn't do anything to inadvertently trigger the pill." On the current record there appear to be some, but not extensive, interactions between Third Point and Marcato regarding Sotheby's.

As the Company was engaged in its capital allocation review, on December 5, 2013, Ruprecht wrote Weibling to discuss an upcoming Finance Committee call. Ruprecht stated:

> [e]volving our capital structure is important, and ongoing, and [thankfully] we continue to make quite a lot of money, so I feel the risks we take on at the levels of capital return we are recommending is prudent. And it makes enough of a gesture that the coming proxy battle or its variants are made much more complex by saying 'no capital for you' to shareholders. In fact, I put it quite starkly. Either we make a significant capital return or we will empower Loeb in particular to wound our company and our board, and our prospects very materially. I assess the risks of a full proxy battle with him as very severe, and the consequences of capital distribution as much less severe.

On December 13, the Board held its next regular meeting. One topic on the agenda was the Company's capital allocation review, and one part of the Board's deliberation on that subject was "the impact of a $250 million return to shareholders versus a $425 million return," as well as the fact that "the Company and its advisors cannot be certain whether either level would be sufficient to satisfy Marcato and Third Point (or deter them from running a proxy fight)."

On January 29, 2014, pursuant to the Company's capital allocation review, Sotheby's announced a special dividend of $300 million and a $150 million share repurchase.

### 13. Loeb's interactions with the Company

There is some evidence in the record indicating that throughout late 2013 and into early 2014, Loeb conducted himself as though he already had significant influence over the Company's decisionmaking. He represented himself to some of Sotheby's employees at a December 2013 art show, for example, as the person who "was going to be the one appointing management in the future." Loeb also called a New York real estate developer that the Company was working with in its real estate assessment and apparently informed the developer that he (Loeb) was "in charge" of Sotheby's and would be making the Company's future real estate decisions. Moreover, Loeb appears to have followed through with his October letter to Ruprecht in that he approached at least three prominent members of the art community about whether they would be interested in Ruprecht's job.

By January 2014, at the latest, Sotheby's "business getters" were hearing from possible consignors and clients questions such as "[i]sn't it likely that most of you won't be here in the spring when my property comes up for sale? Won't Dan Loeb be changing most of s[enio]r m[ana]g[emen]t" and "With Loeb coming on board and making lots of changes, Sotheby's seems weak and in flux, how can I trust you with my property?"

### 14. Third Point and Sotheby's fail to negotiate a solution

In February 2014, Third Point and Sotheby's began negotiating in earnest in an attempt to avoid a proxy contest. The "core" of Third Point's settlement proposal was that: (1) the Company redeem or modify the Rights Plan to allow 15% ownership; (2) the roles of CEO and Chairman be separated; and (3) Loeb and "1 other Loeb designee" join the Board. Loeb also emphasized that, as a director, he would focus on instituting annual "360 degree director reviews,"[4] and a mandatory Board retirement age. On the issues of separating the CEO and Chairman roles, 360 degree reviews, and a mandatory retirement age, Dodge "strongly favored" Third Point's position, and noted "[w]e can fault Loeb for his ego, his rough edges, for his 'ready, fire, aim' approach, but on the substance he is far from all wrong, and he is with us already on the core issue of returning capital in measured amounts." On the more controversial issue of representation on the Board, Sotheby's responded that it was prepared to offer Third Point one nominee, who could not be Loeb. Third Point rejected this offer. The Company later offered to allow just Loeb on to the Board if he agreed to abide by certain terms, including a standstill agreement that would cap Third Point's holdings in Sotheby's at around the 10% mark. This offer also was rejected.

On February 27, the Board held a regularly scheduled meeting which included a "Capital Allocation update and activist update." De Sole reviewed his recent discussions

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[4] This refers to a broad based method of assessing job performance in which the subject receives reviews from their immediate work circle, which often includes reviews from subordinates, peers, and supervisors.

with Third Point "over a variety of topics, including the Shareholder Rights Plan, the role of the Chairman and CEO" and "representation of Third Point on the Corporation's Board of Directors." McClymont discussed with the Board "the alternatives available to the Corporation with respect to the [Rights Plan]," which led to a "general discussion" of the Rights Plan. Based on the potential impact a proxy fight would have on Sotheby's business and the prospect of another proxy contest in 2015 regardless of the results of the 2014 election, Ruprecht expressed his view that "[Sotheby's] should consider reaching a settlement with Third Point." After discussing whether Third Point should be offered one or two seats on the Board, the directors agreed to re-offer Loeb, and only Loeb himself, a seat on the Board to avoid a proxy fight.

While the Board meeting was in progress, Third Point filed another Amended Schedule 13D. This new filing revealed that Third Point had increased its stake in Sotheby's to 9.53% and that Third Point intended to run a director slate of three directors – Loeb, Harry J. Wilson, and Olivier Reza – to be voted on at the Company's upcoming annual meeting. Loeb knew that the Board was meeting when Third Point filed its Amended Schedule 13D because he had indicated to De Sole that he would not move ahead with a proxy contest until the Board could consider a settlement proposal during the February 27 meeting. The record supports a reasonable inference that the timing of the Amended 13D was deliberate.

The following day, a small group of senior Company managers held a strategy call with outside advisers. In addition to discussing whether the Company should offer Marcato the "Loeb deal" of a single board seat, the group also discussed the Rights Plan.

According to notes from the meeting, there was a discussion regarding whether "[a]s part of engaging with ISS, does Sotheby's formally accelerate the expiration of the [Rights Plan]?" Those at the meeting decided, "[w]e need to come to figure out how much it would swing ISS and our chances of winning," and that it would be important to "[g]et feedback from Vanguard and Blackrock. If they want to get rid of the [Rights Plan], then it may be worth doing to win their support."

**15. Third Point requests a waiver of the 10% trigger**

On March 13, 2014, the Company announced that Dodge would not stand for re-election at the upcoming annual meeting. The same day, Third Point again amended its Schedule 13D, revealing that it owned, directly or beneficially, 9.62% of Sotheby's stock. In addition, Third Point sent a letter to Sotheby's requesting that the Company grant it a waiver from the Rights Plan's 10% trigger, and allow it to purchase up to a 20% stake in the Company.

Also that same day, Ruprecht and McClymont met with Tom Hill of Blackrock. Hill recommended that Sotheby's settle for two seats with Loeb because he was "going to win." Hill also told Ruprecht and McClymont that "I really like Marcato, he is very smart, and while Dan's current position is polar opposite to Mick's, that won't last and he will change his mind." Ruprecht did not "have a conclusion" based on his meeting with Hill.

The Board met six days later on March 19 to, among other things, receive an update from its advisors about "possible voting outcomes" in the ongoing proxy contest with Third Point and to consider Third Point's waiver request. As to the proxy contest,

Morrow expressed the view that in the likely event that ISS, an influential proxy firm, supported Third Point, the proxy contest would be "a dead heat."[5] Goldman agreed with Morrow's assessment and described the proxy contest as "a very close race." The Company's third proxy-related advisor, CamberView, also agreed and noted that "investors could perceive there to be compelling arguments on both sides."

The Board then turned to Third Point's waiver request. According to the meeting minutes, which not unexpectedly appear to have been prepared by Sotheby's lawyers and which were finalized after this litigation began:

> Mr. McClymont updated the Board on a conversation that he had had with Mr. Loeb regarding [the waiver] letter. The directors discussed among themselves and with their advisors the Board's rationale for putting the Rights Plan in place in October 2013: the Board's determination that the rapid accumulation of shares by Marcato and Third Point constituted a threat to the Company's corporate policy and effectiveness and might be evidence of an attempt to achieve a change in effective control of the Company without having to pay any premium to shareholders. The directors then considered whether the same rationale still applied in determining how to respond to Third Point's request. With its advisors, the Board considered the basis for the Rights Plan in the context of Third Point's letter and discussed at length whether Third Point and other activist investors continued to pose a threat to corporate policy and effectiveness and a risk of creeping control. The Board reviewed the interactions over the past eight months between Sotheby's, on the one hand, and Third Point and Mr. Loeb, on the other, including the risk that Third Point could obtain "negative control" or effectively a controlling influence without paying a premium with respect to certain matters if it achieved a 20% stake. . . . The Board considered Mr. Brownstein's advice and ultimately concluded that nothing had changed that would

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5 As it currently stands, ISS supports two of the three Third Point nominees.

