

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

SELECTICA, INC.,
Plaintiff,
v.
VERSATA ENTERPRISES, INC., and
TRILOGY, INC.,
Defendants.
and
VERSATA ENTERPRISES, INC. and
TRILOGY, INC.,
Counterclaim Plaintiffs,
v.
SELECTICA, INC., JAMES ARNOLD,
ALAN B. HOWE, LLOYD SEMS,
JIM THANOS, and BRENDA ZAWATSKI,
Counterclaim Defendants.

C.A. No. 4241-VCN

MEMORANDUM OPINION

Date Submitted: October 2, 2009
Date Decided: February 26, 2010

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NOBLE, Vice Chancellor

I. INTRODUCTION

This is an action for declaratory judgment with respect to the validity of (1) the implementation of a rights agreement adopted by the plaintiff company in attempt to preserve certain net operating loss carryforwards perceived to be at risk as a result of share purchases by the defendants; (2) certain subsequent actions taken by plaintiff's board of directors in response to defendants' purposeful trigger of the rights agreement; and (3) the amended and restated rights agreement established in the wake of the rights agreement's triggering. The defendants who triggered the rights agreement have countersued seeking to have the rights agreement and other actions by plaintiff's board of directors declared invalid, void, and unenforceable, as well as the entry of an order enjoining or rescinding them. The defendants also seek damages for alleged breaches of fiduciary duty by the plaintiff's board.

II. BACKGROUND

A. *A Brief Explanation of NOLs*

At its core, this case is about the value of net operating loss carryforwards ("NOLs") to a currently profitless corporation, and the extent to which such a corporation may fight to preserve them. For convenience, the Court provides a brief overview—although perhaps a simplistic and certainly incomplete one—of the concepts surrounding NOLs, their calculation, and possible impairment.

NOLs are tax losses realized and accumulated by a corporation that can be used to shelter future (or immediate past) income from taxation.¹ If taxable profit has been realized, the NOLs operate to provide a refund of prior taxes paid or to reduce the amount of future income tax owed. Thus, NOLs can be a valuable asset, as a means of lowering tax payments and producing positive cash flow. However, NOLs are considered a contingent asset; their value is contingent upon the firm's reporting a future profit (or having an immediate past profit). Should the firm fail to realize a profit during the lifetime of the NOL (20 years), the NOL expires worthless. The precise value of a given NOL is impossible to determine since its ultimate use is subject to the timing and amount of recognized profit at the firm. If the firm never realizes taxable income, at dissolution, its NOLs, regardless of their size, would have zero value.

In order to prevent corporate taxpayers from benefiting from NOLs generated by other entities, Internal Revenue Code Section 382 establishes limitations on the use of NOLs in periods following an "ownership change." If Section 382 is triggered, the law places a restriction on the amount of prior NOLs

¹ NOLs may be carried backward two years and carried forward twenty years.

that can be used in subsequent years to reduce the firm's tax obligations.² Of course, once NOLs are so impaired, a substantial portion of their value is lost.

The precise definition of an "ownership change" under Section 382 is rather complex. At its most basic, an ownership change occurs when more than 50% of a firm's stock ownership changes over a three-year period. Specific provisions in Section 382 define the precise manner by which this determination is made. Most importantly for the Court's purposes, the only shareholders considered in the context of calculating an ownership change under Section 382 are those who hold, or have obtained during the testing period, a 5% or greater block of the corporation's shares outstanding.³ Calculating the likelihood of a Section 382 ownership change at a given company at a particular time is extraordinarily difficult and requires making a number of factual assumptions, subject to varied interpretations of the correct application of Section 382, upon which reasonable experts may disagree.⁴

With this general background in place, the Court now turns to the facts of this case.⁵

² The annual limitation on the use of past period NOLs following a change in control is calculated as the value of the firm's equity at the time of the ownership change, multiplied by a published rate of return, the federal long term exemption rate.

³ Consequently, it is understood that in most acquisitions an "ownership change" under Section 382 occurs because the acquirer purchases more than 50% of the target's stock.

⁴ See, e.g., DX 777; DX 787; PX 127; Tr. 1298-312.

⁵ The facts evidencing "what happened" are largely uncontested. The inferences to be drawn from those facts and the motivations of those involved are, however, fertile sources of debate.

B. *The Parties*

Plaintiff and Counterclaim-Defendant Selectica, Inc. (“Selectica” or the “Company”) is a Delaware corporation, headquartered in California and listed on the NASDAQ Global Market. It provides enterprise software solutions for contract management and sales configuration systems. Selectica is a micro-cap company with a concentrated shareholder base: the Company’s seven largest investors own a majority of the stock, while fewer than twenty-five investors hold nearly two-thirds of the stock.⁶

Defendant and Counterclaim-Plaintiff Trilogy, Inc. (“Trilogy”) is a Delaware corporation also specializing in enterprise software solutions. Trilogy stock is not publicly traded, and its founder, Joseph Liemandt, holds over 85% of the stock. Defendant and Counterclaim-Plaintiff Versata Enterprises, Inc. (“Versata”) is a Delaware corporation and subsidiary of Trilogy; it provides technology powered business services to clients. Before the events giving rise to this action, Versata and Trilogy beneficially owned 6.1% of Selectica’s common stock.⁷

⁶ PX 121. However, because of the shareholder rights plan first instituted in 2003, no stockholder holds more than 15% of the outstanding shares.

⁷ PX 103.

Following their intentional triggering of Selectica's shareholder rights agreement through the purchase of additional shares, the joint beneficial ownership of Versata and Trilogy was diluted from 6.7% to approximately 3.3%.⁸

Counterclaim-Defendants James Arnold, Alan B. Howe, Lloyd Sems, Jim Thanos, and Brenda Zawatski are members of the Selectica Board of Directors (the "Board").⁹ Zawatski and Thanos also served as Co-Chairs of the Board during the events at issue in the case.¹⁰ In this role, they handled the day-to-day operations of the Company, as Selectica has been without a Chief Executive Officer since June 30, 2008.

C. Selectica's Historical Operating Difficulties and Relationship with Trilogy

Selectica, since it became a public company in March 2000, has lost a substantial amount of money and failed to turn an annual profit, despite routinely projecting near-term profitability. Its IPO price of \$30 per share has steadily fallen and now languishes below one dollar per share, placing Selectica's market

⁸ PX 104; DX 746; Tr. 133.

⁹ Alan Howe was elected to the Board on January 12, 2009, after the events at issue in this case. He has not been charged with any breach of fiduciary duty and has not been served with process. Selectica asserts that Howe is not subject to personal jurisdiction in this Court and seeks to have him dismissed as a Counterclaim-Defendant. Trilogy purports to name Howe as a Counterclaim-Defendant solely "in order to afford [Trilogy] complete relief." Answer and Counterclaims of Defs. Trilogy, Inc. and Versata Enterprises, Inc. ¶ 62.

¹⁰ On August 19, 2009, Thanos stepped down as Co-Chair and Zawatski became sole Chair of the Board and continued to handle the Company's daily operations. Defs./Counterclaim Pls.' Second Mot. for Judicial Notice under Del. R. of Evidence 201 ("RJN2"), Ex. A at 4.

capitalization at roughly \$23 million at the end of March 2009.¹¹ By its own admission, its value today “consists primarily in its cash reserves, its intellectual property portfolio, its customer and revenue base, and its accumulated NOLs.”¹² By consistently failing to achieve positive net income, Selectica has generated an estimated \$160 million in NOLs for federal tax purposes over the past several years.¹³

Selectica has had a complicated and often adversarial relationship with Trilogy, stretching back at least five years. Both compete in the relatively narrow market space of contract management and sales configuration. In April 2004, a Trilogy affiliate sued Selectica for patent infringement and secured a judgment that required Selectica, among other things, to pay Trilogy \$7.5 million. While the suit was pending, in January 2005, Trilogy made an offer to buy Selectica for \$4 per share in cash—a 20% premium from the then-trading price—which the Board rejected. Nevertheless, during March and April of that year, a Trilogy affiliate acquired nearly 7% of Selectica’s common stock through open market trades. In early fall 2005, Trilogy made than another offer for Selectica’s shares at a 16%-23% premium, which was also rejected. In September 2006, a Trilogy-affiliated holder of Selectica stock sent a letter to the Board questioning whether certain

¹¹ Defs./Counterclaim Pls.’ Mot. for Judicial Notice Under Del. R. of Evidence 201 (“RJN”), Ex. A at 35, 53.

¹² Pre-Trial Br. of Pl. Selectica, Inc. and Counterclaim Defs. (“Selectica Pre-Trial Br.”) at 5.

¹³ Tr. 34-35, 379-80.

stock option grants had been backdated.¹⁴ The following month, Trilogy filed another patent lawsuit against Selectica, which was settled in October 2007, when Selectica agreed to a one-time payment of \$10 million, plus an additional amount of not more than \$7.5 million in subsequent payments to be made quarterly. In late fall 2006, Trilogy sold down its holdings in Selectica.¹⁵

D. The Role of Steel Partners

Steel Partners is a private equity fund that has been a Selectica shareholder since at least October 2006 and is its largest shareholder. One of the apparent investment strategies of Steel Partners is to invest in small companies with large NOLs with the intent to help pair the failing company with a profitable business in order to reap the tax benefits of the NOLs.¹⁶ Steel Partners has actively worked with Selectica to calculate and monitor the Company's NOLs since the time of its original investment.

¹⁴ A special committee empanelled by the Board ultimately concluded that certain options had, in fact, been backdated. Consequently, Selectica was required to restate its financial statements to record additional stock-based compensation and related tax effects for past option grants and incurred fees associated with the investigation in excess of \$6.2 million. DX 214 at 21; DX 260 at 14. This episode also led to the resignation of Selectica's then-Chairman and Chief Executive Officer Stephen Bannion (who had been the Company's Chief Financial Officer at the time of the grants of question) and the appointment of then-Director Robert Jurkowski to the Chief Executive and Chair position.

¹⁵ From late fall 2006 until October 2008, neither Trilogy nor its affiliates owned any Selectica stock.

¹⁶ See, e.g., Howard Dep. at 25-27, 56-60, 109-11; Thanos Dep. at 61-62; PX 63; DX 211.

By early 2008, Steel Partners was advocating a quick sale of Selectica's assets, leaving an NOL shell that could be merged with a profitable operating company in order to shelter the profits of the operating company.¹⁷

In October 2008, Steel Partners informed members of the Board that it planned to increase its ownership position to 14.9%, just below the 15% trigger of the 2003 Pill, which it later did. Jack Howard, President of Steel Partners, lobbied for a Board seat twice in 2008, citing his experience dealing with NOLs, but was rebuffed.¹⁸

E. Selectica Investigates its NOLs

In 2006, at the urging of Steel Partners, the Company directed Alan Chinn, its outside tax adviser, to perform a high-level analysis into whether the Company's NOLs were subject to any limitations under Section 382 of the Internal Revenue Code. Chinn concluded that five prior changes in ownership had caused the forfeiture of approximately \$24.6 million of NOLs.¹⁹ Selectica provided the results of this study to Steel Partners, though not to any other Selectica shareholder. In March 2007, again at Steel Partners's recommendation, Selectica retained a second accountant who specialized in NOL calculations, John Brogan of Burr Pilger & Mayer LLP, to analyze the Company's NOLs more carefully and

¹⁷ Howard Dep. at 57-60.

¹⁸ Tr. 994-1000; Thanos Dep. at 60-63.

¹⁹ The Company disclosed this information in its financial statements for fiscal year 2008. DX 394 at F-22.

report on Chinn's Section 382 analysis.²⁰ Brogan had previously analyzed the NOLs at other Steel Partners ventures. Brogan ultimately determined that Chinn's conclusions were erroneous. The Company engaged Brogan in additional work on the topic of NOLs in June 2007. One of Steel Partners's employees, Avi Goodman, worked closely with Brogan on the matter, although Brogan was working for and being paid by Selectica and received no compensation from Steel Partners. Brogan's draft letter opinion, concluding that the Company had not undergone an "ownership change" for Section 382 purposes since 1999, was shared with Steel Partners, although again not with any other outside investors.

In the fall of 2007, Brogan proposed a third, more detailed, Section 382 study, which Selectica's then-CEO Robert Jurkowski opposed. In February 2008, the Board voted against spending \$40,000-\$50,000 to fund this Section 382 study. By July, however, the Board asked Brogan to update his study, and he delivered the draft opinion that, as of March 31, 2008, the Company had approximately \$165 million in NOLs.²¹ Brogan was later asked to advise the Board in the fall of 2008 on the updated status of its NOLs when the Board moved to amend its rights plan.

²⁰ Selectica concedes that it valued Steel Partners's recommendation in these matters as it found its principals to be knowledgeable on the topic of NOLs. Pl.'s Pre-Trial Br. at 6.

