IN THE
SUPREME COURT OF THE STATE OF DELAWARE

JOHN A. MORAN and THE DYSON-KISSNER-MORAN CORPORATION, *Plaintiffs Below-Appellants,* and GRETL GOLTER, *Plaintiff Intervenor Below-Appellant,* *against* HOUSEHOLD INTERNATIONAL, INC., a Delaware corporation, DONALD C. CLARK, THOMAS D. FLYNN, MARY JOHNSTON EVANS, WILLIAM D. HENDRY, JOSEPH W. JAMES, MITCHELL P. KARTALIA, GORDON P. OSLER, ARTHUR E. RASMUSSEN, GEORGE W. RAUCH, JAMES M. TAIT, MILLER UPTON, BERNARD F. BRENNAN and GARY G. DILLON, *Defendants Below-Appellees.*	No. 37, 1985 No. 47, 1985 (Consolidated) Appeals from Judgment of the Court of Chancery in and for New Castle County in C.A. No. 7730

ANSWERING BRIEF OF DEFENDANTS BELOW-APPELLEES

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Statement of the Nature of the Proceeding and the Judgment Appealed From

This action seeks to invalidate the action of the Board of Directors of Household International, Inc. ("Household") in adopting a preferred stock purchase rights dividend plan (the "Rights Plan" or the "Plan") on August 14, 1984. On August 17, 1984, plaintiff John A. Moran ("Moran"), a Household director who had unsuccessfully opposed adoption of the Plan at the Board meeting, and his company The Dyson-Kissner-Moran Corporation ("DKM"), filed this action against Household and 13 of the 14 directors who had voted for the Plan. On the first day of trial, Gretl Golter, the holder of 500 Household shares, intervened as a party plaintiff.*

The trial before Vice-Chancellor Walsh was held over 10 days between September 24 and October 12, 1984. The trial Court heard testimony from fifteen witnesses. The transcripts of the depositions of twenty-seven witnesses, as well as hundreds of other documents, were admitted into evidence.

The Court of Chancery filed an opinion on January 29, 1985, granting judgment for defendants on the grounds, *inter alia*, that the Rights Plan "has been properly adopted under Delaware law, is not intended primarily for entrenchment of management and serves a rational corporate purpose" (Op. 54, B56).** The Moran plaintiffs and the plaintiff-intervenor appealed from that judgment. An application by the Moran plaintiffs for leave to expedite their appeal was denied by this Court on February 1, 1985. The Moran plaintiffs filed their opening brief on March 18, 1985. The intervenor filed her opening brief on March 22, 1985. The two appeals were consolidated by Order of this Court dated April 4, 1985.

This is the answering brief of defendants below-appellees.

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*The term "plaintiffs" herein will refer to the Moran plaintiffs and to the plaintiff-intervenor unless the context indicates otherwise.

**The opinion below will be cited as "Op." References with the prefix "B" are to the Appendix of Defendants Below-Appellees, filed herewith.

Summary of Argument

1. Denied.* Sections 157 and 151(g) of the General Corporation Law of the State of Delaware ("DGCL") authorize the Household Board's action in adopting the Rights Plan.

2. Denied. Neither the United States Supreme Court nor any other court has ever held that constitutional limitations upon state regulation of interstate tender offers have any bearing upon the issuance of securities under DGCL § 157, or the taking of other corporate action pursuant to other state corporation statutes, that may affect a takeover. Such matters consistently have been left to state law. Moreover, plaintiffs did not brief or submit to the Court below their contentions that the Commerce and Supremacy Clauses would be contravened if DGCL § 157 were construed as authorizing the Household Board to adopt the Rights Plan.

3. Admitted. Household has never claimed that the business judgment rule is an independent source of power for a board of directors. The business judgment rule does protect from judicial invalidation the good faith exercise of the Household Board's power under DGCL §§ 157 and 151(g).

4. Denied. The Rights Plan neither prevents tender offers for Household nor usurps the shareholders' power to receive tender offers. The Court below correctly held that, as a general matter, "[t]he shareholders' ability to gain premiums through takeover activity is subject to the good faith business judgment of the board of directors in structuring defensive tactics" (Op. 20-21, B22-23), and that "the directors who have the responsibility for the governance of the corporation are entitled to formulate a takeover policy, whether it be to meet a specific threat or a general prospective one, even though that policy may not please all its shareholders" (Op. 44, B46). The record does not support plaintiffs' contention that, among the various takeover defenses adopted by boards of directors and upheld by the courts, the Rights Plan is uniquely "structural". The Court below correctly held that adoption of the Rights Plan leaves

*These numbered paragraphs respond to the Moran plaintiffs' "Summary of Argument."

the Household Board fully subject to its fiduciary duties to act responsibly and not to use the Rights Plan—or any other defense—to frustrate a fair offer. The evidence demonstrated that the directors intend to honor this obligation.

5. Denied. The Rights Plan does not prevent or impede a proxy contest at Household.

6. Denied. The Rights Plan was adopted in good faith by an independent and disinterested Board of Directors acting on an informed basis and for rational business purposes. While the defendants were therefore not required to prove the fairness of the Rights Plan, the evidence presented below demonstrated that the Rights Plan is in fact fair to shareholders. The Plan treats all shareholders equally. It encourages potential acquirors to treat them equally by making an offer for all shares at the same price, rather than a two-tier offer at different prices. The Plan protects shareholders from being frozen out of their investment on unfair terms. The Plan has no adverse impact on Household's on-going business or its financial structure. The Rights are redeemable at modest cost. Adoption of the Rights Plan has not had an adverse impact on the market in Household stock.

7. Denied. The Rights Plan does not restrain the alienation of Household common stock. Shareholders can today buy and sell shares—including in a tender offer—just as they could before the Plan was adopted. Household shares have traded freely on the New York Stock Exchange since the Rights Plan was adopted.*

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*Defendants also deny each and every paragraph of the "Summary of Argument" at pp. 2-6 of the brief filed by the intervenor.

Statement of Facts

A. Introduction

The evidence demonstrated that Household's adoption of the Rights Plan stemmed from its Board's well-founded concern that the company was unprotected against increasingly common acquisition techniques which are widely regarded as unfair and coercive to shareholders. The record showed that the Household Board adopted the Plan to strengthen its negotiating position with potential acquirors and to give an unsolicited acquiror an incentive to proceed by a fair offer for all shares.

The record established that the Rights Plan was not intended to stop all takeovers, and that it will not do so. The speculative testimony of plaintiffs' academic and arbitrageur experts that the Rights Plan makes Household takeover-proof was illogical and unpersuasive. It was clearly outweighed by Household's evidence—from witnesses with significant real-world experience in the field of mergers and acquisitions—that normal market pressures will continue to operate on Household's directors. The Vice-Chancellor was also correct in relying on Household's evidence that the Rights Plan will not prevent or impede a proxy contest, rejecting what he described as the "highly conjectural" claims by plaintiffs that it will.

The record established that adoption of the Rights Plan without a shareholder vote was in no way a departure from accepted and proper corporate practice. The evidence showed that boards of directors adopt defensive responses without a shareholder vote, except as required by statute, and that their decisions to do so have been upheld under the laws of numerous jurisdictions, including Delaware. The record showed that this practice has been sustained even when the defense involved radical changes to a company's business or financial structure, unlike the Rights Plan.

The record established that the requirements of the business judgment rule were fully satisfied. The Household Board is a predominantly outside Board which operates under specific policies to assure the predominance of independent directors. The record showed that the Board sought and relied upon the advice of investment banking and law firms with extensive experience in acquisition matters. The record established that the Board adopted the Plan only after discussion and consideration which, according to uncontradicted testimony from Household's chief financial officer, a former Arthur Andersen & Co. partner with years of board-room experience, "was as extensive, or more extensive, than any that I have witnessed in complex mergers and acquisitions or financing transactions" (Dammeyer X 33, B708).* The Vice-Chancellor correctly stressed that, while the Rights Plan increases the negotiating strength of the Board, it leaves the Board fully subject to its fiduciary duties "to protect all corporate constituencies." He properly refused to presume that the directors would not honor their duties.