> warrant a change in the Rights Plan, including the exemption requested by Third Point.

The following deposition testimony of Sotheby's director Taylor, however, tells a somewhat different story and, at least at this preliminary stage of the litigation, has a ring of truth to it:

> Q: In March, when the board decided to reject Third Point's request for a waiver to buy up to 20 percent, did you specifically discuss what effect that decision would have on the proxy contest?
>
> A: Yes. I mean that was pretty much the whole thing. We did it –
>
> Q: Okay. Tell me about that discussion.
>
> A: We were advised by our proxy advisors that – that the status quo, it was totally up in the air as to who was going to win the proxy contest. We were advised that if he, based on history, that if he, Third Point, had 20 percent of the stock, that it was pretty sure that they would win the proxy contest.
>
> Q: And the board thought it was appropriate to prevent that from happening?
>
> A: The board, the board voted to go ahead with the proxy fight.
>
> Q: And by going ahead with the proxy fight you mean the board rejected the waiver request?
>
> A: Yes.
>
> Q: Okay. And by rejecting the waiver request –
>
> A: Ensuring that there would be a proxy fight
>
> Q: Right. And the board did that because putting more stock into Third Point's hands would make it more

likely that they would win seats in the election, correct?

A: It wasn't about the seats. It was about the control. It was about the 20 percent. And in addition to that the seats didn't help.

Q: So you said in the last answer that it wasn't about the board seats; is that correct?

A: Not per se, it's about the control and the seats are part of that.[6]

After denying Third Point's request, the Board discussed possible re-engagement with Marcato. Because Marcato, in discussions with the Company, had "indicated that it would be willing to support the Company's slate of director nominees if the Company were willing to commit to a specified level of capital return to shareholders in the next twelve months," Ruprecht suggested the Company analyze what level of capital return "the Board might be comfortable with," to decide whether it made sense to try to reach an agreement with Marcato. The Board was amenable to Ruprecht's approach, but based on Marcato's recent decision to support Third Point's nominees and oppose the incumbent slate, no deal between the Company and Marcato ever came to fruition.

Two days later, on March 21, 2014, Sotheby's notified Third Point that the Board had denied its request to waive the 10% trigger.

### C. Procedural History

On March 25, 2014, Third Point commenced this action by filing its verified complaint. Six days later, on March 31, I granted Third Point's motion to expedite and

[6] Taylor Dep. 99-101.

scheduled a hearing on Third Point's motion for a preliminary injunction. On April 10, the Stockholder Plaintiffs moved for entry of a coordination order, which I granted in part and denied in part on that same day. On April 29, after full briefing, which was based on extensive documentary evidence and deposition testimony produced during expedited discovery, I heard argument on Plaintiffs' motions for a preliminary injunction. This Memorandum Opinion constitutes my ruling on those motions.

### D. Parties' Contentions

Plaintiffs argue that under any standard of review that reasonably could be applied in this case, they have demonstrated a reasonable probability of showing that Defendants breached their fiduciary duties by adopting and enforcing the Rights Plan. According to Plaintiffs, there is sufficient record evidence to support an inference that Defendants adopted and enforced the Rights Plan against Third Point for the primary purpose of inhibiting its ability to wage a successful proxy contest without any compelling justification for doing so. Plaintiffs also argue that, regardless of the Board's intentions in adopting a defensive measure against Third Point and refusing to waive a key component of that measure, Defendants' actions both were disproportionate because Third Point posed a minimal, if any, threat to the Company and unreasonable because the Rights Plan is discriminatory in such a way that favors unambiguously and impermissibly the incumbent Board. As to irreparable harm, Plaintiffs aver that, because the Rights Plan interferes with or impedes the effective exercise of the stockholder franchise, they will be harmed if the annual meeting is allowed to proceed while that inhibition on their voting rights exists. Finally, Plaintiffs assert that the balance of the equities weighs in

their favor in this instance because any harm from a brief postponement of the annual meeting is outweighed by the serious harm, both monetary and otherwise, that would have to be incurred if the Court eventually decides the Rights Plan was invalid and requires the Company to hold another director election.

In response, Defendants argue that Plaintiffs cannot establish a reasonable probability of success on their breach of fiduciary duty claims because Third Point presented numerous legally cognizable threats to the Company and the adoption of the Rights Plan, as well as the refusal to waive its key provision, has neither made victory in a proxy contest realistically unobtainable for Third Point nor was it disproportionate to the several threats posed by Third Point. Regarding irreparable harm, Defendants assert that any injury Plaintiffs would suffer in this case is speculative both because Third Point has a good chance of winning the proxy contest even with the Rights Plan in place and because even if the Rights Plan was invalidated, there is no guarantee that Third Point actually would acquire up to 20% of Sotheby's stock or that such an increase would alter the results of the proxy contest. Finally, Defendants argue that the balancing of the equities weighs in its favor because an order postponing the annual meeting would put the Company out of step with the policy of 8 *Del. C.* § 211, which requires the holding of an annual meeting once every thirteen months, and would prolong the disruption, distraction, and harm to the Company that it already is experiencing as a result of the proxy contest with Third Point.

## II. ANALYSIS

To obtain a preliminary injunction a plaintiff must demonstrate: (1) a reasonable probability of success on the merits; (2) that absent injunctive relief, they will suffer irreparable harm; and (3) that the balance of the parties' harms weighs in favor of injunctive relief.[7] An injunction will not issue unless all three elements are satisfied.

### A. Reasonable Probability of Success on the Merits

The fundamental dispute between the parties in this litigation is whether Sotheby's Board breached its fiduciary duties either: (1) in adopting the Rights Plan in October 2013; or (2) by refusing to grant Third Point a waiver from the Rights Plan's 10% trigger in March 2014. As a threshold issue, however, I must determine the proper legal standard under which to analyze the conduct of Sotheby's Board.

#### 1. The legal standard

##### a. *Unocal* provides the proper legal framework for this dispute

Nearly thirty years ago, in the seminal case *Moran v. Household International, Inc.*,[8] the Supreme Court validated the concept of a rights plan. In reaching that conclusion, the Supreme Court's analysis was guided by, and in accordance with, the teachings of its then-recent decision in *Unocal Corp. v. Mesa Petroleum Co.*[9] Since *Moran*, both this Court and the Supreme Court have used *Unocal* exclusively as the lens through which the validity of a contested rights plan is analyzed. This includes cases in

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[7] *In re Netsmart Techs., Inc. S'holders Litig.*, 924 A.2d 171, 191 (Del. Ch. 2007).

[8] 500 A.2d 1346, 1347 (Del. 1985).

[9] 493 A.2d 946, 949 (Del. 1985).

which a rights plan has been used outside of the hostile takeover context.[10] Thus, it is settled law that the Board's compliance with their fiduciary duties in adopting and refusing to amend or redeem the Rights Plan in this case must be assessed under *Unocal*.