²¹ During this time, Brogan included Howard in nearly all correspondence relating to his analysis of Selectica's NOLs, even when Company directors were not. *See, e.g.*, DX 427; DX 456. This was brought to the attention of the Board in September, which then asked Brogan to desist. Tr. 102-03, 230-32, 251-57, 997; Zawatski Dep. at 194-95. The Board did not investigate what Howard had learned or whether Steel Partners had traded on the information provided.

F. Lloyd Sems Joins the Board

In April 2008, the Board began interviewing candidates for an open board seat, giving preference to the Company's large shareholders.²² Selectica investor Lloyd Sems had previously expressed interest in joining the Board and had sought support from certain shareholders, including Steel Partners, through Howard, and Lloyd Miller, another large Selectica shareholder not affiliated with Steel Partners.²³ Both Miller and Howard wrote to the Board in support of Sems's appointment,²⁴ although he was already favored by the Board by that time.²⁵ In June 2008, Sems was appointed to the Board.²⁶

As large shareholders, Sems, Howard, and Miller had periodically discussed Selectica as early as October 2007. At that time, Sems had emailed Howard, stating, "I wanted to get your opinion of how or if you would like me to proceed with [Selectica]." Howard replied, "Lloyd [Miller] said he would call you about [Selectica]."²⁷ Both before and after his appointment to the Board, Sems discussed

²² Zawatski Dep. at 133-35.

²³ Tr. 278-79; Sems Dep. at 21-22; Howard Dep. at 74-77.

²⁴ DX 303; Tr. 762; Jurkowski Dep. at 75-80.

²⁵ Tr. 938-41. Jurkowski testified that, at the time the Board was considering Sems as a potential director, Jurkowski viewed Sems as an investor who "was interested in what we were going to do to grow the business, and perhaps as an investor, anything that he could do to actually help us grow the business, as opposed to somebody who just focused on some of the financial elements of the company." Jurkowski Dep. at 77-78.

²⁶ DX 379.

²⁷ DX 227. Sems explained that this email was a follow-up seeking their opinion on his efforts to join the Board, which he had previously discussed with both, and was sent in an attempt to gain support. Sems Dep. 192-94. In the context of the entire email, this is a plausible explanation, certainly more plausible than as a unilateral offer to be controlled by Steel Partners.

with Howard and Miller a number of the proposals that Sems ultimately advocated for as a director, including that Selectica should buy back its stock,²⁸ that Selectica should consider selling its businesses,²⁹ that the NOLs were important and should be preserved through the adoption of a 5% pill,³⁰ and that Jurkowski should be removed as CEO.³¹ As a Board member, Sems also reached out to Howard and Miller from time to time on other issues, including seeking recommendations for chief financial officer candidates,³² investment bankers to conduct the sale process,³³ and attorneys in the run up to this litigation,³⁴ although the Board apparently adopted none of Howard's recommendations.³⁵

G. Selectica Decides to Restructure and to Explore Strategic Alternatives

In early July 2008, after determining that the Company needed to change course, the Board terminated Jurkowski as CEO and eliminated a number of management positions in the sales configuration business.³⁶ Later that month,

²⁸ DX 609; DX 610; DX 419 at 4; DX 455 at 2-3. The Board had previously concluded that this was not in the Company's best interest. DX 238; DX 281.

²⁹ Sems Dep. 21-23; DX 549.

³⁰ Sems Dep. 16-19; Tr. 766-69.

³¹ DX 376; DXs 265-67; Sems Dep. 189-91.

³² DX 402. In reply, Howard queried, "Should we push to sell the company before [bringing] in a new cfo?" *Id.*

³³ Tr. 743-44; DX 430.

³⁴ DX 707.

³⁵ Tr. 744; Howard Dep. at 142-44; DX 707.

³⁶ The day that the Company released its 8-K announcing the resignations of those officers, Howard wrote an email to Sems, stating, "[Call] me about the news—great job." DX 416.

prompted by the receipt of five unsolicited acquisition offers over the space of a few weeks,³⁷ the Board announced that it was in the process of selecting an investment banker (ultimately, Jim Reilly of Needham & Company) to evaluate strategic alternatives for the Company and to assist with a process that ultimately might result in the Company's sale.³⁸ In view of the potential sale, the Board decided to forgo the expense of replacing Jurkowski and, instead, asked Zawatski and Thanos jointly to assume the title of Co-Chair and to perform operational oversight roles on an interim basis.

H. *The Needham Process*

Needham has actively carried out its task of evaluating Selectica's strategic options since its selection by the Board. Needham first discussed with the Board the various strategic choices that the Company could take, including a merger of equals with a public company, a reverse IPO or other going-private transaction, the sale of certain assets, and the use of cash to acquire another company, as well as stock repurchases or the issuance of dividends, should Selectica decide to continue as an independent public company in the absence of sufficient market interest for an acquisition.³⁹

³⁷ Tr. 318-19.

³⁸ See, e.g., PX 47; PX 67; Tr. 35-40, 182-83, 930-32.

³⁹ Reilly Dep. at 31-32.

In October 2008, Needham prepared an Executive Summary of the assets and operations of Selectica and subsequently reached out to potential buyers, remaining in communication with various interested parties throughout the remainder of the year and into the first part of 2009.⁴⁰ By February 2009, at least a half-dozen parties had come forward with letters of intent and were in the process of meeting with Selectica management and conducting due diligence in the Company, while Needham evaluated their various proposals for the purchase of all or part of Selectica's operations.⁴¹ As of April 2009, Selectica, through Needham, had signed a letter of intent and entered into exclusive negotiations with a potential buyer.⁴²

I. Trilogy Begins Buying

On July 15, 2008, Liemandt called Zawatski to inquire generally about the possibility of an acquisition of Selectica by Trilogy. On July 29, Trilogy Chief Financial Officer Sean Fallon, Trilogy Director of Finance Andrew Price, and Versata Chief Executive Officer Randy Jacops participated in a conference call with Selectica Co-Chairs Zawatski and Thanos on the same topic. During the call, Thanos inquired as to how Trilogy would calculate a value for the

⁴⁰ Reilly Dep. at 137-54. None of the potential buyers expressed specific interest in Selectica's NOLs. Reilly Dep. at 14.

⁴¹ Reilly Dep. at 11-14.

⁴² Reilly Dep. at 135-36.

Company's NOLs. Fallon replied that Trilogy, "really [did not] pursue them with as much vigor as other[s] might since that is not our core strategy."⁴³ The following evening, Fallon contacted Zawatski and outlined two proposals for Trilogy to acquire Selectica's business: (1) Trilogy's purchase of all of the assets of Selectica's sales configuration business in exchange for the cancellation of the \$7.1 million in debt Selectica still owed under the October 2007 settlement with Trilogy; or (2) Trilogy's purchase of the entire operations of Selectica for the cancellation of the debt plus an additional \$6 million in cash. Fallon subsequently followed up with an email reiterating both proposals and suggesting that either proposal would allow Selectica to still make use of its NOLs through the later sale of its corporate entity.⁴⁴

Shortly thereafter, the Board rejected both proposals. The Board made no counterproposal and there were no follow-up discussions. On October 9, 2008, Trilogy made a second bid to acquire all of the Selectica's assets for \$10 million in cash plus the cancellation of the debt, which the Board also rejected. Trilogy was

⁴³ *Id.* However, as part of its 2005 effort to acquire Selectica, Trilogy had performed "a pretty detailed analysis" of Selectica's NOLs. Johnston Dep. at 21 (Sherie Johnston, Trilogy's tax director, performed the analysis). Johnston testified that this analysis was occasionally updated and that similar analyses had been performed on a dozen or so other acquisition targets. *Id.* at 22-26. On or around November 18, 2008, Price and Fallon asked about obtaining an updated change in control calculation for Selectica but, due to other more pressing matters, Johnston never performed it. *Id.* at 27-35.

⁴⁴ PX 78. That this was his suggestion was confirmed by Fallon in his deposition. Fallon Dep. at 98-99.

invited to participate in the sale process being overseen by Needham, but Trilogy was apparently unwilling to sign a non-disclosure agreement, which was a prerequisite for participation.⁴⁵ Around this same time, Trilogy had begun making open-market purchases for Selectica stock, although the Board was apparently not aware of this fact at the time.⁴⁶

On the evening of November 10, Fallon contacted Zawatski and informed her that Trilogy had purchased more than 5% of Selectica's outstanding stock and would be filing a Schedule 13D shortly, which it did on November 13.⁴⁷ On a subsequent call with Zawatski and Reilly, Fallon explained that Trilogy had begun buying because it believed that "the company should work quickly to preserve whatever shareholder value remained and that we were interested in seeing this process that they announced with Needham, that we were interested in seeing that accelerate. . . ."⁴⁸ Within four days of its 13D filing, Trilogy had acquired more than 320,000 additional shares, representing an additional 1% of the Company.⁴⁹

J. The November 16 Board Meeting & Decision to Adopt the NOL Pill

In the wake of Trilogy's decision to begin acquiring Selectica shares, the Board took actions to gauge the impact of these acquisitions, if any, on the

⁴⁵ Reilly Dep. at 46. Fallon also told John Reilly from Needham that "if he were to make another proposal . . . that it would be lower than the last proposal that they had made. . . ." *Id.*

⁴⁶ Fallon Dep. at 118-19.

⁴⁷ The November 13, 2008, Schedule 13D reported that Versata and affiliates had purchased 1,437,891 shares of Selectica stock, increasing its ownership to 5.1%. PX 102.

⁴⁸ Fallon Dep. at 144.

⁴⁹ PX 103.

Company's NOLs, and to determine whether anything needed to be done to mitigate their effects. Sems immediately asked Brogan to revise his Section 382 analysis—which had not been formally updated since July—to take into account the recent purchases. This was delivered to Sems and the Company's new CFO, Richard Heaps, on November 15, showing that the cumulative acquisition of stock by shareholders over the past three years stood at 40%, which was roughly unchanged from the previous calculation, due to some double counting that occurred in the July analysis.⁵⁰

The Board met on November 16 to discuss the situation and to consider amending Selectica's shareholder rights plan, which it had had in place since February 2003. As with many poison pills employed as protection devices against hostile takeovers, Selectica's initial pill had a 15% trigger. The Board considered an amendment that would reduce that threshold trigger to 4.99% in order to prevent additional 5% owners from emerging and potentially causing a change in control event, thereby devaluing Selectica's NOLs.⁵¹ Also present at the meeting were Heaps, Brogan, and Reilly, along with Delaware counsel.

⁵⁰ PX 72. A more formal analysis was provided on November 26, finding a 38.8% change in ownership over the relevant period. DX 688.

⁵¹ Sems had previously recommended reducing the poison pill threshold trigger to 5% at the Board's July 23, 2008, meeting. The Board decided to defer consideration of the recommendation until it received additional information on the potential legal consequences of such an action. DX 455 at 2-3. *See also* Sems Dep. 165-66; Tr. 740-42 (contesting the stated rationale in the Board minutes of protecting against hostile takeovers and testifying that his then-stated rationale was the protection of the NOLs).

Heaps gave an overview of the Company's existing shareholder rights plan and reviewed the stock price activity since Trilogy had filed its Schedule 13D, noting that shares totaling approximately 2.3% of the Company had changed hands in the two days following the filing.⁵² Brogan reviewed the Section 382 ownership analysis that his firm had undertaken on behalf of the Company, noting that additional acquisitions of roughly 10% of the float by new or existing 5% holders would "result in a permanent limitation on use of the Company's net operating loss carryforwards and that, once an ownership change occurred, there would be no way to cure the use limitation on the net operating loss carryforwards."⁵³ He further advised the Board that "net operating loss carryforwards were a significant asset" and that he generally advises companies to consider steps to protect their NOLs when they experience a 30% or greater change in beneficial ownership. Lastly, Brogan noted that, while he believed that the cumulative ownership change calculations would decline significantly over the next twelve months, "it would decline only modestly, if at all, over the next three to four months," meaning that "the Company would continue to be at risk of an ownership change over the near term."⁵⁴

⁵² PX 89 at 2, 4.

⁵³ *Id.* at 4.

⁵⁴ *Id.*

Reilly discussed the Company's strategic alternatives and noted that Steel Partners and other parties had expressed interest in pursuing a transaction that would realize the value of Selectica's NOLs, while also reviewing potential transaction structures in which the Company might be able to utilize its NOLs. Reilly responded to questions from the Board, and noted that "it is difficult to value the Company's net operating loss carryforwards with greater precision, because their value depends, among other things, on the ability of the Company to generate profits," and confirmed that "existing stockholders may realize significant potential value" from the utilization of the Company's NOLs, which would be "significantly impaired" if a Section 382 ownership change occurred.⁵⁵

At the request of the Board, Delaware counsel reviewed the legal standards that apply under Delaware law for adopting and implementing measures that have an anti-takeover effect.⁵⁶

The Board then discussed amending the existing shareholder rights plan, and what the terms of such an amendment might be, including the pros and cons of providing a cushion for preexisting 5% holders, the appropriate effective date of the new shareholder rights plan, whether the Board should have authority to exclude purchases by specific stockholders from triggering the rights plan, and

⁵⁵ *Id.* at 5.