That the adoption of the Rights Plan is a matter of business judgment was not only established by the record but also is confirmed by the circumstances surrounding the filing of the *amicus curiae* brief of the Securities and Exchange Commission ("SEC") in this Court. That brief purports to give this Court the agency's "view" of the business merits of the Plan. Yet the agency's decision to file the brief was itself reached on a bare 3-2 vote of the Commissioners. The two dissenting Commissioners have publicly disagreed with the other three as to the Plan's business merits—they have stated that they do *not* believe the Rights Plan results in entrenchment or represents a "bullet-proof" defense (see Exhibit A).** The SEC's "brief" amounts to opinion testimony from three of the five Commissioners, without according defendants the opportunity to cross-examine.

The fact that numerous other public companies with independent boards of directors have also adopted similar rights plans was also before the Court below. The record further showed that these boards acted on the recommendation of no fewer than three different investment banking firms of national reputation. The record showed that the rights issued under these plans have been accepted for listing by the

*In addition to being cited with the prefix "B" to the Appendix of Appellees, trial testimony will be cited by witness, volume and page number.

**Unreported opinions and other material cited in this brief as "Exhibit" are being filed in a separate compendium.

New York Stock Exchange. Since the trial, two other courts, applying two different states' laws, have rejected similar attacks on two other rights plans.

It is inherently implausible that so many sophisticated, experienced and presumptively honorable business-people are engaged in subverting "fundamental shareholder rights"—or that the New York Stock Exchange, two of the five SEC Commissioners and three different judges are also prepared to countenance an allegedly gross departure from accepted corporate norms.

B. The Current Takeover Environment

Plaintiffs, and the Investment Company Institute ("ICI"), as *amicus*, argue that shareholders have an "inherent right" to sell shares in a tender offer (*e.g.*, POB 3; ICIB 6).* Plaintiffs and the ICI assert that proper corporate practice requires that what they call "structural" changes be adopted only upon a shareholder vote (POB 6; ICIB 7). Plaintiffs charge the Household directors with "arrogating to themselves powers which heretofore were the exclusive province of stockholders" (POB 4; see also ICIB 6). The SEC, as *amicus*, offers this Court its "view" that the Rights Plan will prevent all tender offers and impede proxy fights (SECB 12). None of this was established on the record below. None of it is correct.

1. New, highly coercive forms of takeover activity have emerged.

Tender offers can indeed be beneficial transactions for target company shareholders. But the record showed an increasing use of particular takeover techniques which enable bidders to put shareholders under enormous pressures to tender, regardless of whether the price offered fairly reflects the real value of the company.

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*The Moran Plaintiffs' Opening Brief will be cited as "POB," the Plaintiff Intervenor's Opening Brief as "IOB," the ICI's Brief as "ICIB" and the SEC's Brief as "SECB." Deposition testimony will be cited by witness and "Dep." Trial exhibits introduced by plaintiffs and defendants will be cited as "PX" and "DX," respectively, with parallel citations to the Appendix of Appellees or the Appendix of the Moran plaintiffs.

Notably, there has been a proliferation of what are called front-end loaded, two-tier offers—in which the bidder offers to purchase a low percentage of the target's shares at the outset and states his intention to offer securities of a lower value (and often of dubious quality) in a second-step merger. Plaintiffs' investment banking expert described such securities as "wallpaper" (Abbott III 170, B177, IV 59, B201). To put shareholders under even sharper pressure to tender into the "first tier," bidders sometimes give *no* clear indication of the second-step consideration—except that the value will be lower. Abbott III 170-73, B177-80; Jensen IV 233, B232; Higgins VII 20-30, 211-12, B390-400, 510-11; Tower X 62-63, B713-14; DX 25, B889-919.

Plaintiffs' own investment banking expert, R. Clark Abbott, formerly a managing director of Morgan Stanley & Co., testified that these acquisition techniques are irresistibly coercive. As he stated, shareholders simply *"have no economic choice"*; "at the last minute," as he succinctly put it, *"everybody tenders"* (Abbott III 172-73, B179-80) (emphasis added). Defendants' witnesses agreed (see, *e.g.*, Higgins VII 21-25, 28-30, B391-95, 398-400; Tower X 60-61, B711-12).

These two-tier offers are to be sharply distinguished from tender offers for all shares. An offer for all shares gives the acquiror control, but permits all shareholders to share equally in the offer. Two-tier offers, by contrast, are employed by sophisticated bidders to effect acquisitions at a cheaper price than they would otherwise have to pay and threaten unfair and unequal treatment of shareholders (Higgins VII 21-35, 212, B391-405, 511; Tower X 60-63, B711-14).

Two-tier offers enable bidders to exploit what has been called the "prisoner's dilemma": since an individual shareholder lacks the power to bargain with the bidder, he is under pressure to tender even if he considers the offering price inadequate, out of fear that a sufficient number of his fellow shareholders will tender to enable the bidder to relegate him to the less attractive second step with respect to all of his shares (see Jensen V 5-8, B234A-36). This lack of bargaining power causes individual shareholders to act contrary to what would be in the collective best interests of the shareholders as a whole—*i.e.,* to refrain from tendering unless an adequate price is offered for all their shares (*e.g.,* Jensen V 7-8, B235-36; Abbott III 171-73, B178-80).*

Two-tier offers also threaten inequitable treatment of target shareholders. Market professionals and other sophisticated investors may more readily appreciate the importance of tendering into the first step and are more capable of doing so. Other shareholders are less likely to understand the nature of the offer, or to be able to tender their shares in time. They risk receiving a greater proportion of the inferior second-step consideration. Abbott III 171, B178; Jensen IV 221-24, B228-31; Troubh VIII 103, B572.

Plaintiffs' attacks (POB 17-19) on the Vice-Chancellor's finding that two-tier offers are coercive (Op. 43, B45) are little short of astounding, given Abbott's testimony (supported by that of defendants' experts) that such offers leave shareholders "no economic choice." The Vice-Chancellor was fully supported as well by the report of an SEC Advisory Committee on Tender Offers (Op. 43, B45). The Advisory Committee was composed of distinguished and experienced bankers, lawyers, and regulators who held diverse policy views, but nonetheless came to the conclusion that two-tier offers "have coercive elements" and "the potential . . . for abusive tactics and

*Plaintiffs improperly blur the distinction between two-*tier* and two-*step* acquisitions (see, *e.g.,* POB 14). The record below clearly showed that it was two-*tier* transactions of the sort described above—which seek a low percentage of shares in the first-step tender offer—that the Household Board sought to deter (*e.g.,* Kartalia IX 123-24, B626-27; Tower X 71-72, B720-21). A two-*step* transaction can occur even if the original offer is for all shares, since some number of shares (usually small) will not be tendered even in response to an offer for all shares (Wilcox IX 69-70, B606-07; Higgins VII 120, B481; Fahey Dep. 37-38, B71-72; DX 31, A1063-66). It was offers for *all* shares that the Household Board sought to encourage by means of the Rights Plan, even if a second-*step* merger is thereafter effected.

practices." Advisory Committee on Tender Offers, Report of Recommendations, p. 25.*

The record showed that the development of these takeover techniques, coupled with new forms of takeover financing involving extremely high leverage, has spawned a new breed of "takeover entrepreneurs." Using high-yield, low-quality paper (commonly referred to as "junk bonds"), these bidders have been able to raise huge amounts of debt in order to finance two-tier transactions at less than adequate prices. Moreover, because these bidders are so thinly capitalized, their transactions generally take the form of "bust-up" proposals—two-tier offers followed by rapid liquidation of the target to reduce the heavy debt load incurred to finance the first-tier offer. See, *e.g.*, Moran II 98-101, B116-19; Higgins VII 17-18, 35, B388-89, 405; Clark V 266-67, B312-13, VI 192-93, 201, 244-45, B367-68, 371, 376-77; Tower X 72, B721; McMahon IX 190-94, 200-01, B672-76, 682-83; Wilcox IX 98, B613; PX 203 at 2-3, A791-92.