### b. It is possible, but unlikely, that *Blasius* nevertheless may be implicated within the *Unocal* framework in this case

"Famously, and under very unusual facts, [the case of] *Blasius Industries, Inc. v. Atlas Corp*. held that the board of directors must provide a 'compelling justification' for its actions where the board acted 'for the primary purpose of interfering with the effectiveness of a stockholder vote.'"[11] In *MM Cos. v. Liquid Audio, Inc.*,[12] the Supreme Court reemphasized that "the *Blasius* and *Unocal* standards of enhanced judicial review ('tests') are *not* mutually exclusive."[13] The Court held that the "compelling justification" standard set out in *Blasius* could be applied within the *Unocal* framework, but *only* where "'the primary purpose of the board's action is to interfere with or impede exercise of the shareholder franchise and the shareholders are not given a full and fair opportunity to

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10 *See Versata Enters., Inc. v. Selectica, Inc.*, 5 A.3d 586, 599 (Del. 2010) ("Any NOL poison pill's principal intent, however, is to prevent the inadvertent forfeiture of potentially valuable assets, not to protect against hostile takeover attempts. Even so, any Shareholder Rights Plan, by its nature, operates as an antitakeover device. Consequently, notwithstanding its primary purpose, a NOL poison pill must also be analyzed under *Unocal* because of its effect and its direct implications for hostile takeovers.") (citation omitted).

11 *Yucaipa Am. Alliance Fund II, L.P. v. Riggio*, 1 A.3d 310, 330 (Del. Ch. 2010) (quoting *Blasius Indus., Inc. v. Atlas Corp.*, 564 A.2d 651, 659 (Del. Ch. 1988)).

12 813 A.2d 1118 (Del. 2003).

13 *Id.* at 1130.

vote' effectively."[14] The Court noted specifically, however, that because of its strict criteria, the "compelling justification" standard announced in *Blasius* "is rarely applied either independently or within the *Unocal* standard of review."[15]

In that regard, Plaintiffs have not cited to any case in which this Court or the Supreme Court has invoked *Blasius* to examine a rights plan.[16] There are any number of possible explanations for this dearth of authority, including, but not limited to, that: (1) no Delaware court has ever found that a board of directors adopted a rights plan for the "primary purpose" of interfering with or impeding the exercise of the stockholder franchise;[17] (2) while rights plans can interfere with the franchise, they do not do so in the manner that *Blasius* was concerned with so long as a proxy contest remains a viable

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14 *Id.* (quoting *Williams v. Geier*, 761 A.2d 1368, 1376 (Del. 1996)).

15 *Id.*

16 In *Carmody v. Toll Bros., Inc.*, 723 A.2d 1180, 1194 (Del. Ch. 1998), *Blasius* was one of several grounds used by then-Vice Chancellor Jacobs to invalidate a so called "dead hand" poison pill. The invocation of *Blasius*, however, pertained to the preclusive and coercive effects a "dead hand" provision would have on a proxy contest when the shareholders were unable to elect directors, even if they wished to do so, who could redeem the shareholder rights plan at issue. The court in *Carmody* did not hold that the rights plan's "trigger level" there required a compelling justification.

17 *See Yucaipa Am. Alliance Fund II, L.P. v. Riggio*, 1 A.3d 310, 331 (Del. Ch. 2010) *aff'd*, 15 A.3d 218 (Del. 2011) ("because the [ ]board did not act 'for the primary purpose of thwarting the exercise of a shareholder vote,' *Blasius* does not apply by its own terms."); *Stahl v. Apple Bancorp, Inc.* 1990 WL 114222, at *7 (Del. Ch. 1990) ("Moreover the approach taken in *Blasius, Aprahamian* and other cases is appropriate when board action appears directed primarily towards interfering with the fair exercise of the franchise (*e.g.,* moving a meeting date; adopting a bylaw regulating shareholder voting, etc.). The stock rights plan may or may not have that effect, but it does not represent action taken for the primary purpose of interfering with the exercise of the shareholders' right to elect directors.").

option;[18] or (3) to the extent a stockholder rights plan does adversely affect the franchise, that circumstance is adequately dealt with under the *Unocal* standard such that application of *Blasius* has proven unnecessary.[19] Therefore, although *Blasius* might have some theoretical application to the facts of this case, it appears that, based on the relevant precedent, or more precisely, the lack thereof, *Unocal* provides the appropriate framework.

**c. The *Unocal* standard**

The well-known *Unocal* standard consists of two prongs. The first is "a reasonableness test, which is satisfied by a demonstration that the board of directors had reasonable grounds for believing that a danger to corporate policy and effectiveness existed." In other words, a board must articulate a legally cognizable threat. This first

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[18] *See Yucaipa*, 1 A.3d at 335 ("Although the Supreme Court and this court recognize that poison pills and certain other defenses affect the ability of stockholders to run proxy contests on an unfettered basis and that those effects should be closely examined when conducting a *Unocal* review, the Supreme Court and this court have also recognized that pills such as those in *Moran* do not disenfranchise any stockholder in the sense of preventing them from freely voting and do not prevent a stockholder from soliciting revocable proxies.") (citation omitted); *Stahl*, 1990 WL 114222, at *8 ("The thrust of the Supreme Court's reasoning in *Moran* was simply that the restrictions imposed by the stock rights plan on a proxy contest were immaterial to conducting a proxy fight effectively. In adopting the stock rights plan here, it has not been shown that the [] board could not have reasonably concluded similarly. If it did the restrictions here at issue should be valid, as were those in *Moran*").

[19] *See Yucaipa*, 1 A.3d at 335-36 ("In reality, if a board can meet its burden under *Unocal* to show that a rights plan is not unreasonable in the sense that its trigger is at such a reasonable threshold that the owner of a bloc up to the trigger level can effectively run a proxy contest, the pill would not work the type of disenfranchisement that both invokes *Blasius* review and almost invariably signals a ruling for the plaintiff.").

prong "is essentially a process-based review."[20] "Directors satisfy the first part of the *Unocal* test by demonstrating good faith and reasonable investigation."[21] A good process standing alone, however, is not sufficient if it does not lead to the finding of an objectively reasonable threat. "[N]o matter how exemplary the board's process, or how independent the board, or how reasonable its investigation, to meet their burden under the first prong of *Unocal* defendants must actually articulate some legitimate threat to corporate policy and effectiveness."[22]

The second prong of *Unocal* is a "proportionality test, which is satisfied by a demonstration that the board of directors' defensive response was reasonable in relation to the threat posed." Proportionality review itself consists of two parts. First, the Court must consider whether a board's defensive actions were "draconian, by being either preclusive or coercive."[23] Next, if the board's response to the threat was not draconian, the Court then must decide whether its actions fell "within a range of reasonable responses to the threat" posed.[24] The defendant board bears the burden of proving the reasonableness of its actions under *Unocal*.

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20 *Air Prods. & Chems., Inc. v. Airgas, Inc.*, 16 A.3d 48, 92 (Del. Ch. 2011).

21 *Paramount Commc'ns, Inc. v. Time, Inc.,* 571 A.2d 1140, 1152 (Del. 1990); *see also Unocal,* 493 A.2d at 955.

22 *Air Prods. & Chems., Inc. v. Airgas, Inc.*, 16 A.3d at 92.

23 *Unitrin, Inc. v. Am. Gen. Corp.,* 651 A.2d 1361, 1367 (Del. 1995).

24 *Id.*

**2. The October 2013 adoption of the Rights Plan and the March 2014 refusal to grant Third Point a waiver**

As *Moran* makes clear, the Board's decision to adopt the Rights Plan in October 2013 and its subsequent election to refuse to provide Third Point with a waiver from the plan's conditions each independently must pass muster under *Unocal*.[25] Consequently, I begin my analysis with the October 2013 adoption.