⁵⁶ *Id.*

whether a review process should be implemented to determine periodically whether the rights plan should remain in effect.

The Board then unanimously passed a resolution amending Selectica's shareholder rights plan, decreasing the beneficial ownership trigger from 15% to 4.99%, while grandfathering in existing 5% shareholders and permitting them to acquire up to an additional 0.5% (subject to the original 15% cap) without triggering the NOL Pill.⁵⁷

The resolution also established the Independent Director Evaluation Committee (the "Committee") as a standing committee of the Board to review periodically the rights agreement at the behest of the Board and to "determine whether the Rights Agreement continues to be in the best interest of the Corporation and its stockholders," as well as to review "the appropriate trigger percentage" of the pill, based on corporate and shareholder developments, any broader developments relating to rights plans generally—including academic studies of rights plans and contests for corporate control, and any other factors it deems relevant.⁵⁸ The Board set April 30, 2009, as the first date that the Committee should report back its findings.⁵⁹

⁵⁷ *Id.* at 10-11.

⁵⁸ *Id.* at 11.

⁵⁹ *Id.* at 12.

K. Trilogy Buys through the Pill

The Board announced the amendment of Selectica's rights agreement on Monday, November 17. Early the following morning, Fallon emailed Trilogy's broker, saying, "[W]e need to stop buying SLTC. They announced a new pill and we need to understand it."⁶⁰ Fallon also sent Liemandt a copy of Selectica's 8-K containing the amended language of the NOL Pill.⁶¹ Trilogy immediately sought legal advice about the NOL Pill.⁶² The following morning, Liemandt emailed Price, with a copy to Fallon, asking, "What percentage of [Selectica] would we need to buy to ruin the tax attributes that [S]teel [P]artners is looking for?"⁶³ They concluded that they would need to acquire 23% to trigger a change in control event.⁶⁴

Later that week, Trilogy sent Selectica a letter asserting that a Selectica contract with Sun Microsystems constituted a breach of the October 2007 settlement and seeking an immediate meeting with Selectica purportedly to discuss the breach,⁶⁵ despite the fact that members of its management had been put on

⁶⁰ PX 22. SLTC is Selectica's NASDAQ stock symbol.

⁶¹ PX 21.

⁶² Fallon Dep. at 158-61.

⁶³ DX 649. Liemandt testified that his question meant, "what is the amount that we can buy without hurting it, which is the other way of asking, what's the amount you can buy to ruin it." Liemandt Dep. at 101. Price testified, however, that he understood the question as being more straightforward, specifically, "what percentage would we have to buy to trigger a change of control as per section 382." Price Dep. at 151.

⁶⁴ DX 649.

⁶⁵ PX 24.

notice as to the contract as early as July.⁶⁶ Fallon, Liemandt, and Jacops from Trilogy, along with Zawatski, Thanos, and Heaps from Selectica met on December 17. The parties' discussions at this meeting are protected by a confidentiality agreement circulated in advance. However, Selectica contends that "based solely on statements and conduct outside that meeting, it is evident that Trilogy threatened to trigger the NOL Pill deliberately unless Selectica agreed to Trilogy's renewed efforts to extract money from the Company."⁶⁷

On December 18, Trilogy purchased an additional 30,000 Selectica shares, and Trilogy management verified with Liemandt his intention to proceed with buying through the NOL Pill.⁶⁸ The following morning, Trilogy purchased an additional 124,061 shares of Selectica, bringing its ownership share to 6.7% and thereby becoming an Acquiring Person under the NOL Pill.⁶⁹ Liemandt testified that the rationale behind triggering the pill was to "bring accountability" to the Board and "expose" what Liemandt characterized as "illegal behavior" by the Board in adopting a pill with such a low trigger.⁷⁰ Fallon asserted that the reason for triggering the NOL Pill was to "bring some clarity and urgency" to their discussions with Selectica about the two parties' somewhat complicated

⁶⁶ PX 48.

⁶⁷ Selectica Pre-Trial Br. at 16.

⁶⁸ PX 104.

⁶⁹ *Id.*

⁷⁰ Liemandt Dep. at 126.

relationship by “setting a time frame that might help accelerate discussions” on the direction of the business.⁷¹

Fallon placed a brief telephone call to Zawatski on December 19 to advise her that Trilogy had bought through the NOL Pill. During a return call by Zawatski later that evening, Fallon indicated that Trilogy felt, based on the conversations from December 17, that Selectica no longer wanted Trilogy as a shareholder or creditor. He then proposed that Selectica agree to purchase Trilogy’s shares back, accelerate the payment of its debt, terminate its license with Sun, and make a payment to Trilogy of five million dollars “for settlement of basically all outstanding issues between our companies.”⁷² Zawatski recalled that Fallon indicated to her that Trilogy had triggered the pill “to get our attention and create a sense of urgency”; that, since the Board would have ten days to determine how to react to the pill trigger, “it would force the board to make a decision.”⁷³

L. The Board Considers its Options and Repeatedly Requests a Standstill

The Selectica Board had a telephonic meeting on Saturday, December 20, to discuss Trilogy’s demands and an appropriate response.⁷⁴ The Board discussed “the desirability of taking steps to ensure the validity of the shareholder rights

⁷¹ Fallon Dep. at 200-01.

⁷² *Id.* at 212.

⁷³ Zawatski Dep. at 283.

⁷⁴ PX 91.

plan,” and ultimately passed a resolution authorizing the filing of this lawsuit, which occurred the following day.⁷⁵ On December 22, Trilogy filed an amended Schedule 13D disclosing its ownership percentage⁷⁶ and the Selectica Board met telephonically yet again to discuss the litigation, eventually agreeing to have a representative contact Trilogy to seek a standstill on any additional open market purchases while the Board used the ten-day clock under the NOL Pill to determine whether to consider Trilogy’s purchases “exempt” under the rights plan, or else how Selectica would go about implementing the pill.

The amended rights plan allowed the Board to declare Trilogy an “Exempt Person” during the ten-day period following the trigger, upon its determination that Trilogy would not “jeopardize or endanger the availability to the Company of the NOLs. . . .”⁷⁷ The Board could also decide during this window to exchange the rights (other than those held by Trilogy) for shares of common stock.⁷⁸ If the Board did nothing, after ten days, the rights would “flip in” automatically, becoming exercisable for \$36 worth of newly-issued common stock at a price of \$18 per right.⁷⁹

⁷⁵ *Id.* at 3.

⁷⁶ PX 104.

⁷⁷ PX 99 § 1(n).

⁷⁸ *See* PX 101 § 24(a).

⁷⁹ *See id.* §§ 7(b), 11(a)(ii).

The Board met again by telephone the following day, December 23, to discuss the progress of the litigation and to consider the potential impact of the various options under the NOL Pill.⁸⁰ The Board agreed to meet in person the following Monday, December 29, along with the Company’s financial, legal, and accounting advisors, to evaluate further the available options. The Board also voted to reduce the number of authorized directors from seven to five.⁸¹

On Wednesday, December 24, the Board met once again by telephone upon learning that the Company’s counsel had not succeeded in convincing Trilogy to agree to a standstill.⁸² The Board resolved to have Zawatski call Fallon to determine whether Trilogy was willing “to negotiate a standstill agreement that might make triggering the remedies available under the Shareholder Rights Plan, as amended, unnecessary at this time.”⁸³ Zawatski spoke with Fallon on the morning of December 26. Fallon stated that Trilogy did not want to agree to a standstill, that relief from the NOL Pill was not Trilogy’s goal, and that Trilogy expected that the NOL Pill would apply to it.⁸⁴ Fallon reiterated that the ten-day window would help “speed [the] course” towards a resolution of their claims.⁸⁵

⁸⁰ PX 93.

⁸¹ *Id.* at 3.

⁸² PX 94.

⁸³ *Id.* at 2.

⁸⁴ Fallon Dep. at 219-20; PX 112.

⁸⁵ PX 112 at 1.

The Board and its advisors met again on December 29.⁸⁶ Thanos provided an update on recent developments at the Company, including financial results, management changes, and the Needham process and provided an overview of the make-up of the Company's shareholder base. Reilly then provided a more detailed report on the status of the Needham process to the Board. Thereafter, Brogan gave a presentation on his firm's updated analysis of Selectica's NOLs, finding that the Company had at least \$160 million of NOLs and that there had been a roughly 40% ownership change by 5% holders over the three-year testing period, which would not be expected to "roll off" in the near term, and that "there was therefore a significant risk of a Section 382 ownership change."⁸⁷ Brogan subsequently discussed the possible consequences of the two principal mechanisms for implementing the triggered NOL Pill to the change in control analysis, finding that employing a share exchange would not likely have a materially negative impact on the Section 382 analysis, while expressing more concern over the uncertain effect of a flip-in pill on subsequent ownership levels (specifically, the possibility that a flip-in pill would, itself, trigger a Section 382 ownership change), as well as what steps could be taken to reduce this uncertainty.⁸⁸ Reilly once again addressed the Board to explain the ways he believed the NOLs would be valuable to the

⁸⁶ PX 95.

⁸⁷ *Id.* at 3.

⁸⁸ *Id.* at 4.

Company in its ongoing exploration of strategic alternatives, and to reiterate his opinion that an ownership change would “reduce the value of the Company.”⁸⁹

The Board also discussed Trilogy’s settlement demands and found them “highly unreasonable” and “lack[ing] any reasonable basis in fact,” and that “it [was] not in the best interests of the Company and its stockholders to accept Trilogy/Versata’s settlement demands relating to entirely separate intellectual property disputes as a precondition to negotiating a standstill agreement to resolve this dispute.”⁹⁰ The Board discussed Trilogy’s actions at some length, ultimately concluding that they “were very harmful to the Company in a number of respects,” and that “implementing the exchange was reasonable in relation to the threat imposed by Trilogy,” in particular, because the NOLs were seen as “an important corporate asset that could significantly enhance stockholder value,” and because Trilogy had intentionally triggered the NOL Pill, publicly suggested it might purchase additional stock, and had refused to negotiate a standstill agreement, despite the fact that an additional 10% acquisition by a 5% shareholder would likely trigger an ownership change under Section 382.⁹¹

⁸⁹ *Id.*

⁹⁰ *Id.* at 6.

⁹¹ *Id.* at 9-10.

The Board then authorized Delaware counsel to contact Trilogy in writing, one final time, to seek a standstill agreement, and also passed resolutions delegating the power of the Board to the Committee to determine whether or not to treat Trilogy or its acquisition as “exempt,” and nominating Alan Howe as a new member of the Board.

On the evening of December 29, Selectica’s Delaware counsel emailed Trilogy’s trial counsel at the Board’s instruction, seeking a standstill agreement “so that the Board could consider either declaring them an ‘Exempt Person’ under the Rights Plan . . . or alternatively, settle the litigation altogether in exchange for a long term agreement relating to your clients’ ownership of additional shares.”⁹² The following afternoon, Trilogy’s counsel responded that Trilogy was not willing to agree to the proposed standstill.⁹³

Two days later, on December 31, the Board met telephonically once again, and was informed of Trilogy’s latest rejection of a standstill agreement.⁹⁴ The Board discussed its options with its legal advisors and ultimately concluded that the pill should go into effect and that employing an exchange was the best option, and should be done as soon as possible in order to protect the NOLs, even at the risk of disrupting common stock trading. The Board directed advisers to prepare a

⁹² PX 70.

⁹³ *Id.*

⁹⁴ PX 96.

technical amendment to the NOL Pill to clarify the time at which an exchange would become effective.⁹⁵

M. The Board Adopts the Amended and Restated Pill and Dilutes Trilogy

On January 2, the Board met telephonically once more, reiterating its delegation of authority to the Committee to make recommendations regarding the implementation of the NOL Pill, and passed a resolution expressly confirming that the Board’s delegation of authority included the power to effect an exchange of the rights under the NOL Pill and to declare a new dividend of rights under an amended rights plan (the “Reloaded NOL Pill”).⁹⁶ The Board then adjourned and the Committee—comprised of Sems and Arnold—met with legal and financial advisors, who verified that there had been no new contact whatsoever with representatives from Trilogy, reiterated that the NOLs remained “a valuable corporate asset of the Company in connection with the Company’s ongoing exploration of strategic alternatives,”⁹⁷ and advised the Committee members of their fiduciary obligations under Delaware law.⁹⁸ Reilly presented information about the current takeover environment and the use of poison pills (specifically, the types of pills commonly employed and their triggering thresholds), and reviewed

⁹⁵ *See id.* at 3; PX 100.