That is not the only vice of these techniques. A bidder's mere threat to resort to them is often used to obtain "greenmail," whereby his stock is bought out at a premium not available to other shareholders (*e.g.*, Higgins VII 30-36, B400-06; Troubh VIII 24-27, B552-55; McMahon IX 183-84, B665-66). The record also showed that such takeover entrepreneurs also make "creeping" purchases of significant minority stock positions (*e.g.*, 10% to 20%) to achieve practical control without paying any control premium to the shareholders generally (Troubh VIII 17-19, 23-27, 29, B545-47, 551-55,

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*Plaintiffs' reliance on an SEC Staff Study which disagreed with the Advisory Committee (see POB 17) was hardly binding on the Vice-Chancellor. Indeed, the Staff Study was of limited utility to the Court below in resolving the issues before it. Thus, the Staff Study fails to distinguish between negotiated and non-negotiated transactions, *see* [1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶83,637, at 86,922 n.2 — a significant limitation in assessing whether board action to encourage negotiated transactions is a rational exercise of business judgment. Moreover, the Staff Study "does not attempt to determine" whether "market professionals" make out better in two-tier offers than do public shareholders, *see id.* at 86,916 n.7 — limiting its utility in reviewing the Household Board's judgment that two-tier offers are particularly unfair to public shareholders.

557; Tower X 70-71, B719-20; McMahon IX 199-200, B681-82; Dammeyer X 13-15, B696-98; DX 12 at H1357-59, A959-61).

2. In response to these techniques, new defensive strategies have been developed by target company directors.

The record established that corporate directors who consider these takeover techniques unfair and coercive to shareholders have implemented new defensive strategies to deter their use, and to strengthen their negotiating position when confronted with such activity (*e.g.*, Abbott III 96, 109-57, 163, B126, 127-75; 176; Higgins VII 37-39, 40-43, 48-51, B407-09, 410-13, 418-21; Troubh VII 245-46, 249-51, B522-23, 525-27, VIII 6-8, 16-18, 23-27, B536-38, 544-46, 551-55). The manner in which the benefits of takeover activity are ultimately divided between target and bidder reflects the relative bargaining power of the bidder and the target's directors, as the lower Court found (Op. 54-55, B56-57; Jensen V 21, B238). Because of the "prisoner's dilemma" that confronts individual shareholders, and the practical impossibility of thousands of shareholders acting together, *only* the target board can negotiate on behalf of the target's shareholders (Jensen V 10, B237).*

The evidence showed a wide variety of defensive steps which boards have authorized, without prior shareholder approval, to defend against unfair offers and to enhance the directors' negotiating strength. The record showed that, like Household's adoption of the Rights Plan, many of these defensive steps have been taken by boards of directors in advance of an actual bid. By way of example, boards of directors have made acquisitions they would not otherwise have made in order to get rid of excess cash that might make the company attractive to an acquiror, or purchased companies in regulated industries in order to create regulatory blocks to a takeover,

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*The record established that the Moran plaintiffs have no need for Board intervention because they received a class vote on mergers when they got their Household preferred stock in the sale of a DKM affiliate to Household (Moran II 34-36, B100-02; DX 5, 7, B783-94, 795-800). They can block any merger whose price or other terms they dislike, and therefore have bargaining power in a takeover situation that common stockholders lack.

or placed shares of stock in friendly hands in order to deter or defeat future hostile acquisition attempts (*e.g.*, Higgins VII 36, 38-39, 70-71, B406, 408-09; Troubh VIII 14, 27, B542, 555; Abbott IV 34-35, B193-94).

The evidence also showed that directors of target companies which are surprised by unfair bids, and which lack pre-offer defenses, have had to resort to *post*-offer responses.* Contrary to what plaintiffs and the ICI suggest (POB 20; ICIB 6), such boards do not confine themselves to "seek[ing] a white knight" or "persuad[ing] stockholders not to tender." Instead, they have used a wide variety of defensive measures, including self-tender offers, "PAC-MAN" counter-offers, issuance of securities, purchase of "dog" companies and the payment of "greenmail." Some of these threaten an unwelcome acquiror with serious dilution by reducing the attractiveness of the target's own business. These defensive changes to the target's structure may have an adverse effect, at least in the short run, on the value of the remaining securities. The record below was replete with recent instances of such post-offer responses. The witnesses, including plaintiff's expert Abbott, repeatedly stated that the decision to take defensive actions was an accepted and proper responsibility of directors. See, *e.g.*, Higgins VII 41-50, 80, 95-96, 163, B411-20, 444, 458-59, 496; Abbott III 123-31, 132-36, 156-57, B141-49, 150-54, 174-75; Dammeyer X 25, B702; Troubh VIII 23-27, B551-55.

All of these steps—including those which involved radical changes in the companies' structures—were taken by the directors without prior shareholder approval (*e.g.*, Higgins VII 41-47, B411-17; Abbott III 116-17, B134-35). And in most of these cases the boards' actions were deferred to, and expressly upheld by the courts (see Argument I B, *infra*). The record showed that the Rights Plan has none of the adverse business or financial impacts which result from some of these other defenses (*e.g.*, Higgins VII 80-81, 97, 100-01, B444-45, 460, 463-64; Tower X 73, B722).

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*There is not necessarily a hard-and-fast distinction between pre-offer and post-offer defenses. A post-offer defense which defeats the offer at which it is aimed also deters future offers (Abbott III 112-13, B130-31; see also Higgins VII 46-47, B416-17).

3. Defensive strategies benefit shareholders.

The record also clearly showed that these defenses not only do not prevent takeovers but are part of the free market process by which bidders are led to pay higher prices than they would otherwise offer (*e.g.*, Abbott III 96, 156-57, 173, 175, B126, 174-75, 180, 182; Whitehead VI 63-65, B349-51; Higgins VII 86-95, 155-56, B449-58, 490-91; DX 17, B835-40). Plaintiffs' own witnesses repeatedly testified that such defensive conduct can and frequently does benefit shareholders (*e.g.*, Abbott III 156, B174; Jensen IV 201-02, B221-22; Bradley V 93-95, B258-60; PX 339, B744).

Indeed, plaintiffs acknowledged below that target shareholders may benefit even if the board's defensive conduct defeats a bid and no higher offer emerges. For example, the record showed that Carter Hawley Hale mounted a fierce campaign of resistance to a two-tier takeover attempt by The Limited, Inc. Carter Hawley's defensive conduct included the purchase of over one-half of its stock in the open market, the sale of a crown jewel asset and the issuance of a new voting preferred stock to a "white knight" committed to voting with Carter Hawley Hale's management (Abbott III 132-36, B150-54; Wilcox IX 73, B608). This conduct defeated The Limited's bid. No higher bid emerged. Yet plaintiffs' own reply brief below argued that Carter Hawley's defense benefitted its shareholders. Plaintiffs' Post-Trial Reply Memorandum 31.

The Carter Hawley case was by no means unique. For example, the record showed that the directors of Walt Disney Productions and Warner Communications made substantial greenmail payments to eliminate potential dissidents; Disney also contracted to purchase other companies in exchange for its stock in order to dilute the dissident's holdings (Abbott III 119-26, B137-44; Troubh VIII 23-28, B551-56; Wilcox IX 59-60, B599-600). It was also shown below that the directors of Pogo Producing Co. placed voting stock in friendly hands and conducted a self-tender offer which frustrated a partial offer and materially impacted the voting power of the Pogo shareholders (Higgins VII 42-47, B412-17; DX 12 at H1348, A950). Neither company was later taken over. Yet plaintiffs offered no evidence or argument that there was anything wrong with any of this conduct.