**a. The October 2013 adoption of the Rights Plan**

**1. Plaintiffs do not have a reasonable probability of success as to the first prong of *Unocal***

Plaintiffs here make no serious argument that the Sotheby's Board will be unlikely to meet its burden of demonstrating that it conducted a good faith and reasonable investigation into the threat posed by Third Point. The Board undeniably is comprised of a majority of independent directors. In addition, it is undisputed that the Board retained competent outside financial and legal advisors, which it appears to have utilized and relied on frequently. "The presence of a majority of outside directors, coupled with a showing of reliance on advice by legal and financial advisors, 'constitute[s] a *prima facie* showing of good faith and reasonable investigation.'"[26]

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[25] *See Moran v. Household Int'l, Inc.*, 500 A.2d 1346, 1354 (Del. 1985) ("When the [] Board of Directors is faced with a . . . request to redeem the Rights [Plan], they will not be able to arbitrarily reject the offer. They will be held to the same fiduciary standards any other board of directors would be held to in deciding to adopt a defensive mechanism, the same standard as they were held to in originally approving the Rights Plan.").

[26] *Selectica, Inc. v. Versata Enters., Inc.*, 2010 WL 703062, at *12 (Del. Ch. Feb. 26, 2010) (quoting *Polk v. Good,* 507 A.2d 531, 537 (Del. 1986)).

Having determined that the Board probably can demonstrate on a full record that it conducted the requisite investigation, the next relevant inquiry is whether the Board determined that Third Point presented an objectively reasonable and legally cognizable threat to Sotheby's. While the Board has asserted that, at all relevant times, Third Point has presented a multitude of threats to the Company, for purposes of the October 2013 adoption, I need focus only on one: "creeping control." At the time the Board elected to adopt the Rights Plan in October 2013, it had several hedge funds accumulating its stock simultaneously, and at least as to Third Point, the accumulation was occurring on a relatively rapid basis. The Board also was informed by its advisors that it was not uncommon for activist hedge funds to form a group or "wolfpack," for the purpose of jointly acquiring large blocks of a target company's stock. Based on these facts, and the profiles of Third Point and Marcato presented to the Board in materials prepared by its financial and legal advisors, I cannot conclude that there is a reasonable probability that the Board did not make an objectively reasonable determination that Third Point posed a threat of forming a control block for Sotheby's with other hedge funds without paying a control premium. That is, on the record before me, there is sufficient support for the Board's assertion that its good faith investigation led it to determine that Third Point posed a legally cognizable threat, and I consider that threat objectively reasonable. Thus, Plaintiffs have not demonstrated a reasonable probability of success with respect to the first prong of the *Unocal* analysis for the October 2013 adoption of the Rights Plan.

## 2. The "primary purpose" of the October 2013 adoption of the Rights Plan was not to interfere with the stockholder franchise

For the reasons stated previously, the role of *Blasius* in the stockholder rights plan context is not entirely clear. Nevertheless, I address Plaintiffs' argument regarding the Board's intent in adopting the Rights Plan because, at a minimum, the use of the *Unocal* standard is intended to "smoke out" impermissible pre-textual justifications for defensive actions.[27]

On this truncated record, there is sufficient evidence to support a reasonable inference that the Company has been concerned with the prospect of a proxy fight with an activist stockholder since the Summer of 2013. But the facts here do not support the conclusion that Plaintiffs have a reasonable probability of demonstrating that the Board adopted the Rights Plan in October 2013 for the *primary purpose* of interfering with the franchise of any stockholder, including Third Point, several months later. As stated previously, the Company was facing a rapid increase in hedge fund ownership in its stock that at least one Sotheby's insider believed was "collusive." Based on the advice of its outside legal and financial advisors, it appears, at least at this stage of the proceedings, that the Company believed certain hedge funds were attempting to gain effective control of the Company without paying a premium, and that it was objectively reasonable for the Company to perceive that threat. Because it is reasonably likely that the Board will be able to show that they were motivated to adopt the Rights Plan in response to this control threat and that "any effect of electoral rights was an incident to that end," Plaintiffs have

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[27] *Mercier v. Inter-Tel (Del.), Inc.*, 929 A.2d 786, 807 (Del. Ch. 2007).

not shown that it is reasonably probable that Plaintiffs will be able to establish that interference with the franchise was a major, let alone primary, purpose behind the Board's decision.

There are additional factors that, on the present record, also weigh against the argument that Plaintiffs have a reasonable probability of demonstrating that the Board's primary motivation was impeding the voting rights of any Sotheby's stockholder. First, the record is nearly devoid of facts that would support an inference of entrenchment on the part of the Board. The Board is not staggered, turns over at an above-average rate, and is dominated by outside, independent directors. Moreover, with the possible exception of Ruprecht, there has been no showing that serving on the Sotheby's Board is material, financially or otherwise, to any director such that they have a disabling personal incentive to quash a proxy contest. Although potentially there are reasons beyond entrenchment that would drive an independent, well-advised board to act for the primary purpose of impeding the stockholder franchise, the fact that no discernable entrenchment motive exists here weighs against a finding that the Board acted with such a "primary purpose."[28]

Second, while Plaintiffs have made much of the derogatory way in which various Defendants referred to Loeb in several emails, I am not persuaded that Plaintiffs have a

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[28] The Rights Plan's "qualifying offer" exception, which allows a potential bidder to make an offer for the entire Company and presumably replace the entire Board, if successful, without triggering the Rights Plan, is another factor that makes it unlikely that Plaintiffs will be able to demonstrate that the Board adopted the Rights Plan for entrenchment reasons.

reasonable probability of demonstrating that the Board's decisions vis-à-vis Third Point were motivated by an impermissible animus directed at Loeb. As an initial matter, I note that the majority of the communications in which Loeb is referred to pejoratively were authored by Ruprecht. Additionally, many of those communications were between Ruprecht and a family member, not a fellow Board member. I cannot conclude on the record before me that, with the exception of Ruprecht—who may have taken personally Loeb's harsh critiques and open efforts to replace him—anywhere near a majority of the Sotheby's Board felt that they had endured a similar affront at the hands of Loeb such that it would impede their judgment or motivate their actions with respect to Third Point. It also is difficult to reconcile the notion that the Board, on a personal level, found Loeb so distasteful that it adopted the Rights Plan for the primary purpose of impairing Third Point's electoral rights so that Loeb could not win in a proxy contest, and, yet, later would offer him a seat on the Board as part of settlement discussions. The Sotheby's Board was not required to like Loeb, and it very well may not have liked him. The current record, however, does not support a reasonable inference that Plaintiffs have a reasonable probability of establishing that any such "dislike" was the driving force behind any of the Board's decisions regarding Third Point.

Because Plaintiffs do not have a reasonable probability of demonstrating the Board acted with animus or an entrenchment motive in adopting the Rights Plan, it begs the question, what end would be served by a course of action taken for the primary purpose of disenfranchising Third Point and Sotheby's other stockholders? The fact that this question remains unanswered at this point militates against the conclusion that the

Board acted with the requisite improper "primary purpose" that would be necessary for the Board's actions to have to pass muster under the compelling justification standard set forth in *Blasius*.

Finally, the apparent effect of the Rights Plan itself also weighs against a conclusion that there is a reasonable probability that Plaintiffs can show it was adopted for the primary purpose of interfering with the stockholder franchise. As stated by Chief Justice Strine, then writing as Vice Chancellor in *Mercier v. Inter-Tel*:

> In prior decisions, this court has decided that because board action influencing the election process did not have the effect of precluding or coercing stockholder choice, that action was not taken for the primary purpose of disenfranchising stockholders. Because non-preclusive, non-coercive action did not have the primary purpose of disenfranchisement, the *Blasius* standard did not apply and thus no compelling justification for the board's action had to be shown. That is, the lack of disenfranchising effect provided that the trigger for the test was not pulled.[29]

In this case, Plaintiffs have not shown a reasonable likelihood that they will be able to demonstrate that the Rights Plan is either coercive or preclusive. This Rights Plan does not contain any features that would outright force a stockholder to vote in favor of the Board or allow the Board to induce votes in its favor through more subtle means. Said differently, the Rights Plan does not impose any consequences on stockholders for voting their shares as they wish. Thus, the Rights Plan is not "coercive." Nor is the Rights Plan here preclusive. It is undisputed that Third Point's proxy contest with the

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[29] *Mercier v. Inter-Tel (Del.), Inc.*, 929 A.2d at 818.