⁹⁶ PX 97 at 1-2.

⁹⁷ *Id.* at 8.

⁹⁸ *Id.* at 10.

the Company’s then-current anti-takeover defenses compared with those of other public companies.⁹⁹ Reilly asserted that “a so-called NOL rights plan with a 4.99% trigger threshold is designed to help protect against stock accumulations that would trigger an ‘ownership change,’” and that “implementing appropriate protections of the Company’s net operating loss carryforwards was especially important at present,” given Trilogy’s recent share acquisitions on top of the Company’s existing Section 382 ownership levels.¹⁰⁰ Finally, Reilly reviewed the proposed terms and conditions of the Reloaded NOL Pill, discussed the methodology for determining the exercise price of the new rights, and made recommendations regarding the same. The Committee sought reconfirmed assurances by its financial and legal advisors that the NOLs were a valuable corporate asset and that they remained at a significant risk of being impaired, which the advisors provided.¹⁰¹

The Committee concluded that Trilogy should not be deemed an “Exempt Person,” that its purchase of additional shares should not be deemed an “Exempt Transaction,” that an exchange of rights for common stock (the “Exchange”)

⁹⁹ PX 38. At that time, Selectica had the following defensive measures in place as indicated in Reilly’s presentation: (1) classified board; (2) board fills all director vacancies; (3) shareholders cannot call special meetings; (4) no action by written consent; (5) supermajority vote to remove directors; (6) locked-in charter or bylaw provision; (7) no cumulative voting; and (8) blank check preferred stock. *Id.* at 21. Selectica has since submitted for stockholder vote a proposal to declassify the staggered board terms. RJN2, Ex. A at 2, 10.

¹⁰⁰ *Id.* at 6.

¹⁰¹ *Id.* at 8.

should occur, and that a new rights dividend on substantially similar terms ought to be adopted. It passed resolutions to implement these conclusions, thereby adopting the Reloaded NOL Pill and instituting the Exchange.¹⁰² The Exchange doubled the number of shares of Selectica common stock owned by each shareholder of record, other than Defendants. Consequently, the Exchange reduced Defendants' beneficial holdings from 6.7% to 3.3%. The implementation of the Exchange led to a freeze in the trading of Selectica stock from January 5, 2009 until February 4, 2009, with stock price frozen at \$0.69.¹⁰³ The Reloaded NOL Pill will expire on January 2, 2012, unless the expiration date is advanced or extended, or unless these rights are exchanged or redeemed by the Board some time beforehand.¹⁰⁴

N. *The Parties' Contentions*

Selectica seeks a declaratory judgment that the actions of the Board and the Committee in (1) adopting the NOL pill on November 16; (2) authorizing the Exchange on January 2; and (3) adopting the Reloaded NOL Pill and issuing a new rights dividend on January 2, were valid and proper. Trilogy's counterclaim seeks a declaratory judgment that the NOL Pill and Reloaded NOL Pill are invalid, void and unenforceable, or else unenforceable as to Trilogy, as well as an order enjoining or rescinding the Exchange and requiring Selectica to redeem

¹⁰² *Id.* at 10-21.

¹⁰³ DX 762; DX 796 at 2.

¹⁰⁴ PX 101 § 7(a).

permanently the new rights dividends issued under the Reloaded NOL Pill. Trilogy also seeks money damages for breaches of fiduciary duty.

Selectica asserts that the actions of the Board and the Committee were valid under Delaware law and were appropriate exercises of their fiduciary responsibilities under *Unocal*: specifically, that the Board acted reasonably in concluding that the NOLs constituted a potentially valuable asset that was threatened by Trilogy's actions, and that the adoption of the NOL Pill, implementation of the Exchange, and adoption of the Reloaded NOL Pill and declaration of a new rights dividend were not preclusive but were reasonable and proportionate responses to the identified threat.

To the contrary, Trilogy argues that both the NOL Pill and Reloaded NOL Pill should be declared invalid either because (1) they are both anti-takeover devices that, either per se or on the facts of this case, preclude an effective proxy contest; or (2) they were not a reasonable and proportionate response to a reasonably perceived threat because the Board failed to establish that the NOLs had a value worth protecting and that this value was threatened by Trilogy's purchases.

III. DISCUSSION

A. *The Poison Pill under Delaware Law*

The principal question before the Court is the reasonableness of a board's adoption of a low-threshold poison pill in order to protect assets of speculative and questionable value absent an explicit plan for how such value might be realized.

Since their first appearance nearly thirty years ago, shareholder rights plans—so-called “poison pills”—have been the subject of much debate. Some commentators have suggested that poison pills may be detrimental to shareholder interests because they help perpetuate existing management, preclude value-adding transactions from taking place, and destroy shareholder wealth.¹⁰⁵ In spite of their rather contentious early history and the various arguments made against their use, poison pills remain a common feature of the corporate landscape, and Delaware courts have repeatedly upheld their adoption as consistent with a board's fiduciary duties and business judgment.¹⁰⁶ Indeed, the Delaware Supreme Court's

¹⁰⁵ See, e.g., Lucian Arye Bebchuk, *The Case Against Board Veto Power in Corporate Takeovers*, 69 U. Chi. L. Rev. 973 (2002); Randall S. Thomas, *Judicial Review of Defensive Tactics in Proxy Contests: When is Using a Rights Plan Right?*, 46 Vand. L. Rev. 503 (1993); Michael Ryngaert, *The Effect of Poison Pill Securities on Shareholder Wealth*, 20 J. Fin. Econ. 377, 411 (1988) (concluding that poison pills do not benefit shareholders); Frank H. Easterbrook & Daniel R. Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 Harv. L. Rev. 1161 (1981).

¹⁰⁶ See *Moran v. Household Int'l, Inc.*, 500 A.2d 1346, 1357 (Del. 1985); *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 181-82 (Del. 1986); *Paramount Commc'ns, Inc. v. Time, Inc.*, 571 A.2d 1140, 1153-54 (Del. 1990); *Moore Corp. Ltd. v. Wallace Computer Servs., Inc.*, 907 F. Supp. 1545, 1563-64 (D. Del. 1995); *Leonard Loventhal Account v. Hilton Hotels Corp.*, 780 A.2d 245, 250-51 (Del. 2001).

invocation of the doctrine of *stare decisis* to reaffirm the central holding of *Moran* in the *Leonard Loventhal* case is a strong signal that the legitimacy of the poison pill is settled law.¹⁰⁷

B. *Does the NOL Pill Meet the Unocal Standard?*

The Supreme Court in *Unocal* explained that the business judgment rule does not immediately apply to defensive actions taken by a board in the context of a possible change in control, such as the adoption of a poison pill, “[b]ecause of the omnipresent specter that a board may be acting primarily in its own interests, rather than those of the corporation and its shareholders. . . .”¹⁰⁸ Accordingly, “there is an enhanced duty which calls for judicial examination at the threshold before the protections of the business judgment rule may be conferred.”¹⁰⁹ Such enhanced scrutiny operates to “ensure that a defensive measure to thwart or impede a takeover is indeed motivated by a good faith concern for the welfare of the corporation and its stockholders” and that the board did not act “solely or primarily out of a desire to perpetuate themselves in office.”¹¹⁰

Thus, under the *Unocal* test, in order to be afforded the protection of the business judgment rule with respect to the adoption of a defensive measure, the “directors must show that they had reasonable grounds for believing that a danger

¹⁰⁷ See *Leonard Loventhal*, 780 A.2d at 246.

¹⁰⁸ *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 954 (Del. 1985).

¹⁰⁹ *Id.*

¹¹⁰ *Id.* at 955.

to corporate policy and effectiveness existed . . . [T]hey satisfy that burden ‘by showing good faith and reasonable investigation. . . .’¹¹¹ The board must also demonstrate that its “defensive response was reasonable in relation to the threat posed.”¹¹² As explained in *Unitrin*, a defensive measure is disproportionate (*i.e.*, unreasonable) if it is either coercive or preclusive.¹¹³ Trilogy asserts that the *Unocal* standard is not met here, as the Selectica directors established neither that the NOLs had a value worth protecting, nor that this value was threatened by Trilogy’s purchases.

1. Should Selectica’s Evidence Receive Material Enhancement?

Under *Unocal*, where the defensive actions were taken by “a majority of outside independent directors,” proof of the board’s good faith and reasonable investigation is “materially enhanced.”¹¹⁴ Furthermore, 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.”¹¹⁵

Selectica asserts that all of its directors were independent at the time that the decisions at issue were made; therefore the evidence showing the Board’s good

¹¹¹ *Id.* (quoting *Cheff v. Mathes*, 199 A.2d 548, 555 (Del. Ch. 1964)).

¹¹² *Unocal*, 493 A.2d at 955.

¹¹³ *Unitrin, Inc. v. Am. Gen. Corp.*, 651 A.2d 1361, 1387 (Del. 1995).

¹¹⁴ *Unocal*, 493 A.2d at 955.

¹¹⁵ *Polk v. Good*, 507 A.2d 531, 537 (Del. 1986).

faith and reasonable investigation is entitled to material enhancement. Trilogy claims that three of the Company's then four directors were not outside independent directors and, consequently, that Selectica's proof of good faith and reasonable investigation should not be materially enhanced. Specifically, it argues that Zawatski and Thanos should not be considered "outside" directors due to their roles as Co-Chairs of Selectica during the events at issue, and that their independence is, likewise, compromised by the payment they received to carry out these assignments. Moreover, according to Trilogy, Sems should not be considered independent "with respect to the NOLs" because of an alleged undue influence of Howard and Steel Partners over Sems.¹¹⁶

An "outside" director has been defined by our courts as "a non-employee and non-management director"¹¹⁷ that "receiv[es] no income other than usual directors' fees. . . ."¹¹⁸ In contrast to this seemingly bright-line rule, Delaware courts apply a "subjective 'actual person' standard" in considering the question of director independence, making a determination based upon individualized facts about the specific directors.¹¹⁹ The contextual approach applied to such standard, which "tak[es] into account all circumstances," allows independence

¹¹⁶ Opening Post-Trial Br. of Defs. and Counterclaim-Pls. Versata Enterprises, Inc. and Trilogy, Inc. at 35.

¹¹⁷ *Unitrin*, 651 A.2d at 1375 (citing *Grobow v. Perot*, 539 A.2d 180, 184 n.1 (Del. 1988)).

¹¹⁸ *Moran v. Household Int'l, Inc.*, 490 A.2d 1059, 1074-75 (Del. Ch. 1985).

¹¹⁹ *Cinerama, Inc. v. Technicolor, Inc.*, 663 A.2d 1156, 1167 (Del. 1995).

determinations to be “tailored to the precise situation at issue.”¹²⁰ An independent director is one whose decision “is based on the corporate merits of the subject before the board rather than extraneous considerations or influences,”¹²¹ while a director who is not independent is “dominated or otherwise controlled by an individual or entity interested in the transaction.”¹²² Control is established through facts that demonstrate that “through personal or other relationships the directors are beholden to the controlling person”¹²³ or so “under their influence that their discretion would be sterilized.”¹²⁴

Trilogy points to the emails between Sems and Howard,¹²⁵ as well as to the fact that Howard had recommended Sems to the Board as a candidate for director, as evidence that Sems was unduly influenced by Howard and, thus, not an independent director. According to Trilogy, because Steel Partners was seeking to turn the Company into an NOL shell for its own purposes, Sems cannot be considered independent with respect to decisions involving the Company’s NOLs. Nevertheless, the record does not support Trilogy’s assertions that Sems was controlled by Howard or Steel Partners. Sems, through his personal investment

¹²⁰ *In re Oracle Corp. Deriv. Litig.*, 824 A.2d 917, 941 (Del. Ch. 2003).

¹²¹ *Aronson v. Lewis*, 473 A.2d 805, 816 (Del. 1984).

¹²² *In re MAXXAM, Inc.*, 659 A.2d 760, 773 (Del. Ch. 1995) (quoting *Grobow*, 539 A.2d at 189).

¹²³ *Aronson*, 473 A.2d at 815.

¹²⁴ *Rales v. Blasband*, 634 A.2d 927, 936 (Del. 1993).