Plaintiffs' own witness Abbott put the point best, and most simply, when he stated that "you only sell a company once" (Abbott III 96, B126). The defensive measures adopted by target company directors represent their respective best judgments as to how to assure that that "once" is at the best time and the best price.

4. Defensive strategies protect shareholders' investments.

The record also showed that the takeover activity which has prompted these defenses can be harmful to shareholders by adversely affecting employee morale, customer and supplier relationships, and the company's financial condition. This activity can divert management from the operation and growth of the business on which the value of the shareholders' investment ultimately depends. Takeover defenses can therefore benefit shareholders by enabling the company to strengthen its business to improve shareholder returns—as plaintiffs noted below in defending Carter Hawley's conduct. See, *e.g.*, Troubh VIII 16-23, 28-30, 58-60, B544-51, 556-58, 567-71; Abbott III 156-57, B174-75; Jensen V 62-66, B248-52; Clark V 211-12, 265-67, B275-76, 311-13; DX 12 at H1357-59, A959-61; Plaintiffs' Post-Trial Reply Memorandum 31.

5. Defensive strategies are adopted without a shareholder vote.

The record showed that it is accepted corporate practice for defensive strategies to be adopted without a prior shareholder vote unless one is statutorily required (*e.g.*, Higgins VII 41-47, B411-17; Whitehead VI 39-40, 60-62, B338-39, 346-48; Troubh VIII 27-28, B555-56; Abbott III 116-17, B134-35). Directors use their own best business judgment as to whether takeover activity of a particular sort is or is not fair and in the shareholders' best interests, and as to the proper corporate response if they determine that it is not (*e.g.*, Troubh VII 248-50, B524-26; Kartalia IX 144-45, B635-36). The record did not support plaintiffs' contentions in this Court (POB 73) that there exists a practice of seeking shareholder authorization, where no statute requires it, even if the defense can be called "structural."

To the contrary, the record showed that many of the defenses which were adopted without prior shareholder approval were "structural" by any fair definition of that term. Investment banker Jay Higgins, head of Salomon Brothers' Mergers and Acquisitions Department, testified without contradiction that Carter Hawley's defense "changed the fundamentals of the company" and "ripped the guts out of the company" (Higgins VII 44-45, B414-15); that Pogo's defense created "a much, much different company," "a much more highly leveraged company . . . [with] different investment characteristics" (Higgins VII 44-45, B414-15; see also Dammeyer X 25, B702); and that Martin-Marietta's counter-tender offer for Bendix produced a company "with absolutely unprecedented debt-equity ratios, negative coverage figures such that would in all likelihood . . . change the very operating philosophy [of the business]" (Higgins VII 163, B496).

Nor was there any evidence that corporate directors follow a different practice when defensive steps impact shareholder voting power. For example, no shareholder vote was taken when Disney paid greenmail so that an actual threatened proxy contestant was bought out at a premium (Abbott III 125, B143); no vote was taken when Warner issued shares to a friendly third party to ward off an unwanted acquisition (Troubh VIII 27, B555); no vote was taken with respect to the Carter Hawley board's decision to ward off a hostile acquisition by repurchasing the target company's own stock (Abbott III 134-35, B152-53).

6. There is intense controversy over takeover policy.

The fairness and desirability of current forms of takeover activity, and of defensive responses, are matters of intense controversy in the business, financial and political communities. The differing policy views of the various schools of thought were reflected in the record below (see, *e.g.*, Abbott IV 47-48, B197-98; Jensen IV 211, B225, V 62-63, B248-49; Bradley V 129-33, B261-65; Moran II 57, B105; PX 191 at H401, A706 *et seq.*).

In briefest summary, one side of this policy debate, which permeates plaintiffs' briefs, is that takeover activity at its present levels and in its present forms is fair and desirable. Its proponents view the corporation as a kind of commodity in what they call "the market in corporate control," and contend that takeover activity weeds out inefficient managers. They argue that shareholders have a "right" to receive tender offers, and that this is "inherent" in the "compact" between shareholders and the corporation (*e.g.*, POB 6; ICIB 1, 6).

A leading proponent of this view was plaintiffs' principal academic expert, Professor Michael Jensen. While forcefully expressing his policy views, however, he expressly conceded that they represented merely one side of an intense policy debate over two-tier tender offers and the other takeover phenomena of recent years, and over whether takeover activity promotes economic "efficiency" (*e.g.*, Jensen IV 211, B225, V 62-63, B248-49). He also acknowledged that, in fact, tender offers tend to be made for companies with *strong* managements, and that poorly-run companies typically are not takeover targets (see Jensen V 62-66, B248-52). As the Vice-Chancellor noted, Jensen could not cite any source for the alleged "right" he claimed existed for shareholders to sell into a tender offer (Jensen V 41-45, B241-45; Op. 43-44, B45-46).*

Supporters of this policy view tend to be profoundly skeptical about the disinterestedness of corporate directors, and view the stockholders and directors as antagonists (see, *e.g.*, POB 6). An example

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Much of Professor Jensen's testimony about the Household Rights Plan was predicated upon the SEC Staff Study noted above. See p. 9 n., *supra*. That study was prepared by the agency's Chief Economist, Gregg Jarrell. In light of the agency's decision to present in an *amicus* brief the "view" of three Commissioners regarding the business merits of the Plan—without cross-examination—it should be noted that Jarrell, who was actually in the courtroom (see Jensen IV 161, B215), and whose views the three Commissioners apparently subscribe to, did not take the stand.

The Staff Study in fact underscores that the question of two-tier offers is one of policy, not fact. Thus, the Study was issued in connection with the Commission's decision to solicit the public's views on a number of *policy* questions about the fairness of two-tier offers. *See* [1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶83,637, at 86,915-20. Professor Jensen was unaware of that fact and had not troubled to read the comment letters filed in response to see what other people thought (Jensen IV 209-11, 212-13, B223-25, 226-27).

was the leading Wall Street arbitrageur, Alan Greenberg, whom plaintiffs also proffered as an expert. Greenberg summarily dismissed *all* defensive activities by directors as "burning down the plantation" and "giving the company away just to keep themselves in power, or have their friends keep them in power" (Greenberg IV 83, 87, B204, 206). Greenberg acknowledged that he is a "cynic" about directorial integrity (*id.* 71, 90, B202, 209), and his testimony was predicated upon a presumption of bad faith on the part of corporate directors that is antithetical to Delaware law.

The record also showed that it is the volume of takeover activity that interests the Wall Street professionals represented by Mr. Greenberg—and the professional money managers who comprise the ICI—not the fairness of any particular tender offer. Such professional traders are widely considered to take a short-term perspective on the businesses they invest in, and to regard any premium over market as desirable. See, *e.g.,* PX 191 at H401, A706 *et seq.;* Wilcox IX 15-25, 98, B575-85, 613; Jensen IV 221-23, B228-30; Higgins VII 17, 35-36, B388, 405-06; Greenberg IV 104, B214.*

The other side of this policy debate does not believe that shareholders have an "inalienable right to participate in tender offers" but rather "a right to participate in the economic life of [the] company" (Higgins VII 83-84, B447-48). Its proponents view corporations not as commodities but as "legal entities designed to attract capital [and] to participate in businesses" (*e.g.,* Higgins VII 84, B448). They believe that takeover activity may have deleterious effects on shareholder welfare and that there is a need for close involvement of directors in the takeover process.