Board is eminently winnable by either side.[30] Therefore, even with a 10% cap on the number of shares it can acquire, there is no credible argument that Third Point's success in the pending proxy contest is "realistically unattainable."[31] Because the Rights Plan at issue here is not coercive or preclusive, the effect of the Rights Plan is another consideration that weighs against finding that Plaintiffs have a reasonable probability of showing that the Rights Plan was adopted for the primary purpose of interfering with the stockholder franchise.

In sum, on the record before me I cannot conclude that Plaintiffs have a reasonable probability of being able to establish that the Board acted with the necessary "primary purpose" to invoke *Blasius*'s compelling justification standard. Accordingly, I turn to the issue of whether the adoption of the Rights Plan in October 2013 satisfies the second prong of the *Unocal* standard.

### 3. Plaintiffs have not shown they have a reasonable probability of success as to the second prong of *Unocal*

For the reasons stated *supra*, the Rights Plan at issue here is neither preclusive nor coercive. Because it is not draconian, proportionality review turns on whether the Rights Plan adopted by the Board falls within the "range of reasonableness." "The reasonableness of a board's response is evaluated in the context of the specific threat

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[30] In briefing, Third Point concedes that the Rights Plan is not preclusive. Third Point Opening Br. 59. Moreover, Third Point's proxy expert, Daniel Fischel, described the proxy contest between Third Point and Sotheby's as "basically be[ing] a coin flip." As discussed in Section I.B.15, *supra*, the Company's proxy advisers believe the proxy contest is a "dead heat."

[31] *Versata Enters., Inc. v. Selectica, Inc.*, 5 A.3d 586, 601 (Del. 2010).

identified—the 'specific nature of the threat [ ] 'sets the parameters for the range of permissible defensive tactics' at any given time.'"[32] When evaluating whether a defensive measure falls within the range of reasonableness, the role of the Court is to decide "whether the directors made a reasonable decision, not a perfect decision."[33] Courts applying enhanced scrutiny under *Unocal* should "not substitute their business judgment for that of the directors" and if, on balance, "a board selected one of several reasonable alternatives, a court should not second-guess that choice."[34]

In this case there is a reasonable probability that the Board will be able to show that in October 2013 it was faced with the legally cognizable and objectively reasonable threat that Third Point, alone or with others, could acquire a controlling interest in the Company without paying Sotheby's other stockholders a premium. Thus, the relevant inquiry is whether the adoption of the Rights Plan was a reasonable and proportionate response to that threat of creeping control.

I consider it reasonably probable that the Board will be able to meet its burden to demonstrate that the adoption of the Rights Plan in October 2013 was a proportionate response to the control threat posed by Third Point. Plaintiffs here have not litigated the issue of or whether a 10% rights plan comports with Delaware law. Because the entire Board, collectively, owns less than 1% of Sotheby's stock, a 10% threshold allows

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[32] *Air Prods. & Chems., Inc. v. Airgas, Inc.*, 16 A.3d 48, 122 (Del. Ch. 2011).

[33] *Paramount Commc'ns Inc. v. QVC Network Inc.*, 637 A.2d 34, 45 (Del. 1994).

[34] *Id.*

activist investors to achieve a substantial ownership position in the Company. This is supported further by the fact that at its current ownership level just below 10%, Third Point is the Company's largest single stockholder. When the Rights Plan was adopted there also was the objectively reasonable possibility that Third Point was working in connection with one or more other hedge funds in an attempt to create a control block within the Company's stockholder base. A trigger level much higher than 10% could make it easier for a relatively small group of activist investors to achieve control, without paying a premium, through conscious parallelism.[35] This factor also supports my conclusion the Board has a reasonable probability of being able to show that the Rights Plan was a proportionate response to the control threat posed by Third Point.[36]

The gravamen of Plaintiffs' argument that the Rights Plan is disproportionate pertains mostly to its two-tier structure which permits "passive" investors to buy 20% of the Company shares while "activist" stockholders cannot purchase more than 10%. As an initial matter, I note that while the Rights Plan is "discriminatory" in that sense, it also

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35 *Yucaipa Am. Alliance Fund II, L.P. v. Riggio*, 1 A.3d 310, 360 n.254 (Del. Ch. 2010) *aff'd*, 15 A.3d 218 (Del. 2011). While it may be the case that Sotheby's could have achieved the same goal with a trigger level higher than 10%, Delaware law mandates a reasonable response, not a perfectly tailored solution.

36 The fact that the Board does not appear to have considered the effect of 8 *Del. C.* § 203 in adopting a Rights Plan with a 10% trigger, or later denying Third Point's request for a waiver, does not make the Board's decision disproportionate or unreasonable. The fact that Section 203 would make it more difficult for Third Point to extract some non-*pro rata* benefit from the Company if its stake went above 15% does not change the fact that the ability to control the direction of the Company, regardless of how the benefits of that control are shared, is something a board is entitled to protect against being transferred without the payment of an appropriate premium.

arguably is a "closer fit" to addressing the Company's needs to prevent an activist or activists from gaining control than a "garden variety" rights plan that would restrict the ownership levels for every stockholder, even those with no interest in obtaining control or asserting influence. In any event, the importance of the "discriminatory" nature of the challenged Rights Plan appears to be overstated in the circumstances of this case. Because I already have determined that the Board is likely to be able to show that the Rights Plan's 10% trigger for activist stockholders is reasonable and proportionate, the reason the discriminatory nature of the Rights Plan would be most likely to be found unreasonable or disproportionate is that it allows Schedule 13G filers, who may be more inclined to vote with the Company's management,[37] to acquire up to 20% of the Company's shares, and not because a 10% cap on activist stockholders is, itself, unreasonable or disproportionate.

In this case, Third Point is the Company's largest stockholder meaning that there are no Schedule 13G filers who own more than 10% of Sotheby's stock. Thus, while the question of whether Schedule 13G filers should be permitted under a rights plan to buy a larger interest in a company than activist stockholders is important in a general sense, I

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[37] While I do not mean to endorse the Rights Plan's two-tiered feature, and I am inclined to agree that the discrimination between "active" and "passive" shareholders raises some valid concerns, it also is important not to overstate the way in which shareholders that file Schedule 13Ds differ from those who file Schedule 13Gs. Based on the evidence presented here, there do not appear to be any restrictions whatsoever on a Schedule 13G filer who wishes to vote for a dissident slate in a proxy contest. Said differently, there is no evidence that a Schedule 13G filer would have to file a Schedule 13D or would otherwise "trigger" the Rights Plan simply because they decide to vote for directors other than those endorsed by the Company.

am not persuaded it can or should serve as a basis to enjoin the Sotheby's annual meeting when, as a practical matter, it is a complete non-issue in terms of the current composition of Sotheby's stockholders.

Based on the record before me, Plaintiffs have not shown that there is a reasonable probability that the Board will be unable to establish that the adoption of the Rights Plan in response to a legitimate control threat was a reasonable and proportionate response. As such, Plaintiffs have not demonstrated a likelihood of success on the merits of their claim that the Board breached its fiduciary duties in adopting the Rights Plan in October 2013. I turn next to the Plaintiffs' fiduciary duty claim pertaining to the Board's refusal to grant Third Point a waiver from the 10% trigger in March 2014.