¹²⁵ DX 227; DX 402; DX 416; DX 430; DX 549; DXs 609-10; DX 707; *see supra* text accompanying notes 27-36.

and that of his fund, was Selectica's sixth-largest shareholder, and Selectica was one of Sems Capital LLC's largest positions.¹²⁶ Further, there is no evidence in the record that Sems had any reason to defer to Steel Partners's wishes to his own financial detriment. To the contrary, Sems testified that the value of Selectica's NOLs played into his investment rationale as a shareholder.¹²⁷ Although Howard did endorse Sems's candidacy, Sems was already favored as a director candidate before Howard's endorsement.¹²⁸ In addition, there is little evidence that Sems took any position that was unduly favorable to Howard at the expense of Selectica shareholders during his time on the Board. Indeed, Howard made several suggestions to the Board that the Board chose not to heed.¹²⁹ Howard, himself, twice asked to be named as a Selectica director, most recently in November 17, 2008, after Sems had become a director, and was apparently turned down by an undivided board.¹³⁰ While there may be cause to suspect that Sems had something of a desire to ingratiate himself with Steel Partners, there is not sufficient evidence to find that Sems was not independent from Howard and Steel Partners.

Trilogy asserts that Zawatski and Thanos similarly cannot be considered outside independent directors with respect to the Board actions at issue due to their

¹²⁶ Tr. 738.

¹²⁷ Tr. 732.

¹²⁸ Tr. 938-41.

¹²⁹ Tr. 209-14, 744; DX 170; DX 364; PX 42.

¹³⁰ PX 42; Tr. 936-37, 994-1000.

Co-Chair positions, which seemingly run afoul of various independence guidelines and which Selectica, itself, concedes was “a capacity similar to that of a chief executive officer.”¹³¹ Additionally, from July 2008 until March 2009, Thanos was paid \$164,125 and Zawatski paid \$274,273 to serve in this function, in addition to their standard compensation as directors.¹³² Trilogy suggests that such a material level of compensation is beyond the customary bounds accorded directors and serves to preclude their independence, further noting that neither is considered independent under Securities and Exchange Commission (“SEC”) and NASDAQ rules. Selectica responds that the position is a temporary one and that both Zawatski and Thanos have testified that they have no desire to continue serving in a management role beyond what will be necessary,¹³³ do not consider themselves Selectica employees,¹³⁴ and that the compensation that they receive as Co-Chairs is not material to them.

Given the nature of Thanos and Zawatski’s duties, and the apparent bright-line rule for distinguishing between inside and outside directors, the Court concludes that neither can be considered an “outside” director for material

¹³¹ RJN, Ex. A at 60.

¹³² *Id.* Both are paid \$250/hour for management work.

¹³³ Indeed, as noted above, Thanos has already since stepped down as Co-Chair, as of August 2009.

¹³⁴ Tr. 373-74; 966-67. In addition, Selectica points out that neither director receives a salary, both work, on average, fewer than twenty hours a week in this capacity, and neither signs the Company’s periodic securities filings. Tr. 958; Zawatski Dep. at 237.

enhancement purposes. However, although nominally not outside directors, the record suggests that both were, nonetheless, independent.

Admittedly, the compensation that Thanos and Zawatski have received in their capacity as Co-Chairs is material by any measure. Nevertheless, determining their respective independence under the “actual person” standard, this Court does not have enough evidence to conclude that such compensation was sufficiently material to either Thanos or Zawatski to preclude their independence. Both Thanos and Zawatski were retired and took on the Co-Chair position following successful careers in the private sector. Both serve on multiple boards and both have testified that the income they receive in these roles is not personally material to them, and that they hope to be able to resign these positions in the near term.¹³⁵ While Trilogy characterizes such testimony as “self-serving,” the Court has no reason to doubt either director’s testimony on this issue, nor has Trilogy provided evidence as to why it should.

The rationale behind materially enhancing the proof of good faith and reasonableness of those decisions made by a majority of outside independent directors is directly related to the primary concern that enhanced scrutiny under *Unocal* is designed to address: that a board might adopt defensive measures simply to retain control, whether or not those measures are in the best interest of

¹³⁵ Tr. 215, 949-50. *See also* Tr. 153-54 (discussing family situation more generally).

shareholders. Where decisions are made by outside independent directors instead of members of management who have a presumptive desire to retain their employment, the concern that the board's decisions are tainted by self-serving motives is mitigated, and there naturally follows a greater presumption of good faith and reasonable investigation. This is the essence of the material enhancement rubric in *Unocal* and its progeny.

In this case, while the Board does not meet the specific "requirements" for material enhancement, any concern that the Board's actions stem from a desire for entrenchment is seemingly groundless. At the time that the NOL Pill was adopted, the Company had been actively seeking suitors for nearly six months and the Board was receiving constant updates on the sale process. Both Zawatski and Thanos had previously been outside directors before taking over management duties and had only temporarily assumed these duties in lieu of hiring a new CEO in anticipation of the Company's proximate sale. Further, one may readily presume that, given the financial plight of the Company, attracting additional independent and qualified directors might be difficult. Finally, the Board ultimately delegated final decision-making authority over the adoption of the Reloaded NOL Pill and the implementation of the Exchange to the Committee, which was comprised only of outside independent directors. Nevertheless, regardless of whether or not the Board is technically entitled to "material

enhancement” under *Unocal*, the Court concludes that there is sufficient evidence to find good faith and reasonable investigation by the Board here.

2. Were there Reasonable Grounds to Conclude that a Threat Existed?

a. *Is the Preservation of NOLs a Valid Corporate Objective?*

The first part of the *Unocal* test requires a board to show that it had reasonable grounds for concluding that a threat to a corporate objective existed. This case presents unique grounds for establishing this first part of the *Unocal* test as employing a poison pill for the ostensible purpose of protecting NOLs is a distinct departure from the poison pill’s originally intended use: the prevention of hostile takeovers. Delaware courts have only considered the poison pill in the context of an anti-takeover device, and the *Unocal* test is one that analyzes the board’s response to such an outside threat.¹³⁶ In contrast, an NOL pill’s principal function is to prevent the inadvertent forfeiture of potentially valuable assets, not to protect against hostile takeover attempts.¹³⁷

As a result of its unique objective, a pill designed to protect NOLs necessitates precluding a lesser accumulation of shares than might be appropriate for a pill designed to prevent a hostile acquirer from establishing a control position

¹³⁶ *But see Paramount Commc’ns*, 571 A.2d at 1153 (“The usefulness of *Unocal* as an analytical tool is precisely its flexibility in the face of a variety of fact scenarios.”).

¹³⁷ Typically, companies with large NOLs would not be at risk of takeover attempts if the NOLs are the company’s principal asset, as the takeover would likely trigger a change in control and impair the asset.

in the company. Consequently, the 5% trigger necessary for an NOL pill to serve its function imposes a far greater cost on shareholders than the pill thresholds traditionally employed and held as acceptable by our courts in the anti-takeover context. Not surprisingly, pills with a 5% trigger remain fairly uncommon,¹³⁸ though they have been employed with greater frequency in recent years.¹³⁹

Trilogy argues that NOLs cannot be viewed as assets worth protecting absent a reasonable expectation of their probable future use. Unlike the corporate objectives traditionally being protected by boards mounting takeover defenses, all NOLs, by their very nature, have the potential of ultimately providing zero value to the company. Granting judicial sanction to low-threshold poison pills employed for the purpose of protecting NOLs guarantees the somewhat unpalatable outcome of acquiescing to the expansion of the universe of reasonable takeover defenses in order to protect assets of questionable, even dubious, value. However, expert testimony has been proffered that NOLs have a material value even absent an obvious mechanism for their use.¹⁴⁰ Trilogy has put forward contradictory

¹³⁸ *See, e.g.*, DX 776 at 5 (expert report cataloging academic analyses on the frequency of various pill trigger percentages, reporting that pills with a trigger of 15% or 20% made up at least 90% of each sample studied, and concluding that pills with a trigger below 5% are “quite rare”).

¹³⁹ Tr. 851-52.

¹⁴⁰ *See, e.g.*, PX 130 at 17 (expert report of Professor Merle Erickson, explaining that NOLs are economically valuable assets and concluding that the Board had a rational basis for taking steps to protect the NOLs); Tr. 502-04 (expert testimony of Patricia W. Pellervo, asserting that NOLs are “always valuable” unless imminently about to expire, and equating the value of NOLs to that of out-of-the-money options).

testimony that, because NOLs derive their value from future taxable income, they are not always valuable.¹⁴¹ Nevertheless, as NOL value is inherently unknowable ex ante, a board may properly conclude that the company's NOLs are worth protecting where it does so reasonably and in reliance upon expert advice. As the Court in *Unocal* recognized, "our corporate law is not static. It must grow and develop in response to, indeed in anticipation of, evolving concepts and needs."¹⁴² Consequently, the Court concludes that the protection of company NOLs may be an appropriate corporate policy meriting a defensive response when threatened.¹⁴³ Indeed, the protection of corporate assets against an outside threat is arguably a more important concern of the Board than restricting who the owners of the Company might be.¹⁴⁴

b. *Trilogy's Contentions Regarding Board Process*

Trilogy argues that, in order to establish the first prong of the *Unocal* test, the Selectica Board was obligated to have a plan for whether and how the NOLs

¹⁴¹ Tr. 1331-32; DX 788.

¹⁴² *Unocal*, 493 A.2d at 957. As a result of the current economic environment, one might expect that the number of corporations with NOLs worth protecting will continue to increase, as will the number of corporate boards that opt for a 5% poison pill to protect them.

¹⁴³ With this conclusion, it is unnecessary to resolve the parties' debate over the import of 8 *Del. C.* § 202(d) and its possible reflection of legislative support for the use of poison pills to protect NOLs.

¹⁴⁴ Shareholder advisory firm RiskMetrics Group now supports rights plans with a trigger below 5% on a case-by-case basis if adopted for the stated purpose of preserving a company's net operating losses. PX 129 at 6-7. The factors it will consider in determining whether to support a management proposal to adopt an NOL pill are the pill's trigger, the value of the NOLs, the term of the pill, and any corresponding shareholder protection mechanisms in place (such as a sunset provision, causing expiration of the pill upon exhaustion or expiration of the NOLs). *Id.* at 7.

could be used in the future prior to adopting the NOL Pill. NOLs can only be used upon the creation of taxable income, which occurs by one of three ways: through operations, through the sale of assets, or by way of an acquisition. Yet in Selectica's case, Trilogy argues, none of these would have established an asset worth protecting because (1) Selectica had never generated taxable income and the Board had no reason to think that it would in the near-term, (2) the limits placed on NOLs following a Section 382 change in ownership do not apply when using NOLs to offset a taxable gain achieved through the sale of assets, and (3) any basis for the NOLs' use after an acquisition was purely speculative.¹⁴⁵ In order to determine whether the NOLs were assets worth protecting, the Board, according to Trilogy, needed to have conducted a formal analysis of when the Company could reasonably expect to receive tax savings from the use of its NOLs, as well as the amount of tax savings it could reasonably expect to obtain.

Furthermore, Trilogy claims that, to the extent that the Board did discuss the value of Selectica's NOLs, the discussions suggested that the Board believed they had no value. Trilogy points to Jurkowski's testimony that concedes that he did

¹⁴⁵ Trilogy points out that the Board did not know whether or how Steel Partners might utilize the NOLs (Tr. 810, 991-93), and that Reilly did not have a meeting with Steel Partners regarding the means by which Steel Partners proposed to retain the NOLs until after the events in question, which Trilogy characterizes as evidence that the Board could not have received any meaningful advice from him about the potential for such a transaction.

not believe the NOLs had much value,¹⁴⁶ and similar assertions by Thanos in August 2008,¹⁴⁷ as well as the fact that the Board voted against the more detailed Brogan study in February 2008.¹⁴⁸ Additionally, in Selectica's annual and quarterly filings with the SEC, the Company did not recognize any deferred tax assets for NOLs on its balance sheet—a determination that it was more likely than not that the Company would not use its NOLs—and continued to make such a representation even after the NOL Pill was adopted. Finally, Trilogy asserts that an ownership change occurred on November 14, 2008, prior to the adoption of the NOL Pill, that severely impaired the value of Selectica's NOLs and made the adoption of the NOL Pill unnecessary, a determination that the Selectica Board would have made before adopting the NOL Pill had it engaged Brogan in a more in-depth Section 382 analysis.¹⁴⁹

¹⁴⁶ Jurkowski Dep. at 45 (stating that his recommendation was not to move forward with additional study work by Brogan “because [he] did not understand what the value would be.”).

¹⁴⁷ PX 80. Trilogy refers to a short reply email written in August 2008 by Thanos agreeing with the statement made by another Selectica employee that “NOL’s [sic] do not appear to be of great value,” and noting that the investment bankers he had spoken to “didn’t put much emphasis on them.” Thanos explained his email, stating that, at the time, these investment bankers expected the most likely buyers of Selectica to be more interested in the Company’s intellectual property than its NOLs, which Thanos testified changed over time as such buyers dropped out of the process. Tr. 933-34; Thanos Dep. at 238-40.

¹⁴⁸ DX 255 at 3; Tr. 93-94. Trilogy also raises issue with the fact that the Board did not question the existence of discrepancies between the Chinn study and the Brogan study, or why Brogan disregarded Chinn’s earlier conclusions.