Such proponents include not only the expert witnesses who testified for defendants, but several present and former SEC Commis-

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*Plaintiff Moran is also a professional investor and a promoter of takeover activity. The record shows that he proposed so-called "leveraged buy-outs" to the managements of two companies which he served as a director, Household and American Natural Resources Company. In Household's case, he suggested a plan whereby management could make (in his words) a "bundle of money" by buying out the shareholders and selling off the assets (Clark V 183-84, 190, 219-27, B269-70, 271, 280-88; DX 22, B844-65; see also Moran I 62-64, B83-85).

sioners, members of Congress, prominent business-people, and the boards of the many target companies which took defensive measures to defeat or deter unfair takeover activity (see Exhibits B, C, D). Indeed, plaintiffs' expert Abbott conceded that, for example, two-tier tender offers give shareholders "no economic choice" and that board action to deter or defeat them is proper (Abbott III 171-73, B178-80).

The intensity of this policy debate has also been evidenced by events since the trial—including the fact that the SEC's decision to file an *amicus* brief in this very case split the agency right down the middle (see Exhibit A). As this appeal was being briefed, three national newsmagazines devoted "cover" stories to the controversy.* Senator Proxmire has recently introduced legislation to curb what he calls the "leveraging of corporate America" and other ills which he attributes to the "binge of unfriendly [takeover] activity we have been experiencing over the past couple of years" (see Exhibit B, pp. S3243-46), while the SEC has supported (and Congress has failed to enact) legislation to restrict defensive activities by directors (see Exhibit H, pp. 21-22).

The courts have uniformly refused to take sides in this debate. They have limited their role to enforcing the requirements of the business judgment rule and to satisfying themselves that the defensive conduct in question was not illegal. See Argument I B, *infra*. The courts have not recognized an "inherent right" of shareholders to participate in a tender offer, or regarded as the "exclusive" preserve of shareholders the decision whether to accept or reject a tender offer. Rather, as the Vice-Chancellor stated in his opinion, "[t]he shareholders' ability to gain premiums through takeover activity is subject to the good faith business judgment of the board of directors in structuring defensive tactics" (Op. 20-21, B22-23).

As the Vice-Chancellor concluded:

> [E]very decision of a target board to oppose a tender offer, or invite a third party to make another offer, has the same

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*See "Why is No One Safe?" *Forbes*, March 11, 1985, p. 134 (Exhibit E); "The Raiders," *Business Week*, March 4, 1985, p. 80 (Exhibit F); "High Times for T. Boone Pickens," *Time*, March 4, 1985, p. 52 (Exhibit G).

> effect [*i.e.*, of limiting a shareholder's ability to sell his shares to the bidder]. Such actions by a target board, if taken to protect all corporate constituencies and not simply to retain control, have been consistently approved under the business judgment rule. *Panter* v. *Marshall Field, supra; Crouse-Hinds* v. *InterNorth, supra; Cheff* v. *Mathes, supra; Bennett* v. *Propp, supra.* Indeed the directors who have the responsibility for the governance of the corporation are entitled to formulate a takeover policy, whether it be to meet a specific threat or a general prospective one, even though that policy may not please all its shareholders.
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> —Op., p. 44, B46.

C. The Record Squarely Contradicts Plaintiffs' Claim that the Rights Plan Prevents Takeovers, Whether by Tender Offer or Proxy Fight.

Plaintiffs sought at trial to attack the Rights Plan on the basis of the *factual* assertion that the Rights Plan will stop all tender offers, and is therefore *legally* distinguishable from, and more "extreme" than, other defensive conduct. The record did not support their assertions: neither competent expert opinion nor the lessons of practical experience in takeover matters supported their claims that the Rights Plan makes Household "takeover-proof." Plaintiffs' academic and arbitrageur testimony to this effect was simply overwhelmed by defendants' proof to the contrary.*

The experience and sophistication of defendants' witnesses—Jay Higgins, head of the Mergers and Acquisitions Department of Salomon Brothers; Gordon McMahon, a partner of Goldman Sachs and a member of its Mergers and Acquisitions Department; and Raymond F. Troubh, formerly a partner of Lazard Freres and now a director of numerous public companies and a Public Governor of the American Stock Exchange—clearly outweighed what plaintiffs offered (Higgins VII 6-11, B381-86; McMahon IX 148-51, B638-41; Troubh VII

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*Professor Jensen acknowledged that there was no professional literature to support his assertion that the Rights Plan is more "extreme" than other defensive steps (Jensen IV 199-201, B219-21).

234-37, B516-19, VIII 10-12, B539-41; DX 24, B870-89). And *only* Household presented a proxy contest expert—John Wilcox, head of the proxy department of Georgeson & Co. and a veteran of 50-100 proxy fights, who has also had extensive tender offer experience (Wilcox IX 14-15, 62-63, B574-75, 602-03).*

Higgins squarely opined that, "[i]n no way will it [the Rights Plan] prevent a change of control that is not blessed by the Household board" (Higgins VII 51, B421). McMahon agreed: "The rights plan does not stop a takeover of the company" (McMahon IX 205, B687; see also *id.* 203-04, B685-86).

Troubh too supported the Rights Plan, noting that some of the companies on whose boards he serves—which were actually the targets of "two-tier" offers, "creeping" stock accumulations and/or "greenmail" demands—would have been spared much needless turmoil if they had had a rights plan in force (Op. 16-17, B18-19). And Wilcox specifically testified, in response to a question from the Court, that the Rights Plan would not inhibit a Household shareholder from being able to wage a successful proxy fight (Wilcox IX 53, B597).

But beyond the "battle of the experts," defendants demonstrated that plaintiffs' assertions neither made logical sense nor were consistent with the real-world experience in takeover matters.

1. The Rights Plan does not prevent tender offers.

Plaintiffs offered no evidence that any actual offer for Household has been prevented or deterred by the Rights Plan. Instead, as the Vice-Chancellor correctly observed, "much of the evidence presented by plaintiffs was intended to conjure up examples of possible arbitrary power by the Household Board in using the Rights Plan to deter

*The academic experts proffered by plaintiffs had no practical experience in takeover matters (*e.g.,* Jensen V 39, 58, 71, B240, 247, 253; Bradley V 88-89, B256-57). Indeed, in one of the trial's memorable moments, Professor Jensen proclaimed proudly that he does not spend his time "poring over the entrails" of actual transactions (Jensen IV 236, B233). Plaintiffs themselves treat Abbott as a "non-person": his testimony is not described anywhere in their briefs. That leaves Mr. Greenberg, the self-confessed "cynic" about directorial integrity (Greenberg IV 71, 90, B202, 209).

acquisition approaches which might well be in the interests of all shareholders" (Op. 55, B57). Although closely scrutinizing the Plan in light of plaintiffs' claims, he properly refused to base his decision on such "evidence."

a. Household remains attractive to acquirors.

Plaintiffs argued below that potential acquirors who see money to be made in acquiring Household will nonetheless "pass silently by" (Tr. I 34, B30), and give up the gains they perceive from acquiring Household, solely because of the Rights Plan. The record did not support plaintiffs' argument. As their own expert Abbott testified, Household is a "unique entity"; "an opportunity only comes by once to buy this particular collection [of assets]" (Abbott III 174, B181; see also McMahon IX 194, B676). Abbott's testimony accurately reflects the reality that potential acquirors who believe their companies would benefit from owning and running Household cannot find "another" Household.