**b. The refusal to waive the 10% trigger in March 2014**

**1. Plaintiffs have not shown they have a reasonable probability of success as to the first prong of *Unocal***

As with the Board's October 2013 decision to adopt the Rights Plan, I find that the Board likely will be able to meet its burden of demonstrating that it undertook a good faith and reasonable investigation in response to Third Point's request to waive the 10% trigger in the Rights Plan. The majority of the Board still were independent and disinterested directors and had utilized their outside legal and financial advisors continuously since the adoption of the Rights Plan in October 2013. Thus, the key inquiry in terms of the first prong of *Unocal* is whether the Board determined there was an objectively reasonable and legally cognizable threat to the Company in March 2014 when Third Point made its waiver request.

This presents a much closer question than the Board's original decision to adopt the Rights Plan in October 2013. Had Third Point asked the Board to waive the Rights Plan in its entirety, rather than just the 10% trigger, based on the record before me, it would have been relatively easy to determine that Third Point posed at least the same threat to the Company that it did when the plan was adopted in the first place. That, however, is not what happened.

Third Point asked only for a waiver of the 10% trigger for Schedule 13D filers so that it could buy up to a 20% interest in the Company. Third Point did not ask, for example, that the Rights Plan be redeemed or that the Company waive the Rights Plan's proscription of concerted action. It is not clear, therefore, that the Board did or should have had the exact same concerns in March 2014 that it did in October 2013 when it adopted the Rights Plan. As a result, I am skeptical that there is a reasonable probability that the Board could establish that when it rejected the request for a waiver, it had an objectively reasonable belief that Third Point continued to pose a "creeping control" risk to the Company, either individually or as part of a "wolf pack."

Nevertheless, despite the change in circumstances, I am persuaded that Sotheby's has made a sufficient showing as to at least one objectively reasonable and legally cognizable threat: negative control. Plaintiffs are correct that the Delaware case law relating to the concept of negative control addresses situations in which a person or entity obtains an explicit veto right through contract or through a level of share ownership or board representation at a level that does not amount to majority control, but nevertheless

is sufficient to block certain actions that may require, for example, a supermajority vote.[38] The evidence currently available indicates that Sotheby's may have had legitimate real-world concerns that enabling individuals or entities, such as Loeb and Third Point, to obtain 20% as opposed to 10% ownership interests in the Company could effectively allow those persons to exercise disproportionate control and influence over major corporate decisions, even if they do not have an explicit veto power.

The notion of effective, rather than explicit, negative control obviously raises some significant concerns, chief among them being where does one draw the line to ensure that "effective negative control" does not become a license for corporations to deploy defensive measures unreasonably. In this case, however, on the preliminary record developed to date there appears to be an objectively reasonable basis to believe that Third Point could exercise effective negative control over the Company. If Third Point was given the waiver it requested and achieved 20% ownership it would, by far, be Sotheby's largest single stockholder. That fact, combined with the aggressive and domineering manner in which the evidence suggests Loeb has conducted himself in relation to Sotheby's, provides an adequate basis for legitimate concern that Third Point would be able to exercise influence sufficient to control certain important corporate

[38] *Loral Space & Commc'ns Inc. v. Highland Crusader Offshore P'rs, L.P.*, 977 A.2d 867 (Del. 2009); *In re Trados Inc. S'holder Litig.*,73 A.3d 17 (Del. Ch. 2013); *Balch Hill P'rs, L.P. v. Shocking Techs., Inc.*, 2013 WL 588964 (Del. Ch. Feb. 7, 2013); *Johnston v. Pendersen*, 28 A.3d 1079 (Del. Ch. 2011); *Miller v. Miller*, 2008 WL 372469 (Del. Ch. Jan. 31, 2008); *In re Loral Space & Commc'ns Inc.*, 2008 WL 4293781 (Del. Ch. Sept. 19, 2008); *In re IAC/InterActive Corp.*, 948 A.2d 471 (Del. Ch. 2008); *Bentas v. Haseotes*, 769 A.2d 70 (Del. Ch. 2000); *Odyssey P'rs, L.P. v. Fleming Co.*, 735 A.2d 386 (Del. Ch. 1999).

actions, such as executive recruitment, despite a lack of actual control or an explicit veto power. Therefore, I find that Plaintiffs have not satisfied their burden of showing that there is a reasonable probability that the Board will not be able to demonstrate that it identified an objectively reasonable and legally cognizable threat to Sotheby's corporate policy and effectiveness. Based on that finding, I turn next to an evaluation of whether the Board's refusal to waive the 10% trigger level satisfies the second *Unocal* prong.

### 2. Plaintiffs have not shown they have a reasonable probability of success as to the second prong of *Unocal*[39]

[39] Because I find that there is a reasonable probability that the Board will be able to establish that in March 2014 it refused to provide Third Point with a waiver from the 10% trigger to prevent Third Point from achieving negative control, it follows that I do not find that the Board refused to provide the waiver for the primary purpose of interfering with the franchise of Third Point. Based on the record before me, however, that question is uncomfortably close. It gives me pause that the Board elected not to grant Third Point the waiver it sought soon after the Board learned from its proxy advisors that allowing Third Point to acquire an additional 10% stake likely would ensure a Third Point victory in the ongoing proxy contest. I am not unsympathetic to Plaintiffs' position here. As a general matter, shareholder rights plans are potent defensive measures. This is due in no small part to the fact that rights plans can, and do, affect the shareholder franchise. In *Moran*, however, the Supreme Court held that, based on the threat presented by a hostile takeover, some incidental reduction of the shareholder franchise as a result of adopting a rights plan was acceptable so long as a proxy contest remained a viable option. Since *Moran*, the scope of threats that a Company permissibly may respond to with the adoption of a rights plan, and, thus, the scope of threats that will justify a corporation incidentally impinging, at least to some extent, on the franchise of its shareholders has been extended beyond the hostile takeover context. *See Versata Enters., Inc. v. Selectica, Inc.*, 5 A.3d 586, 601 (Del. 2010) (upholding use of shareholder rights plan to protect corporation's ability to use its net operating losses). In this case, I have found that Plaintiffs have not met their burden on a preliminary injunction motion to show that they have a reasonable likelihood of success on the merits. Plaintiffs' claims that the challenged actions of the Board improperly impinge on the shareholders franchise appear to be at least colorable and raise important policy concerns that deserve careful consideration in the examination of poison pills under *Unocal.*

For the reasons already discussed *supra*, the Rights Plan does not implicate issues of preclusion or coercion. Consequently, the relevant inquiry is whether the Board's refusal to grant Third Point a waiver from the 10% trigger falls within the range of reasonableness. The Board's refusal to grant Third Point a waiver was a response to the threat that it posed to the Company of obtaining, at least, negative control and threatening corporate policy and effectiveness. The refusal to waive the Rights Plan's 10% trigger level is consistent with the Board's stated purposes, and the operation of the Rights Plan at the 10% level would help the Board achieve that end. While it is of course conceivable that there is some level of ownership between 10% and 20% that the Board could have allowed Third Point to increase its stake in the Company to without allowing it to obtain negative control, the 10% cap must be reasonable, not perfect. Based on the record before me, I find that Plaintiffs have not shown that there is a reasonable probability that the Board will be unable to demonstrate that its refusal to waive the 10% trigger in the Rights Plan was within the "range of reasonable" responses to the negative control threat posed by Third Point. Therefore, Plaintiffs have not established a likelihood of success on the merits of their claim that the Board breached its fiduciary duties by refusing to allow Third Point in March 2014 to acquire up to 20% of the Company's stock.