¹⁴⁹ This conclusion comes from a report prepared by Trilogy’s expert witness, Elliott G. Freier, a tax attorney specializing in Section 382 work with the firm of Irell & Manella, LLP. DX 777 at 12-13. Selectica disputes that an ownership change has occurred, and offered up Patricia W. Pellervo, a principal in the Mergers & Acquisition section of the Washington National Tax Services practice of PricewaterhouseCoopers, as a rebuttal witness asserting that a November

However, the record is replete with evidence suggesting to the contrary that the Board had ample reason to conclude, and did conclude, that the NOLs were an asset worth protecting and, thus, that their preservation was an important corporate objective. The facts show that many of Selectica's largest shareholders, including Steel Partners, Lloyd Miller, and Lloyd Sems, who collectively owned nearly 30% of the Company's shares outstanding, all believed that the NOLs were one of Selectica's most significant assets, and actively worked with the Board to ensure that they were protected.¹⁵⁰ While the Board opted not to spend additional money on an in-depth report by Brogan in February 2008, it first analyzed the NOLs in September 2006, and sought updated Section 382 analyses from Brogan in March 2007, June 2007, July 2008, and November 2008.¹⁵¹

2008 Section 382 ownership change did not occur, that Freier's critiques of the Brogan study do not invalidate Brogan's conclusions, and that it was reasonable for the Board to conclude, based upon Brogan's advice, that Selectica was at risk of an ownership change at the time of the adoption of the NOL Pill. PX 123; PX 127. Freier's rebuttal is DX 787.

¹⁵⁰ Tr. 102, 465-67, 766-69, 810.

¹⁵¹ PXs 1-6.

c. *DGCL § 141(e) and the Board's Reliance on Experts*

The record suggests that the Board placed considerable reliance on the advice of outside experts in making its determination as to the value of Selectica's NOLs and the importance of protecting them from the threat posed by Trilogy.

The Delaware General Corporation Law Section § 141(e), states:

A member of the board of directors, or a member of any committee designated by the board of directors, shall, in the performance of such member's duties, be fully protected in relying in good faith . . . upon such information, opinions, reports or statements presented to the corporation . . . by any other person as to matters the member reasonably believes are within such other person's professional or expert competence and who has been selected with reasonable care by or on behalf of the corporation.¹⁵²

Under § 141(e), where a board has relied on an expert's advice in making a decision, a due care claim challenging that decision must establish such facts as would make reliance on the expert opinion unreasonable.¹⁵³ Trilogy would need to show either that: (a) the Board did not in fact rely on the experts; (b) such reliance was not in good faith; (c) the Board did not reasonably believe that the relevant expert's advice was within that expert's professional competence; (d) the experts were not selected with reasonable care, and the faulty selection was attributable to the directors; (e) the omitted information that the Board allegedly should have

¹⁵² 8 *Del. C.* § 141 (e).

¹⁵³ A board's reliance on expert advice "evidence[s] good faith and the overall fairness of the process." *Cinerama, Inc. v. Technicolor, Inc.*, 663 A.2d 1134, 1142 (Del. Ch. 1994), *aff'd*, 663 A.2d 1156 (Del. 1995).

considered was so obvious and reasonably available that it was gross negligence for the Board to fail to consider it, regardless of expert advice or lack thereof; or (f) the decision of the Board was so unconscionable as to constitute waste or fraud.¹⁵⁴

The record indicates that the Board was presented with expert advice on numerous occasions that supported its ultimate findings that the NOLs were a company asset worth protecting, that the NOLs were at risk as a result of Trilogy's actions, and that the steps that the Board ultimately took were reasonable in relation to that threat. Outside experts were present and addressed the Board on these matters at both the November 16 meeting that established the NOL Pill and the Board's December 29 meeting, while the Committee heard from advisers a third time at the January 2 meeting prior to instituting the Exchange and adopting the Reloaded NOL Pill.

Trilogy argues that the Board and the Committee were not justified in relying upon Reilly for advice regarding the value of the NOLs in the context of determining whether they were worth preserving because he was not an expert in NOLs or Section 382. Trilogy claims that the Board and the Committee also could not have reasonably relied on advice from Brogan about the value of the NOLs and the threat that Trilogy's purchases posed, since Brogan only provided his opinion

¹⁵⁴ See *Brehm v. Eisner*, 746 A.2d 244, 262 (Del. 2000).

on the level of ownership changes and the amount of available NOLs, not on how the NOLs could be used to generate value.

Additionally, from Trilogy's perspective, any reliance on Brogan was unreasonable because the Board knew that he had been recommended by Steel Partners, had continued communicating with Steel Partners with respect to Selectica after he began work on his analysis, and was aware of the outcome desired by Steel Partners; therefore, his advice was not disinterested. Further, the Board should have known that Brogan had not completed the in-depth NOL study in February 2008 and did not have time to do such a thorough study between the filing of Trilogy's 13D and the adoption of the NOL Pill, thus, that such analysis was incomplete. In addition, Trilogy points out that Brogan's final refinement of his analysis that calculated an ownership change percentage between 38-39% was less than the 40% he had initially reported to management and included offsetting transactions which should have been a "red flag," that, Trilogy maintains, "should have alerted the Board to question Brogan's analysis."¹⁵⁵

These allegations aside, there is no evidence in the factual record to conclude that the Board was unreasonable in relying upon expert advice in determining whether and how to respond to Trilogy's actions. Though Reilly is

¹⁵⁵ Pre-Trial Br. of Defs. and Counterclaim-Pls. Versata Enterprises, Inc. and Trilogy, Inc. at 43. Yet, Trilogy has also put forward expert testimony arguing that Brogan underestimated the proximity of a Section 382 ownership change and that Selectica suffered a change in control event as a result of Trilogy's November purchases. DX 777.

not an expert in Section 382 and NOLs, as an experienced investment banker he was qualified to speak to which assets were worth preserving in the context of a potential company sale, whether or not he was personally qualified to place a specific value on them. Likewise, because Brogan's firm calculated the magnitude of Selectica's NOLs along with the magnitude and timing of the Section 382 ownership change that the Company had experienced, the Board could reasonably rely on Brogan's help in establishing the size of the asset under consideration and the risk of that asset being compromised.

That Steel Partners recommended Brogan's firm is of no consequence, and is not surprising, given Steel Partners's past experience with NOLs. It does not suggest anything untoward that should undermine Brogan's expert advice. In order to reasonably rely on Brogan, the Board needed only to find that Brogan was an expert in the matters to which he was providing advice and that he had been selected with due care. Brogan's work history as a tax attorney, CPA, and partner at several accounting firms specializing in tax accounting in the context of mergers and acquisitions, not to mention the dozens of Section 382 studies he had performed, gave the Board ample cause to consider him an expert qualified to speak on Selectica's NOLs and on the threat of their impairment.¹⁵⁶ Although it

¹⁵⁶ Brogan is also a former chair of the Corporate Tax Section of the California Bar Association and serves on the faculty of the Graduate School of Taxation at Golden Gate University. Tr. 424, 548-51.

was theoretically possible for Brogan to have prepared a more thorough study that could have given the Board a more granular sense of the immediacy of the threat Trilogy posed, its absence did not render his advice unreliable. Within the context of the rushed timeline for determining and responding to Trilogy, the Court cannot conclude that any additional information was readily available but not presented to the Board, or that such information would have contradicted the expert advice that Brogan provided.

Trilogy raises issue with the fact that no expert provided advice as to the precise value of the NOLs to Selectica by estimating the probability of future taxable income, arguing that an expert could have been brought in to model their “potential value by considering various scenarios and assigning probabilities to assess the likelihood of the NOLs being monetized.”¹⁵⁷ Yet, such analysis, although arguably helpful, was unnecessary in this case. In order to conclude that a serious threat existed, the Board needed only reasonably conclude that the NOLs were a legitimate asset worth protecting. The Board recognized that the NOLs were material relative to the then-market value of the Company,¹⁵⁸ and that the NOLs, if preserved, had a long window during which they would be available for

¹⁵⁷ Opening Post-Trial Br. of Defs. and Counterclaim-Pls. Versata Enterprises, Inc. and Trilogy, Inc. at 40.

¹⁵⁸ See, e.g., Tr. 34-35, 379-80, 731-32, 737-38, 805.

use.¹⁵⁹ If perhaps somewhat optimistic, they had rational expectations for the Company's near-term profitability.¹⁶⁰

Trilogy is correct in pointing out that it is not sufficient to conclude that an asset with potential value is worth protecting without considering the probability of that value being realized, and that Selectica's failure to generate taxable income in prior years colors this probability. However, the absence of a formal study calculating such a value does not mean that the directors were unreasonable in concluding that a sufficiently material probability existed to merit the asset's preservation, or that such a determination was not implicit in their calculus.¹⁶¹ In connection with the expert advice it received, the Court is satisfied that the Board was reasonable in concluding that Selectica's NOLs were worth preserving and that Trilogy's actions presented a serious threat to their impairment.¹⁶²

¹⁵⁹ See, e.g., Tr. 42-43, 379-80, 402-03, Zawatski Dep. at 105.

¹⁶⁰ The Court received *in camera* testimony at trial from Zawatski as to then-upcoming, as yet unaudited quarterly financial results for Selectica, in which she predicted that Selectica would finally turn a profit. Counsel for Selectica advised the Court after trial, however, that Selectica had determined that its audited financial results for the quarter would show a GAAP basis loss and that, as such, there was no need to transcribe this testimony and that the Court should not rely upon it in deciding the matter. Letter, dated June 8, 2009, from Gregory V. Varallo, Esquire at 1.

¹⁶¹ Similarly, Trilogy's argument that the full valuation allowance recorded for NOLs in Selectica's SEC filings suggests that the Board recognized that utilization of the NOLs was unlikely is unavailing. A company may simultaneously conclude that there is less than a 50% chance of recognizing the value of an asset while reasonably taking steps to preserve that asset.

¹⁶² The Court acknowledges that it is easy to be skeptical about whether Selectica will ultimately be able to recognize all or any of the value of its NOLs. A comparison of Selectica's market capitalization (\$22.8 million) to a highly optimistic calculated value of, say, \$58 million in tax offsets as a result of the NOLs (based on accumulated federal NOLs of \$166.5 million and an assumed tax rate of 35%, and presuming sufficient income to be offset and otherwise full

3. Were the Board's Actions a Reasonable Response to the Perceived Threat?

The second prong of *Unocal* requires an evaluation of whether a board's defensive response to the threat was preclusive or coercive and, if not, whether it was "reasonable in relation to the threat" identified.¹⁶³ It is the specific nature of the threat that "sets the parameters for the range of permissible defensive tactics."¹⁶⁴ A reasonableness analysis "requires an evaluation of the importance of the corporate objective threatened; alternative methods for protecting that objective; impacts of the 'defensive' action and other relevant factors."¹⁶⁵ The court should evaluate the board's "overall response, including the justification for each defensive measure, and the results achieved thereby."¹⁶⁶ Where all of the defenses "are inextricably related, the principles of *Unocal* require that such actions be scrutinized collectively as a unitary response to the perceived threat."¹⁶⁷

Trilogy asserts that the NOL Pill, the Exchange, and the Reloaded NOL Pill were not a reasonable collective response to the threat of the partial impairment of Selectica's NOLs. Trilogy asserts that the NOL Pill is preclusive, either per se or

availability of the NOLs) suggests such a skepticism in the market. RJN, Ex. A at 35, 53, 56. Nevertheless, there is sufficient evidence that the Board acted in good faith in concluding that the NOLs had a value worth protecting or, perhaps more importantly, that the directors relied in good faith on the advice of experts in coming to such a conclusion.

¹⁶³ *Unocal*, 493 A.2d at 955.

¹⁶⁴ *Unitrin*, 651 A.2d at 1384.

¹⁶⁵ *Paramount*, 571 A.2d at 1154.

¹⁶⁶ *Unitrin*, 651 A.2d at 1386-87.

¹⁶⁷ *Id.* (citing *Gilbert v. El Paso Co.*, 575 A.2d 1131, 1145 (Del. 1990)).

in conjunction with certain other factors unique to Selectica (most prominently, its staggered board). Trilogy also argues that the Board (1) failed to consider the negative consequences of the NOL Pill and Reloaded NOL Pill; (2) failed to consider any alternatives to these pills; and (3) failed to demonstrate that any benefit achieved by the pills outweighed their negative impact on Trilogy and other Selectica shareholders.

a. *Does the 5% Trigger Make the NOL Pill Preclusive?*

Under *Unitrin*, a defensive measure is disproportionate and unreasonable if it is draconian, being either coercive or preclusive.¹⁶⁸ A coercive response is one that is “aimed at ‘cramming down’ on its shareholders a management-sponsored alternative.”¹⁶⁹ A defensive measure is preclusive where it “operate[s] to unreasonably preclude a takeover”¹⁷⁰ or “preclude[s] effective stockholder action”¹⁷¹—specifically, where the measure “makes a bidder’s ability to wage a successful proxy contest and gain control either ‘mathematically impossible’ or ‘realistically unattainable.’”¹⁷²

¹⁶⁸ *Id.*

¹⁶⁹ *Id.* (citing *Paramount*, 971 A.2d at 1154-55). The parties do not dispute that the NOL Pill, Exchange, and Reloaded NOL Pill are not coercive.