Household's continued attractiveness to potential acquirors is one of the major benefits of the Rights Plan. The Plan neither results in any outflow of money from the corporation (Higgins VII 97, B460) nor impairs its financial flexibility (Dammeyer X 24, B701). It has no adverse effect upon Household's balance sheet, assets or income statement (Higgins VII 80-81, B444-45). It does not impair the day-to-day conduct of Household's businesses (Clark V 241, B292; Higgins VII 81, B445) or dilute earnings per share (PX 191 at H422, A727). It has no adverse tax consequences for the corporation or its shareholders (Clark V 241, B292; PX 191 at H422, A727). And the Plan has not adversely affected the market price of Household's stock—notwithstanding the testimony of plaintiff's arbitrageur expert that, if a company had made itself "takeover-proof," the effect on the stock price would be "very negative" (Greenberg IV 98-99, B210-11).*

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*The record showed that none of the companies which adopted rights plans experienced adverse stock price effects as a result (Higgins VII 100-12, B463-75; Abbott IV 8-9, B184-85; DX 27, B920). Since plaintiffs repeatedly suggested at trial—without proof—that these companies' stocks had substan-

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The Household directors believed that advance planning such as the Rights Plan is far preferable to the last-minute defenses which other companies have been forced to use against an unfair or inadequate offer—devices which radically altered the structure of the targets' businesses and had "substantial adverse ramifications for them down the road" (Dammeyer X 25, B702; Clark V 263-66, B309-12; Kartalia IX 125-26, B628-29; Tower X 71-73, B720-22). As director Raymond Tower testified at trial, the Rights Plan leaves Household "evergreen":

> [A] lot of the alternatives, and some that I'm familiar with, are sort of irrevocable alternatives in which you create a situation which is irreversible. The thing I like about this plan is that under any number of circumstances the board of directors in their interest of maximizing the shareholders' wealth can redeem those rights through purchase, and therefore an acquirer has a fair chance of acquiring the company if the value is appropriate. They haven't had a scorched earth situation. It's still evergreen.
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> —Tower X 73, B722.

b. The Household directors remain subject to normal market pressures.

Defendants demonstrated at trial that a prospective acquiror could make a successful acquisition of Household, even assuming initial opposition by the Board, by bringing *pressure* upon the directors to force them to redeem the Rights—which they can do at nominal cost (Higgins VII 60-68, B424-32). In this fundamental respect, Household remains no different from any other company. Just as an acquiror will want to pressure another company not to implement a *post*-offer defense—to sell off valuable assets, or engage in a self-tender or a countertender—it will want to pressure House-

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tially underperformed the market (see, *e.g.*, Higgins VII 104, B467), defendants filed with their post-trial brief a series of tables, prepared by Salomon Brothers, showing *indexed* stock price histories for all companies which had then adopted a rights plan. These tables clearly showed that their stocks had not been adversely affected even when indexed to market movements (Exhibit I). Plaintiffs' post-trial reply brief did not take issue with the accuracy of those tables.

hold to withdraw its pre-offer defense. Just as arbitrageurs now have to appraise whether a post-offer defense will succeed, they will have to appraise, among other factors, whether the Rights will be redeemed (Greenberg IV 83-84, 88-89, B204-05, 207-08).

Higgins' testimony shows, for example, that a prospective acquiror could make an attractive proposal to Household (a "bear hug") and go public with it, thereby pressuring the Board to redeem the Rights (Higgins VII 62-63, B426-27). The prospective acquiror could threaten the Board with a less attractive transaction (Higgins VII 67-68, B431-32). The prospective acquiror could also make a tender offer at an attractive price, which could be conditioned on the tender of a high percentage of the Rights; the tender of a high percentage of the shares and Rights would evidence shareholder support for the offer and thereby put enormous pressure on the directors, who might well decide to redeem the Rights rather than risk a proxy fight (Higgins VII 64-66, 187, B428-30, 501). A prospective acquiror could also actually mount a proxy contest or consent solicitation in connection with the offer if the implicit threat of one did not produce results (Higgins VII 72-73, B436-37). The record showed that the same or similar pressure tactics have been used—and used successfully—where a target had initially employed one or another defensive technique (*e.g.*, Abbott IV 35-36, B194-95; Troubh VII 243-44, 253, B520-21, 529, VIII 28-29, B556-57; Higgins VII 71, B435; DX 18, B841-43).

Plaintiffs' claim that the Plan prevents a takeover implicitly assumes that takeovers are essentially static transactions—either purely hostile or purely friendly. But this assumption was unsupported by the evidence. The record showed that in the real world the tender offer is a dynamic device. As Higgins explained, target companies that may begin by resisting are exposed to market and shareholder pressures by the tactics which the bidder devises, and the circumstances which the bid creates, such that a transaction which starts off being "hostile" often comes to a negotiated conclusion. In the real world, people who see money to be made by acquiring the "particular collection [of assets]" which is Household will devise such tactics, and the Household Board will not be immune to their effects (Abbott III 174, B181; Higgins VII 60-73, 81-83, 166-67, B424-37, 445-47, 497A-B). Indeed, outside director Kartalia squarely testified that he would be responsive to such pressure, and Household Chairman Donald Clark testified that it was "just inconceivable" that the Household Board "would stand in the way" if a tender offer generated substantial shareholder support (Kartalia IX 127-30, B630-33; Clark VI 78, 82-83, B354, 356-57).*

Household elicited detailed evidence of actual transactions to back up these conclusions. The evidence showed, for example, that Gulf Oil, which Higgins served as investment banker, succumbed to pressure generated by a tender offer for only a small percentage of its shares, and the implied threat of a proxy contest (even though it had just prevailed in one such contest), by agreeing to a sale of the company despite the board's earlier refusal to do so (Higgins VII 30-35, 74-78, B400-05, 438-442). The Gulf situation, about which Higgins testified in detail, clearly confirmed that even a board in a strong bargaining position will bow to market pressures.

The record also showed that the boards of several companies, some acting on the recommendation of Abbott's former firm, Morgan Stanley, issued securities which were also labelled a "poison pill" by critics—a preferred stock carrying a highly dilutive "put" feature which obliged the issuer to redeem all outstanding stock at a premium price if a stated percentage of the stock was acquired (Abbott IV 34-35, B193-94; Troubh VII 243-51, B520-27; Higgins VII 70-71, 78-79, B434-35, 442-43; DX 37, B967-68; DX 16, B831). The mandatory redemption feature of this "poison pill" preferred meant that a bidder could not avoid the dilutive effect of the stock once a "triggering event" had occurred (Troubh VIII 13-14, 51-54, B541A-42, 565-68). In contrast, the Household Rights only have a dilutive impact if and when the acquiror seeks to effect a second-step merger.**

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*Any contention that the Rights might somehow become "accidentally" non-redeemable (*cf.* POB 77) is without basis in the record. A 20% acquisition of Household stock would represent an investment of some $400 *million*, which obviously would not be made accidentally. The disclosure requirements of §13(d) of the Securities Exchange Act would enable the company to monitor any such acquisition.

**The record does not support the SEC's assertions that the Rights Plan is the more powerful deterrent (SECB 20-21). To the contrary, Troubh, who

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Yet intense takeover activity continued at Enstar and the other companies that adopted a "poison pill" preferred. Enstar itself was subjected to a proxy contest and was later taken over by Unimar, an affiliate of Allied Corporation (Troubh VII 243-44, 251-55, B520-21, 527-31; DX 51, B1037-49). Likewise, Lenox began by resisting Brown-Forman's tender offer, announced a "poison pill" dividend, but wound up negotiating a friendly deal at a higher price—in a transaction in which the arbitrageurs fully participated, notwithstanding the issuance of the "poison pill" (Abbott IV 34-35, B193-94; Higgins VII 70-71, 78-79, B434-35, 442-43; DX 50, B1029-36; see also Greenberg IV 79, B203 (re Superior Oil)).

The expectation of a similar dynamic process no doubt explains why Household's stock, and that of the other companies which have adopted rights plans, have not performed as if the companies were takeover-proof (Greenberg IV 98-99, B210-11; DX 27, B920; Exhibit I). Plaintiffs offered no testimony as to why these dynamic market forces would not operate on the Household directors, even if one assumes that they would initially resist an offer. Plaintiffs' experts treated these possibilities as irrelevant. Jensen conceded that any such possibility was a "separate issue" outside the ambit of his testimony (Jensen V 37, B239; see also Jensen V 41, B241). Plaintiffs' other experts failed to address the issue at all. Thus, Household's detailed testimony as to how these market pressures would operate on the Household Board stood uncontradicted.