## B. Third Point, but Not Stockholder Plaintiffs, Has Made a Marginal Showing of Imminent, Irreparable Harm

Assuming for purposes of argument that Plaintiffs had been able to demonstrate a likelihood of success on the merits, I next consider whether they have demonstrated that they face a threat of imminent, irreparable harm. Preliminary injunctive relief is granted

"only upon a persuasive showing that it is urgently necessary."[40] In that regard, "the alleged injury must be imminent and genuine, as opposed to speculative."[41]

At a high level of generality, Plaintiffs argue that, unless the injunction they seek is granted, they will suffer imminent irreparable harm in three ways. First, Third Point contends that it will suffer irreparable harm because its odds of winning the proxy contest will be reduced, if the Rights Plan remains in place as is. Second, both Third Point and the Stockholder Plaintiffs assert that the Board's self-interested use of the corporate machinery to interfere with the stockholder franchise and manipulate the proxy contest is irreparably harmful to stockholders. Third, the Stockholder Plaintiffs emphasize that the consequences of allowing the election to be held with the discriminatory Rights Plan in place will be to chill socially valuable activist stockholder activity in the future and will have negative policy implications.

Although it is a close question, I find that Third Point's reduced odds of winning the proxy contest due to the Rights Plan likely would have qualified as a threat of irreparable harm, if Third Point had established a likelihood of success on the merits. I do not find persuasive, however, the second and third grounds Plaintiffs advanced to demonstrate a threat of imminent and irreparable harm.

As to the first alleged basis for imminent, irreparable harm, Third Point argues that the Board's improper use of the Rights Plan has caused a threat of imminent, irreparable

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[40] *Abrons v. Maree*, 911 A.2d 805, 810 (Del. Ch. 2006) (citing *Cantor Fitzgerald, L.P. v. Cantor*, 724 A.2d 571, 579 (Del. Ch. 1998)).

[41] *Aquila, Inc. v. Quanta Servs., Inc.*, 805 A.2d 196, 208 (Del. Ch. 2002).

harm because the proxy contest between Third Point and the Board is a close contest, in which every vote counts, and Third Point's inability to purchase more shares substantially reduces its odds of winning. If Third Point loses the proxy contest due to the Rights Plan, Third Point argues that it would have suffered irreparable harm because no relief the Court could provide would be an adequate substitute for its right to have a fair vote of the stockholders on its director nominees at Sotheby's annual meeting.

In response, Defendants aver that, at this point, the harm Third Point alleges it will suffer—namely, losing the proxy fight due to the Rights Plan—is merely speculative and does not justify granting the extraordinary relief that it requests. Defendants emphasize that, by all accounts, Third Point has even or better odds of winning the proxy fight, even with the Rights Plan in place. Moreover, Defendants contend that it is highly uncertain whether the relief Third Point seeks actually would affect the outcome of the vote. Lastly, Defendants argue that any harm Third Point might suffer would not be irreparable, because if the Court ultimately determined that the Board's use of the Rights Plan was improper, the Court could invalidate the vote and order a new election.

I address first the harm that Third Point stands to suffer from its decreased odds of winning the election and then address whether that harm is irreparable. On the facts before me, Third Point's showing of harm resulting from its reduced odds of winning the proxy contest would be questionable, even if it had established a likelihood of success on the merits. Third Point enjoys a substantial 10-to-1 advantage over the incumbent Board in shareholdings. According to Third Point's principal expert in this case, Daniel Fischel, the election is "basically a coin flip," and Third Point has "close to a 50-percent chance

of winning even with the 10 percent" poison-pill trigger.[42] Moreover, Loeb admitted in his deposition that nothing has prevented him from "making [his] case" to stockholders.[43] Thus, there is a substantial possibility that Third Point will win the proxy contest, which would make any preliminary intervention by this Court unnecessary.

Moreover, as Defendants note, even if Third Point still runs the risk of losing the proxy contest, it is uncertain that the relief Third Point requests would affect the outcome of the vote. Specifically, in order for the requested injunctive relief to make a difference, Third Point would have to lose by a small enough margin that increasing its holdings by 10% could swing the election. It is also uncertain whether Third Point actually would purchase up to an additional 10% of Sotheby's stock (and the related proxies). In addition, the effect of Third Point's increased holdings on the election would depend on who Third Point acquired its shares from—only shares purchased from holders who were backing the Board would change the ultimate distribution of votes.

Although the foregoing factors suggest that there is a significant possibility that the relief requested by Third Point ultimately might prove either unnecessary or futile, I am not prepared to say that the threatened harm to Third Point is so insubstantial as to render it speculative. The proxy contest, as it presently stands, is a "dead heat," and is likely to be determined by a relatively thin margin. In such a close contest, as Sotheby's own principal expert, Daniel Burch, acknowledged, "[i]t stands to reason that in the event

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[42] Fischel Dep. 13–14.

[43] Loeb Dep. 201–02.

that Third Point were permitted to increase its ownership position to approximately 20% of the outstanding voting shares, Third Point's likelihood of success in the proxy contest would be improved."[44]

Moreover, the intuitive proposition that Third Point's odds of winning would be improved if the 10% trigger were waived is supported by empirical research conducted by Fischel.[45] Fischel attempted to quantify the difference between Third Point's odds of success with 10%, as opposed to 20%, holdings by analyzing 34 proxy contests that occurred in 2012 and 2013, in which there were contested elections of individual director nominees. Those proxy contests collectively involved 112 individual director elections. Based on the empirical distribution of unaffiliated stockholder votes in these contests, Fischel concluded that the 10% trigger reduces the probability that Third Point will prevail in the proxy contest by between 21-25%, depending upon assumptions about voter turnout.[46] Thus, had Third Point been able to demonstrate a likelihood of success on the merits, I find that both the "dead heat" nature of the Sotheby's proxy contest and Fischel's expert evidence would support a conclusion that Third Point faces an imminent threat of harm, based on its reduced odds of winning the proxy contest with the 10% trigger in place.

I also conclude that the harm Third Point would suffer, were it to lose the proxy contest as a result of the 10% trigger, likely would be irreparable. Defendants argue that

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[44] Burch Report ¶ 22.

[45] Fischel Report ¶¶ 15–19.

[46] *Id.* ¶ 19 & n.31.

if Third Point's director nominees lose the proxy contest as a result of its inability to purchase additional Sotheby's shares, and the Court ultimately determines that the Rights Plan is invalid, the Court could remedy the harm by invalidating the vote and ordering a new election.[47] As this Court found in *American Pacific Corp. v. Super Foods Services, Inc.*,[48] however, the harm to a dissident slate from a flawed stockholder vote typically cannot be remedied after-the-fact by holding a second meeting. In that regard, while a "vote on the Directors could be nullified . . . , the effect of reversing any exercise of 'the will of the stockholder', even for their own benefit, is to create an insurmountable obstacle of confusion and antipathy."[49] Thus, the plaintiff competing in a flawed proxy contest "will not be able to achieve the real remedy, *i.e.*, a fair proxy contest with an informed electorate."[50]

For the foregoing reasons, if Third Point had been able to demonstrate a reasonable likelihood of success on the merits, I conclude that it also likely would have

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[47] Defendants also argue that the harm to Third Point would not be irreparable because the Rights Plan is set to expire in October 2014. Thus, Defendants contend that, even if Third Point loses this year's election due to the Rights Plan, it could begin buying additional shares in October and run another proxy contest next year, thereby remedying any temporary harm it might have suffered. I disagree. Losing one year's presence on the Sotheby's Board and having to incur the costs and uncertainty of running another proxy contest a year from now would constitute irreparable harm.

[48] 1982 WL 8767 (Del. Ch. Dec. 6, 1982).

[49] *Id.* at *326.