¹⁷⁰ *Gaylord*, 753 A.2d at 482 n.72.

¹⁷¹ *Chesapeake Corp. v. Shore*, 771 A.2d 293, 320 (Del. Ch. 2000) (quoting *Unitrin*, 651 A.2d 1388-89).

¹⁷² *Carmody*, 723 A.2d at 1195. The Court in *Carmody* held that “dead hand” pills (poison pills that contain a provision that states that only the original directors that adopted the pill may vote to redeem it) met this standard, as they eliminate the use of a proxy contest as a possible means to gain control since any insurgent directors would be incapable of redeeming the pill.

The mere adoption of a garden-variety pill is not in itself preclusive under Delaware law.¹⁷³ This is despite the fact that a poison pill “dilutes the would-be acquirer’s stake in the company and increases the costs of acquisition.”¹⁷⁴ That a combination of defensive measures makes it “more difficult for an acquirer to obtain control” of a board does not make such measures preclusive; indeed “[i]t would . . . be surprising if defensive measures did not have this effect.”¹⁷⁵ Preclusive measures are those that are “insurmountable or impossible to outflank.”¹⁷⁶

The Supreme Court in *Moran* found that a poison pill with a 20% trigger was not per se preclusive because it did not “strip[] stockholders of their rights to receive tender offers”¹⁷⁷ or “fundamentally restrict[] proxy contests.”¹⁷⁸ The court recognized that, while a rights plan “does deter the formation of proxy efforts of a

Cf. Omnicare, Inc. v. NCS Healthcare, Inc., 818 A.2d 914, 936 (Del. 2003) (holding that the defensive measures employed by the board made it mathematically impossible and realistically unattainable for any insurgent proposal to succeed because they rendered the board-approved merger a “fait accompli,” and therefore were coercive and preclusive).

¹⁷³ *Gaylord*, 753 A.2d at 481. However, the Court in *Unitrin* recognized the legal scholarship that argues that the poison pill “warrants special attention chiefly because its preclusive effect frequently exceeds that of other takeover defensive tactics. . . . [and] makes it effective even in circumstances where other defensive tactics may not work.” *Unitrin*, 651 A.2d at 1379 n.25 (quoting Jeffery N. Gordon, *Corporations, Markets, and Courts*, 91 Colum. L. Rev. 1931, 1946 (1991)).

¹⁷⁴ *Unitrin*, 651 A.2d at 1369 n.6.

¹⁷⁵ *Gaylord*, 753 A.2d at 482.

¹⁷⁶ *Id.*

¹⁷⁷ *Moran*, 500 A.2d at 1357.

¹⁷⁸ *Id.*

certain magnitude, it does not limit the voting power of individual shares.”¹⁷⁹ More importantly, because the purpose of the poison pill was not to provide an impenetrable barrier to control acquisitions but to give the target board leverage over a potential acquirer, where a potential acquirer may secure board control through a proxy contest and thereafter redeem the pill, the pill will not be considered preclusive.¹⁸⁰ The *Moran* Court found the assertion that a poison pill would preclude proxy fights “highly conjectural” and pointed to “recent corporate takeover battles in which insurgents holding less than 10% stock ownership were able to secure corporate control through a proxy contest or the threat of one.”¹⁸¹

Trilogy asserts that the NOL Pill and the Reloaded NOL Pill are distinctly more preclusive than those poison pills previously evaluated by Delaware courts and that, consequently, they should be declared invalid. Specifically, Trilogy claims that a 4.99% pill renders the possibility of an effective proxy contest realistically unattainable. Trilogy argues that, because a proxy contest can only be successful where the challenger has sufficient credibility, the 4.99% pill prevents a potential dissident from signaling its financial commitment to the company sufficient to establish such credibility. In addition, a pill with such a low trigger, in

¹⁷⁹ *Id.* at 1355.

¹⁸⁰ *Gaylord*, 753 A.2d at 481.

¹⁸¹ *Moran*, 500 A.2d at 1355. The Court additionally noted that “many proxy contests are won with an insurgent ownership of less than 20%,” and that “the key variable in proxy contest success is the merit of an insurgent’s issues, not the size of his holdings.” *Id.*

conjunction with a staggered board, renders a conditional takeover bid “unrealistic” since a proxy contest would have to be sustained over multiple years, decreasing the probability that a would-be challenger would rationally incur the costs of such a proxy contest. As a result, such a pill would significantly lock in the existing ownership structure absent a board “exemption.”¹⁸²

Professor Ferrell, Trilogy’s expert witness, additionally testified that the existence of such a pill in conjunction with a charter-based staggered board removes the ability of challengers to issue a conditional takeover bid—a bid conditional on the election of a slate of insurgent directors—in order to improve the likelihood of a successful proxy fight under these constraints. Such a bid would be highly unlikely, according to Professor Ferrell, because the offer would have to remain outstanding across multiple director election cycles. In addition, the 5% cap on ownership exacerbates the free rider problem already experienced by investors considering fielding an insurgent slate of directors, and makes initiating a proxy fight an economically unattractive proposition.¹⁸³ Given all of

¹⁸² These were the findings of Trilogy’s expert witness, Professor Allen Ferrell, who reviewed and analyzed eight academic studies, in conjunction with additional data he personally compiled. DX 776 at 3-4; Tr. 1061-62. Selectica’s expert witnesses, Professor John C. Coates IV and Peter C. Harkins, dismissed Professor Ferrell’s findings in rebuttal reports and in trial testimony. PX 122; Tr. 834-43.

¹⁸³ The free rider problem is that, even if an investor believes that replacing the board would result in a material benefit to shareholders, the investor has to bear the full cost of a proxy fight while only receiving her proportionate fraction of the benefit bestowed upon shareholders. Along with the reduced likelihood of success at a 5% position, the capped position would mean that the challenger would be unable to internalize more of the benefits by increasing her share

the above, Trilogy asserts that the NOL Pill, particularly within the context of Selectica’s other defenses, makes a change in board control “realistically unattainable.”¹⁸⁴

Selectica counters that the distinguishing feature of the NOL Pill and Reloaded NOL Pill—the 5% trigger—is not sufficient to differentiate them from other poison pills previously blessed by Delaware courts, and that there is no evidence that a challenger starting below 5% could not realistically hope to prevail in a proxy contest at Selectica. Selectica, primarily through Professor Coates’s expert testimony, has identified more than 50 publicly held companies that have implemented NOL pills with triggers at roughly 5%, including several large, well-known corporations, including some among the Fortune 1000.¹⁸⁵

ownership. Trilogy claims that the average cost of a proxy solicitation is roughly \$368,000, or \$746,000 across two cycles, yet the current value of a 4.99% share in Selectica is approximately \$1,000,000, and that no investor would be willing to stake so much money in proxy fights given such a small investment and where they would only receive 5% of any benefits of a change in control.

¹⁸⁴ *Carmody*, 723 A.2d at 1195.

¹⁸⁵ PX 128, Ex. D; Plaintiffs’ Third Motion for Judicial Notice at 3. Certainly, the fact that the adoption of pills with 5% triggers “is customary is not proof that it is, in fact, permissible or justifiable under the specific circumstances faced by the board.” *San Antonio Fire & Police Pension Fund v. Amylin Pharm., Inc.*, 2009 WL 1337150, at *10 n.45 (Del. Ch. May 12, 2009) (citing *La. Mun. Police Employees’ Retirement Sys. v. Crawford*, 918 A.2d 1172, 1181 n.10 (Del. Ch. 2007)). Likewise, “the fact that the combination [of defenses] might be unusual does not make the combination unreasonable.” *Gaylord*, 753 A.2d at 480 n.64. Nevertheless, the presence of similar pills adopted outside the context of shareholder/control disputes or an imminent takeover offer lends considerable support to the conclusion that the NOL Pill was “a statutorily authorized form of business decision which a board of directors may routinely make in a non-takeover contest” to be considered as part of the reasonableness review. *Unitrin*, 651 A.2d at 1389.

Selectica expert witness Harkins of the D. F. King & Co. proxy solicitation firm analyzed proxy contests over the three-year period ended December 31, 2008, and found that, of the fifteen proxy contests that occurred in micro-cap companies where the challenger controlled less than 5.49% of the outstanding shares, the challenger successfully obtained board seats in ten contests, including in five contests involving companies with classified boards.¹⁸⁶ Selectica also asserts that Trilogy's calculations of the average cost of proxy fights do not take into account Selectica's unique shareholder profile that would considerably reduce the costs associated with such a fight.¹⁸⁷ Trilogy seeks to discount these findings by pointing out that Selectica has failed to indicate any examples where a dissident shareholder in a micro-cap company with less than a 5% stake successfully obtained control over a company with a classified board.¹⁸⁸

Though Trilogy's expert testimony suggests that a poison pill with a less than 5% trigger "has a substantial preclusive effect,"¹⁸⁹ the Court cannot conclude

¹⁸⁶ PX 121. There were eight such contests at micro-cap companies in which the challenging shareholder held less than 4.99% of the outstanding shares. Challengers prevailed in six of these contests, including at three companies that had classified boards. *Id.*

¹⁸⁷ Selectica points out that six investors control a majority of its outstanding shares, and that twenty-two investors collectively own 62% of the outstanding shares, making the likely cost of a proxy fight at Selectica considerably cheaper than the average cost asserted by Trilogy. PX 121 at 7-9; Tr. 1023-30. Of those investors, only Sems is an "insider." *Cf. Unitrin*, 651 A.2d at 1383 n.33 ("That institutions held a high percentage of Unitrin stock is not as significant as the fact that the relatively concentrated percentage of stockholdings would facilitate a bidder's ability to communicate the merits of its position.").

¹⁸⁸ Tr. 1043.

¹⁸⁹ Although Professor Ferrell testified that the combination of such a pill with a classified board had a "substantial preclusive effect," he conceded that it was "not 100 percent preclusive" and

that the NOL Pill, Exchange, and Reloaded NOL Pill were preclusive, and thereby draconian. Such a high standard operates to exclude only the most egregious defensive responses. As the court in *Unitrin* noted, “This Court's choice of the term draconian in *Unocal* was a recognition that the law affords boards of directors substantial latitude in defending the perimeter of the corporate bastion against perceived threats.”¹⁹⁰ The requirement of either the mathematical impossibility or realistic unattainability of a proxy contest reinforces the exactness of the preclusiveness standard. It is not enough that a defensive measure would make proxy contests more difficult—even considerably more difficult.¹⁹¹ To find a measure preclusive (and avoid the reasonableness inquiry altogether), the measure must render a successful proxy contest a near impossibility or else utterly moot, given the specific facts at hand. The NOL Pill and Reloaded NOL Pill do not meet this standard.

b. *Range of Reasonableness Review*

Upon a finding that a defensive measure is neither coercive nor preclusive, the *Unocal* proportionality test “requires the focus of enhanced judicial scrutiny to

that it was a “theoretical possibility” for an insurgent to win a proxy contest under such circumstances. Tr. 1085-86.

¹⁹⁰ *Unitrin*, 651 A.2d at 1388 n.38.

¹⁹¹ It is not clear that a 5% threshold would have much of an affect on the ability of a dissident to wage a successful proxy fight. *See Unitrin*, 651 A.2d at 1383 (“The key variable in a proxy context would be the merit of [the challenger’s] issues, not the size of its stockholdings.”).

shift to ‘the range of reasonableness.’”¹⁹² Such a proportionality test is “inherently qualitative.”¹⁹³

Trilogy argues that the Board’s review of the range of reasonable responses to the threat to Selectica’s NOLs failed because there was an inadequate assessment of the impact that the adoption of these defensive measures would have, as seemingly required by the *Unocal* test. This impact includes that they: (1) make takeovers more difficult;¹⁹⁴ (2) effectively freeze the existing equity ownership structure in place;¹⁹⁵ (3) deter institutional investors from investing in Selectica;¹⁹⁶ and (4) prevent 5% holders from selling their interest as a single block, thereby impacting the liquidity of these investments,¹⁹⁷ while the implementation of the Exchange in this instance essentially cut Selectica’s stock price in half, putting the Company at risk of being delisted for non-compliance with NASDAQ rules.¹⁹⁸ Trilogy argues that the Board failed even to consider these consequences, much less weigh their effects against the importance of protecting the NOLs and the likelihood of their impairment, otherwise. Finally, Trilogy asserts that the Board failed to consider whether there were alternative

¹⁹² *Id.* at 1388 (quoting *Paramount Commc’ns, Inc. v. QVC Network, Inc.*, 637 A.2d 34, 45 (Del. 1994)).