Indeed, it was a basic assumption in plaintiffs' case that the Household Board will act irresponsibly and fail to redeem the Rights even if a fair bid were made for all shares. This was concededly Abbott's premise. He analyzed a hypothetical $45 offer for shares and Rights, conditioned on a minimum tender of 95%. His conclusion that it would fail—although at a 50% premium over market, which he assumed was "full and fair"—was premised on the assumption of non-redemption by the Board (Abbott IV 15, 21, B186, 188). Yet, on cross-examination, Abbott had to concede that he had never

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was a director of Enstar when that company issued such a preferred stock, testified that that preferred was a more powerful deterrent (Troubh VIII 13-14, 51-54, B541A-42, 565-68).

heard of a board blocking a transaction which its investment banker had opined was made at a full and fair price (Abbott IV 18, B187).

Moreover, as the Court below carefully noted, the adoption of the Rights Plan puts Household's directors under a continuing obligation to assure that the Plan is not used to the stockholders' detriment (Op. 55-56, B57-58). The Court made it very clear that the Board's obligations of good faith and diligence were in no respect lessened—and, if anything, were heightened—by their adoption of the Plan.

c. A purely hostile offer for all Household shares could succeed.

Even if one assumes that the Board would seek to thwart exactly the kind of fair, high-minimum bid which it says it would support—and withstand all pressures to redeem—it is simply illogical to assume further, as plaintiffs' witnesses uniformly did, that the hypothetical $45-a-share, 95%-minimum-condition offer, on which the experts based their trial testimony, would be defeated because Household shareholders would hold out for a "bonanza" in the second-step merger (see, *e.g.*, POB 22). It is only on the basis of this wholly improbable assumption that plaintiffs "proved" that the prospect of second-step dilution will prevent all offers.*

The record showed that shareholders living in the real world would not act on such facile assumptions. Plaintiffs' trial witnesses really could not accept them either. Abbott had to concede that, since "a bird in the hand is worth two in the bush," shareholders will tend to act so as to get the premium price available only if the offer succeeds— *i.e.,* they will tender into the first-step offer rather than gamble on the remote possibility of a super-premium in a second-step (Abbott IV 27-30, B189-92). Even Professor Jensen conceded that, "absolutely," a shareholder will be powerfully motivated to tender at $45 rather than own a $30 stock (Jensen IV 55-56, B199-200).

Rational shareholders will understand that the "super-premium" in the second-step merger would be available only in the unlikely

*Jensen conceded that his "analysis" was not based upon any study as to how shareholders actually behave in the real world (Jensen V 49, B246).

event that: (a) the offeror had irrevocably committed itself to effectuate a second step; *and* (b) the 95% minimum condition was met in the first step by tenders from other shareholders; *and* (c) the board elected not to redeem the Rights before the offer was consummated despite such an outpouring of shareholder support for the offer. As Higgins testified, shareholders make economic decisions based on the real-world probabilities of achieving returns on their investments and, accordingly, they will tender into the first-step offer to receive the 50% premium that is available *only* if the offer succeeds rather than risk losing the 50% premium by holding out for this speculative second-step bonanza (Higgins VII 58-59, B423A-B).

Plaintiffs contend that the hypothesized $45-per-share offer for all shares and Rights could not succeed because a high-minimum-condition offer is perceived as "weak" (POB 22-24). Concededly it is the conventional wisdom that, where nothing about the *target* accounts for a high minimum condition, Wall Street professionals would reason that such a condition reflected some financial or other impediment to the *offeror's* ability to proceed (Wilcox IX 67-68, B604-05). But as Wilcox went on to explain, in testimony carefully ignored by plaintiffs, were such an offer made for Household the financial community would understand that it was the Rights Plan, and not the offeror's situation, that justified the condition (Wilcox IX 68-69, B605-06; see also Higgins VII 187-89, B501-03).*

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*In other testimony which plaintiffs also ignore, their own expert, Abbott, said essentially the same thing (Abbott III 88-89, B124-25). Moreover, an offer can be made with a very high, but less than 95%, minimum condition (Higgins VII 184-85, B499-500). The record clearly established that it is not uncommon for a tender offer to attract 90-95% of the shares (Wilcox IX 69-70, B606-07; Higgins VII 120, B481; Fahey Dep. 37-38, B71-72; DX 31, A1063-66). Indeed, 95.3% of the shares sought were tendered into the offer by a subsidiary of plaintiff DKM for Criton Corporation (DX 31 at 1, A1063).

Plaintiffs' "simple arithmetic" contention (POB 24) that shares owned by directors or by clients of directors would not be tendered, so that any offer would therefore fail to achieve its minimum, is baseless. Household's Board is predominantly comprised of non-management directors; the idea that a predominantly outside board would forgo an attractive profit opportunity for all shareholders—themselves included—solely to keep management in power is just another reflection of plaintiffs' cynicism about corporate directors.

In short, the record clearly supported the conclusion expressed by Higgins:

> In no way will it [the Rights Plan] prevent a change of control that is not blessed by the Household board.
>
> * * *
>
> As any student of the merger and acquisition marketplace, a serious student, I think, has to appreciate, there has been an evolving potpourri of mechanisms that have been introduced into the marketplace to give additional advantages to either the buyer or the seller. This rights plan I think is ingenious, clever, terrific, but I don't think it is the bullet-proof, you know, show stopper that is going to prevent Household or anybody else who implements it from preventing a change of control of their company that's not approved by the board of directors.
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> —Higgins VII 51, B421.

McMahon of Goldman, Sachs agreed (McMahon IX 202-208, B684-90; PX 203 at 9-10, A798-99). Plaintiffs were unable to come up with any witness of equivalent stature and experience to testify otherwise.

Moreover, events since the trial have confirmed Higgins' judgment that somebody who sees money to be made by acquiring Household will find means to circumvent the Plan (Higgins VII 52-53, 157-59, B422-23, 492-94). For example, Carl Icahn's recent tender offer for Phillips Petroleum, which had adopted a rights plan similar to Household's, was accompanied by a consent solicitation by Icahn to bring pressure on the Board. See Exhibit J. Icahn's takeover effort ended when Phillips agreed to increase the value of the securities it was issuing in an exchange offer for its own shares. *Id.*

Even as this brief is being written, there are takeover attempts actually being mounted against at least two of the companies that adopted a rights plan (Crown Zellerbach and Rorer), one by means of a tender offer (and the threat of a proxy fight) and one by means of a proxy fight. See Exhibits K and L. These events confirm Higgins' testimony that "the fruits of success [in takeover transactions] are so astronomical that there is a marketplace for ideas that's every bit as active as the marketplace for companies" (Higgins VII 53, B423).

d. A partial offer for Household shares could succeed.

Furthermore, the record does not support plaintiffs' assertions (*e.g.*, POB 1-2) that Household can only be taken over by a transaction which gives the bidder immediate 100% control. Thus, Higgins explained in detail that an offeror could well conclude that there was money to be made even by owning less than 100% of Household; that, since the Rights would be freely-trading securities after they became non-redeemable, an acquiror who wished to get to 100% ownership could purchase them or do an exchange offer for them; and that, in the interim, the public shareholders would get "the benefit of being treated pari passu, exactly equal, with the 51 or 60 percent that is owned by the guy who now controls Household" (Higgins VII 148-51, 162-64, 192-95, 219-22, B486-89, 495A-97, 505-08, 512-15; see also Clark VI 80, B355). The Rights would not prevent such a "partial" offer because the dilutive impact of the Rights occurs only in a second-step merger.*

e. Even if hostile two-tier offers are prevented, the record does not support plaintiffs' claims that shareholders would be harmed.