[50] *Id.*

been able to demonstrate a threat of imminent, irreparable harm, due to its reduced likelihood of winning the election as a result of the Rights Plan.[51]

As to the second alleged basis for imminent, irreparable harm, both Third Point and the Stockholder Plaintiffs argue that the Board's self-interested use of the corporate machinery to interfere with the stockholder franchise and manipulate the proxy contest is irreparably harmful to stockholders. In support of their argument, Plaintiffs, at various points in their collective briefing, cite to *Kallick v. Sandridge Energy, Inc.*[52] for the proposition that it is a "fundamental offense to the dignity of the corporate office" imposing "immediate, irreparable harm" when directors act "to enhance the incumbent's [sic] board chances of procuring stockholder votes in a closely contested election, which could be decided by a few percentage points." Plaintiffs argue that this holding applies to

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[51] I note that *Aquila, Inc. v. Quanta Servs., Inc.*, 805 A.2d 196 (Del. Ch. 2002), a case relied on by Defendants to support their argument that Third Point faces no threat of irreparable harm, is distinguishable based on the availability there of a remedy that would allow the Court to avoid having to nullify an election and order a second one held. In *Aquila*, the Court held that plaintiff, a dissident stockholder, had demonstrated a likelihood of success on the merits on his *Unocal* challenge to the defendant company's creation of a stock employee compensation trust (SECT). That trust placed newly issued voting shares accounting for approximately 10% of the company's total outstanding shares in the hands of employees who were likely to support the incumbent board. Nonetheless, the Court determined that the plaintiff had not demonstrated an imminent threat of irreparable harm. Importantly, in that case, if the stockholder failed to obtain a majority by 10% or less of the votes, the Court could simply void the SECT votes and determine under 8 *Del. C.* § 225 whether the stockholder's director nominees had won. No such remedy exists in this case, however, due to the lack of any readily identifiable set of proxies or votes that the Court could invalidate to correct for Third Point's inability to purchase up to 20% of Sotheby's shares.

[52] *Kallick v. Sandridge Energy, Inc.*, 68 A.3d 242, 244 (Del. Ch. 2013)

this case, because the Board sought to leverage a Rights Plan to enhance the incumbent directors' chances of winning the proxy contest. Specifically, Plaintiffs contend that the Board attempted to prevent shares and the concomitant voting rights from trading into the hands of Third Point, in a closely contested election that may be decided by a few percentage points.

The *Kallick* case also is distinguishable from this case. At issue in *Kallick* was an incumbent board's improper use of a "proxy put," which is a provision that may be included in a company's credit agreements requiring the company to refinance its debt in the event of a change in the majority of the board, if that change was not approved by a majority of the pre-existing directors. In *Kallick*, the board of the defendant company, Sandridge, used the company's proxy put as a coercive tool to dissuade stockholders from voting to elect a new board majority, warning them that to do so would result in material economic harm because Sandridge's lenders would have the right to put $4.3 billion worth of notes back to the company. A Sandridge stockholder sued the incumbent directors, seeking injunctive relief that would neutralize the Board's refusal to approve the dissident slate for purposes of the proxy put. Crucial to the Court's finding of "immediate, irreparable harm" sufficient to merit granting a preliminary injunction was its conclusion that "it constitutes a fundamental offense to the dignity of [the] corporate office for a director to use corporate power to seek *to coerce* stockholders in the exercise of the vote."[53]

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[53] *Id.* at 264.

As this Court has noted elsewhere, "[a] coercive response is one that is aimed at 'cramming down' on its stockholders a management-sponsored alternative."[54] The Board's use of the proxy put in *Kallick* was found coercive, because the Sandridge board was using the proxy put as a tool to force stockholders to support the incumbent board over the dissidents, or risk causing the company to suffer dire economic consequences. By contrast, for the reasons previously discussed, the Rights Plan at issue here is not coercive. While Third Point was capped at acquiring 10% of Sotheby's shares, nothing about the Rights Plan forces Third Point or any other stockholder to support the incumbent management. Rather, Sotheby's stockholders will be free to vote at the annual meeting for whomever they wish. Thus, *Kallick*'s concern with boards using corporate power to coerce stockholders in the election context is not implicated here.

As to the final alleged basis for imminent, irreparable harm, the Stockholder Plaintiffs argue that the consequences of allowing the election to be held with the discriminatory Rights Plan in place will be to chill socially valuable activist stockholder activity in the future, among other negative policy implications. Among other arguments they make, the Stockholder Plaintiffs contend that the effect of Sotheby's Rights Plan here will be to chill activist stockholder activity, because the 10% trigger artificially limits an investor's ability to absorb the costs of a bruising proxy fight. The Stockholder Plaintiffs contend that this outcome would be irreparably harmful because passive investors depend on activists to pursue value-enhancing initiatives, including proxy

[54] *Versata Enterprises, Inc. v. Selectica, Inc.*, 5 A.3d 586, 601 (Del. 2010) (citing *Unitrin, Inc. v. Am. Gen. Corp.*, 651 A.2d 1361, 1387 (Del. 1995)).

fights, which often serve the long-term interests of stockholders. The Stockholder Plaintiffs also argue that the discriminatory nature of the Rights Plan is inherently troubling, because stockholders should be treated equally and, moreover, because it puts both active investors and currently passive investors who want to reserve the right to challenge management at a disadvantage to purely passive investors, who are more likely to support management.

Although this Court is generally sympathetic to the policy concerns that the Stockholder Plaintiffs have articulated, they do not meet the relevant requirement of the preliminary injunction standard, for the simple reason that they do not present *imminent* threats. These factors, instead, speak to the long-term reasonableness of the Rights Plan and can be considered by the Court in a final hearing on the merits.

### C. The Balance of the Equities Weighs Slightly in Plaintiffs' Favor

Had Plaintiffs been able to satisfy their burden of showing a likelihood of success on the merits and a threat of irreparable harm, I also would have found that the balancing of the equities weighs slightly in favor of Plaintiffs' request for injunctive relief. This Court has discretion to grant or deny an application for injunctive relief in light of the relative hardships of the parties.[55] Thus, in order to obtain preliminary injunctive relief, a plaintiff must prove that this Court's failure to grant the injunction will cause it greater harm than granting the injunction will cause the defendants.[56]

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[55] *Cantor Fitzgerald, L.P. v. Cantor*, 724 A.2d 571, 587 (Del. Ch. 1998).

[56] *Id.*

Sotheby's argues first that the balance of the equities weighs in its favors because an injunction delaying the annual meeting would put the Company "out of step" with 8 *Del. C.* § 211. This assertion is without merit. Section 211 operates to protect stockholders by ensuring that they have certain reliable opportunities to exercise their electoral rights. It largely would defeat the purpose of Section 211, however, if the voting rights to be exercised are being impinged on impermissibly by, for example, a rights plan that is likely to be held invalid.[57] In this case, had Plaintiffs been able to show a likelihood of success on the merits, Third Point also would have been able to demonstrate that its franchise rights would have been irreparably harmed if the annual meeting had proceeded as scheduled.

Defendants also aver that the balance of the equities weighs against an injunction because of the harm the Company is enduring as a result of its ongoing proxy contest with Third Point. According to Sotheby's, the proxy fight has both been disruptive to its operations and given its main competitor Christie's the opportunity to poach valuable business opportunities. Thus, prolonging the uncertainty of the proxy contest by enjoining the meeting would cause real and significant harm to the Company.

Although credible, the Company's argument that enjoining the annual meeting would be materially harmful to its business is insufficient to outweigh the harms Third

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[57] Defendants' reliance on Section 211 is also unpersuasive because the length of any delay in the annual meeting likely would have been relatively minimal. This case already has been proceeding on an expedited track and it appears that a material portion of the necessary discovery already has been completed. Thus, had an injunction issued, an expedited trial could have been held, and a decision on the merits rendered within a matter of a few months.

Point and the Stockholder Plaintiffs would endure if the meeting were not enjoined. Protection of the stockholder franchise is important in every instance, but it is of particular importance here, where Third Point is engaged in a hotly contested proxy fight with the Company and certain of the Company's directorships are at stake.

## III. CONCLUSION

For the foregoing reasons, Plaintiffs' motions for a preliminary injunction are denied.

**IT IS SO ORDERED**.