¹⁹³ *Unitrin*, 651 A.2d at 1373 n.13.

¹⁹⁴ DX 776 at 3.

¹⁹⁵ Tr. 1062, 1198-1200.

¹⁹⁶ Tr. 1074-75.

¹⁹⁷ Tr. 1198-99.

¹⁹⁸ Tr. 803-04. NASDAQ listing rules have a \$1.00 minimum bid price requirement for listed companies. NASDAQ Rule 5450.

methods for protecting the NOLs other than those the Board ultimately employed. Trilogy asserts that the Board could have amended the corporate charter to add limitations on the transferability of stock—thereby rendering any non-approved acquisitions void *ab initio*, lowered the poison pill threshold by shareholder vote, or simply diluted only the portion of Trilogy’s interest that exceeded the threshold, instead of its entire holding.

There is sufficient evidence, however, that the Board met its obligation to evaluate the reasonableness of its response relative to the danger it faced. Sems testified about the Board’s internal debate on how to proceed, noting, “We were trying to do everything to—do a measured approach to a fairly big threat.”¹⁹⁹ In addition, Arnold testified that the Board “talked about the impact [of the NOL Pill] to the shareholders,”²⁰⁰ testimony corroborated by Zawatski²⁰¹ and Sems.²⁰² Trilogy points to testimony that Board members did not specifically consider what effect lowering the pill threshold would have on certain of the consequences its experts have raised in trial, as listed above.²⁰³ However, as Zawatski noted, the Board established the Committee in part to monitor the likelihood of a near-term

¹⁹⁹ Tr. 753.

²⁰⁰ Tr. 125.

²⁰¹ Tr. 369-71.

²⁰² Tr. 751-52 (“Being a shareholder, too, I was in some ways apprehensive about it, because you never want to limit what shareholders can do. . . . But, to me, the trade-off was important, because it was such a large asset compared to the value of the company, once again.”).

²⁰³ See, e.g., Tr. 125-26, 473-74, 802-03.

ownership change and to increase the pill threshold if and when the burden of the Reloaded NOL Pill on shareholders outweighs its benefit in preserving Selectica's NOLs.²⁰⁴

Most importantly, Trilogy has failed to suggest any meaningfully different approach that the Board could have taken in November and December 2008 to avoid the seemingly imminent impairment of Selectica's NOLs by Trilogy.²⁰⁵ The Board was put on notice of Trilogy's presence as a 5% holder and apparent intention to trigger a change in control on November 10.²⁰⁶ Amending the charter would have required a vote of Selectica's shareholders,²⁰⁷ which would have necessitated the filing of a proxy statement and delayed any defensive response for several months, making such action implausible as an immediate reaction to the threat that Trilogy posed. Seeking prior shareholder approval of the NOL Pill would have been likewise ineffectual.

²⁰⁴ Tr. 370-72.

²⁰⁵ When asked by the Court about what else Selectica could have done to protect its NOLs at the time in question other than employing the NOL Pill, counsel for Trilogy did not offer up any other specific options that would have been less preclusive. Instead, she merely suggested that “[t]here may be a device similar to the pill that has a duration measured to the threat, that has a penalty, if you will, geared to the violation in the first place—in other words, not diluting down, past or beyond the actual amount; and that does not affect the shareholder franchise in the way that this micro-cap company is affected in having a classified board. . . . Another thing they could have done, they said they didn’t have enough time, was to ask the shareholders whether they wanted to do it.” Post-trial Oral Arg. Tr., 89-90 (unofficial transcript).

²⁰⁶ Indeed, Trilogy argues that a Section 382 change in control did occur almost immediately thereafter, on November 14. DX 777.

²⁰⁷ Selectica's charter does not permit shareholder actions by written consent. PX 131 (“Second Amended and Restated Certificate of Incorporation of Selectica (March, 2000)”), Article VIII.

Trilogy contends that Selectica's differing reaction to Trilogy's purchases, when compared to other shareholders' purchases in the past, including those by Steel Partners, suggests bias in favor of certain shareholders and animus toward Trilogy, and/or that preserving the NOLs was merely an excuse proffered by the Board in order to freeze out Trilogy.²⁰⁸ In particular, Trilogy points out that Selectica only took action to protect its NOLs after Trilogy began buying, and had not done so in the immediately preceding months when Steel Partners increased its holdings to the 15% level allowed under the previous pill, which was the cause of the increase in the Section 382 ownership change calculation to 40%. Additionally, Selectica repeatedly sought a standstill agreement with Trilogy to prevent further share purchases following the filing of its 13D, but did not seek out similar agreements with other large shareholders during this same period. Trilogy maintains that the reasonableness of the Board's response should be assessed in light of the fact that the Board would have had considerably more, and less preclusive, options at its disposal in the months before a Section 382 ownership

²⁰⁸ As evidence of this animus, Trilogy points to the testimony of Michael Shaw, former head of Selectica's sales configuration business, who testified that Thanos's general feeling was that Selectica would sell to Trilogy "over my [Thanos's] dead body." Shaw Dep. at 43-44. Likewise, Zawatski admitted at trial that she does not like Trilogy. Tr. 327. Trilogy asserts that Selectica's "well-known dislike for Trilogy" is evidenced by the statement made by an investor during Selectica's Second Quarter 2007 earnings call advocating for a sale to Trilogy, who noted, "I understand you probably hate them. You probably would prefer nothing than—you'd probably stick pins in your eyes rather than sell the Company to them. But that is what the right thing for shareholders is at this point." DX 163 at 6.

change was imminent, and that any precipitous threat arguably necessitating more draconian measures was the result of the Board's failure to act at an earlier date.

A board's timing in moving to protect NOLs through the adoption of a poison pill is certainly relevant to the question of whether the board reasonably perceived a legitimate threat to the corporation. However, under *Unocal*, the reasonableness of a board's response is judged in relation to the "specific threat" identified, at the time it was identified.²⁰⁹ In this case, Trilogy posed a distinctly different threat to Selectica's NOLs than the general threat Selectica previously faced of an inadvertent change in ownership triggered by the actions of a careless or unknowing shareholder. Here, the record demonstrates that a longtime competitor sought to employ the shareholder franchise intentionally to impair corporate assets, or else to coerce the Company into meeting certain business demands under the threat of such impairment. It is in relation to that specific threat—and not a more general threat of impaired NOLs—that the Court must consider the reasonableness of Selectica's response.²¹⁰

With respect to Trilogy's argument that Selectica should have more narrowly tailored the amount by which Trilogy's position was diluted by reducing

²⁰⁹ See, e.g., *Moran*, 500 A.2d at 1351; *Paramount Commc'ns, Inc. v. Time, Inc.*, 1989 WL 79880, at *30 (Del. Ch. July 14, 1989).

²¹⁰ As Sems noted, "I kept on going through what was their rationale for purposefully tripping the pill. . . . [W]hy would you . . . ruin the value of an NOL that you, the shareholder, are part of that value. It's an asset to you as a shareholder. Why would you destroy your own asset?" Tr. 755.

the impact of the NOL Pill, there is no evidence in the record that this was even a plausible option. As it was, the implementation of the Exchange—seemingly the simplest mechanism for transferring the rights—caused trading in Selectica stock to halt for more than four weeks. Besides, taking Trilogy down to under 5% would not have eliminated the threat, at least in the absence of a standstill agreement. However, the Exchange employed by the Board was a more proportional response than the “flip-in” mechanism traditionally envisioned for poison pills. Because the Board opted to use the Exchange instead of the traditional “flip-in” mechanism, Trilogy experienced less dilution in its position than a poison pill is traditionally designed to achieve.²¹¹

Ultimately, *Unocal* and its progeny require that the defensive response employed be a proportionate response, not the most narrowly or precisely tailored one. The Supreme Court in *QVC* explained the nature of judicial function in applying the range of reasonableness inquiry to enhanced judicial scrutiny of board actions:

²¹¹ The Exchange reduced Trilogy’s holdings from 6.7% to 3.3%. In contrast, employing the flip-in would have likely reduced the company’s holdings to below 1.0%. PX 38 at 29 (Needham presentation estimating that a flip-in pill would reduce a 5.0% triggering stake to 0.7% after the rights were exercised). As Sems testified, “[o]ne of the things you could do, instead of a flip-in, you could do the exchange. We looked at the difference between doing both of those and came to the conclusion that exchange was not only better for shareholders, but better for Trilogy as well, too. We were trying to do everything to—do a measured approach to a fairly big threat.” Tr. 753.

[A] court applying enhanced judicial scrutiny should be deciding whether the directors made *a reasonable* decision, not *a perfect* decision. If a board selected one of several reasonable alternatives, a court should not second guess that choice even though it might have decided otherwise or subsequent events may have cast doubt on the board's determination. Thus, courts will not substitute their business judgment for that of the directors, but will determine if the directors' decision was, on balance, within a range of reasonableness.²¹²

The *Unitrin* court suggested that the reasonableness of measures ought to be construed broadly by courts and allow defenses to extend beyond an immediate threat: “[T]he board of directors is the defender of the metaphorical medieval corporate bastion and the protector of the corporation’s shareholders. The fact that a defensive action must not be coercive or preclusive does not prevent a board from responding defensively before a bidder is at the corporate bastion’s gate.”²¹³ Likewise, once a siege has begun, the board is not constrained to repel the threat to just beyond the castle walls.

Finally, the implementation of the Reloaded NOL Pill was a similarly reasonable response in the context of Selectica’s other defensive measures. Although the NOL Pill and the Exchange effectively rebuffed Trilogy’s immediate threat to Selectica’s NOLs, the general threat of a Section 382 change in control was not substantially lessened by their implementation. Following implementation of the Exchange, Selectica still had experienced a roughly 40% ownership change

²¹² *QVC*, 637 A.2d at 45 (emphasis in original).

²¹³ *Unitrin*, 651 A.2d at 1388.

for Section 382 purposes and there was no longer a pill in place to discourage additional acquisitions by 5% holders.²¹⁴ As such, the Reloaded NOL Pill was reasonably considered as a necessary defensive measure. In addition, the Reloaded NOL Pill's three-year life is mitigated to an extent by the periodic review process to be employed by the Committee.²¹⁵

Thus, the Court finds that the combination of the NOL Pill, the Exchange, and the Reloaded NOL Pill was a proportionate response to the threatened loss of Selectica's NOLs.

There is, of course, the risk that accumulated net operating losses could provide a convenient pretext for perpetuating a board-preferred shareholder structure.²¹⁶ For this reason, shareholder rights plans, such as the ones adopted by Selectica, must be subject to careful review. In this instance, however, the Board reasonably believed, based on the guidance of appropriate experts, that the NOLs had value, a value worth protecting. In its view of the actual value of the NOLs, the Board may have been incorrect. It is not for the Court, however, to substitute its judgment for the reasonable conclusions of the Board protected as they are by

²¹⁴ See also *Gaylord*, 753 A.2d at 485 (“[T]he board’s decision to put into place seamless defensive coverage efficiently cannot be deemed an unreasonable approach to the situation it faced.”).

²¹⁵ See *Unitrin*, 651 A.2d at 1378 (“[T]his Court has upheld the propriety of adopting poison pills in given defensive circumstances. Keeping a poison pill in place may be inappropriate, however, when the circumstances change dramatically.”).

²¹⁶ Indeed, companies most in need of new management, new investment, new ideas, and the invigoration that shareholder democracy often brings may well be companies that have not achieved or maintained profitability and, accordingly, have accumulated sizeable NOLs.

8 *Del. C.* § 141(e). Moreover, the threat posed by Trilogy was reasonably viewed as qualitatively different from the normal corporate control dispute that leads to the adoption of a shareholder rights plan. In this instance, Trilogy, a competitor with a contentious history, recognized that harm would befall its rival if it purchased sufficient shares of Selectica stock, and Trilogy proceeded to act accordingly. It was reasonable for the Board to respond, and the timing of Trilogy's campaign required the Board to act promptly. Moreover, the 4.99% threshold for the NOL Pill was driven by our tax laws and regulations; the threshold, low as it is, was measured by reference to an external standard, one created neither by the Board nor by the Court. Within this context, it is not for the Court to second-guess the Board's efforts to protect Selectica's NOLs.

IV. CONCLUSION

For the foregoing reasons, the Court concludes that the adoption of the NOL Pill and the Reloaded NOL Pill and the implementation of the Exchange were valid exercises of the Board's business judgment. Selectica's declaratory relief is granted. It follows that Trilogy and Versata's claims fail. Counsel are requested to confer and to submit an implementing form of order.