In tacit retreat from the contention that no hostile offer for Household is possible, plaintiffs now argue that the Plan is more extreme than other defenses because it prevents two-tier, front-end loaded transactions in which a large quantity of stock is left unpurchased in the tender offer and a second-step merger is promptly effected (*e.g.*, POB 21). But even if this were so, plaintiffs' conclusions would not follow.

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*Plaintiffs' assertion that Higgins called such an offer "totally theoretical" (POB 16) is a distortion of his testimony. As he clearly explained, "it is totally theoretical that anybody is going to launch any offer about anybody" (Higgins VII 196, B509). Higgins refused to testify that an offeror would not make a bid for a controlling, but less-than-100% interest, despite repeated attempts by Moran's counsel to get that testimony (see Higgins VII 138, 140-41, 157-58, B482, 483-84, 492-93).

Indeed, Sir James Goldsmith in his current tender offer for Crown Zellerbach (see Exhibit K) states that if the rights are not redeemed by the board of directors he might accept the shares tendered and *not* do a second-step merger.

While plaintiffs argue that two-tier offers can be good or bad depending on the circumstances, they fail to mention that every "good" two-tier offer cited by them at trial or in their briefs—notably Dupont's offer for Conoco, U.S. Steel's for Marathon, and Unimar's offer for Enstar—was a friendly, negotiated deal with a substantial, well-financed bidder, in which the target's board had negotiated to maximize shareholder values (see POB 18; Higgins VII 141-42, B484-85; Troubh VII 253-54, B529-30; Tower X 74-79, B723-28; PX 345, A927-33; PX 350 at 1-7, B748-54). However, it is undisputed that the Rights Plan leaves absolutely unimpaired the Household Board's power to agree to a "good" two-tier offer, just as the directors of Conoco, Marathon and Enstar enjoyed.

And the existence of the Rights also tends to assure that Household will not be victimized by "bad" partial or two-tier transactions, as were the shareholders of Pabst, Becton-Dickinson and Warner, which Troubh testified about from personal experience as a director of all three companies (Troubh VIII 16-30, B544-58; DX 12 at H1357-59, A959-61). The existence of the Rights tends to assure that the threat of such "bad" transactions will not force the Household directors to a Hobson's choice between paying greenmail, as the Disney and Warner directors had to do, or adopting at the eleventh hour another of the defenses which exposes a bidder to unacceptable dilution by harming the target company itself.

2. The Rights Plan does not prevent or impede a proxy contest.

Plaintiffs' assertion that the Household Rights Plan must be invalidated because of its alleged impact on possible proxy contests is one of the most curious parts of their case. It went unmentioned in any of their complaints. Neither the Moran plaintiffs' complaint, nor the intervenor's, nor Moran's amended complaint—filed on consent after full discovery—contained any challenge to the Rights Plan on proxy contest grounds.*

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*The SEC's statements that the Moran plaintiffs' complaint asserted proxy contest claims (SECB 8-9) are flatly wrong.

Moreover, plaintiffs' counsel offered not one witness to testify that the Household Rights Plan will impede or inhibit a proxy contest. They were apparently unable to persuade any of the experienced proxy contest professionals to testify, and subject themselves to cross-examination, on that proposition. Even after Household's expert, John Wilcox of Georgeson & Co., squarely testified that the Rights Plan would *not* inhibit a shareholder from being able to wage a successful proxy fight (Wilcox IX 53, B597), plaintiffs offered no rebuttal evidence. Not even Moran himself was able to testify that the Rights Plan would prevent him, or anybody else, from waging and winning a proxy contest at Household. Indeed, as soon as the Plan was adopted, Moran filed a Schedule 13D stating that he was considering a proxy contest (Clark VI 84, B358; PX 288 at 7-8, B735-36).

Furthermore, plaintiffs did not offer a single witness to explain how it could be that companies can properly buy out corporate dissidents, as the directors of Disney and Warner did—so that corporate funds are actually expended to forestall a proxy fight—or achieve the kind of practical voting control the Carter Hawley Hale directors achieved by buying in publicly-held stock, but Household cannot issue Rights which have no votes and do not alter existing voting strength in any way (Wilcox IX 59-62, B599-602; Clark VI 84, B358; PX 204, A819-81). Neither by testimony nor by legal argument did plaintiffs even try to establish a principled distinction that would justify what Disney, Warner and Carter Hawley Hale did, yet somehow still condemn the Rights Plan.

Plaintiffs' proxy contest assertions represent a disingenuous attempt to put a voting rights "gloss" on their basic, tender-offer-oriented objections to the Rights Plan. While they go on at length about the supposed impact of the 20% "triggering event" on proxy fights, they fail to deal with the fact that 20% of Household stock would represent an investment of nearly $400 *million*. The record did not support their claims that anybody with an investment even half that large who wished to redress grievances could not finance a proxy fight. The Vice-Chancellor understated the matter when he described plaintiffs' 20% contentions as "somewhat strained," given the amounts of money involved (Op. 46-47, B48-49).*

As the Court below recognized (Op. 48, B50), the "creeping" purchase of a potentially controlling block of stock without treating all shareholders fairly and equally is precisely one of the evils that the Plan is designed to deter. The record compiled by Household showed that such accumulations expose companies to demands for "greenmail" and can also be used as a "toehold" for a low-priced, two-tier offer (*e.g.*, Wilcox IX 18-20, B578-80; Troubh VIII 17-19, 23-27, 29, B545-47, 551-55, 557; DX 12 at H1357-58, A959-61).**

The Vice-Chancellor correctly recognized that this conduct is no less harmful if the "creeping" acquiror has as part of his plan the launching of a proxy fight. As Wilcox explained, greenmailers often use the threat of a proxy fight "to get bought out by the company" (Wilcox IX 19, B579; see generally *id.* 18-20, B578-80; see also Clark VI 243-44, B375-76). Indeed, it was in part to prevent just that scenario that the directors of Disney and Warner made greenmail payments (Wilcox IX 59-60, B599-600; Troubh VIII 23-27, B551-55). Since plaintiffs offered no evidence—and it is not the fact—that Household has any 20% shareholder or that a shareholder would need or want to form a group with a 20% investment (*i.e.*, worth $400 million) to wage a proxy fight, the Vice-Chancellor was clearly correct in concluding that "it is highly conjectural to assume that a particular effort to assert shareholder views in the election of

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*Indeed plaintiff Moran conceded that shareholders with a lesser stake would have ample wherewithal to mount a proxy fight (Moran II 94-96, B113-15; see also Clark VI 87, B361). And plaintiffs offered no evidence to rebut the testimony of Wilcox that, since the costs of proxy contests are relatively modest in light of the matters at stake, he "cannot imagine" that a Household shareholder would have to form a 20% group in order to fund a proxy fight (Wilcox IX 31-32, 54, B588-89, 598).

**The record showed that 20% is a well recognized threshold for measuring control (*e.g.*, Tower X 70-71, B719-20; Dammeyer X 13-15, B696-98); as director Tower testified, a 20% interest is "really tantamount to having control or can be interpreted as having control."

directors or revisions of corporate policy will be frustrated by the proxy feature of the Plan" (Op. 48-49, B-50-51).*

The record established that the Rights Plan will not impair the ability of Household shareholders to vote and run a proxy fight. The Rights have no votes on any subject at any time. They were distributed on an equal basis to all shareholders and thus did not change the make-up of the shareholder electorate in any respect.

Moreover, the record also showed that comparable provisions in other defensive plans have had no adverse impact on proxy contest activity. For example, if, as plaintiffs contend, the "group" definition in the Rights Plan impedes proxy activity, the same effect should have been visible at the companies which earlier issued so-called "poison pill" preferred stocks. See p. 23, *supra*. For notwithstanding the differences between the Rights Plan and the "poison pill" preferred, they are identical in this respect: like the non-redeemability of the Household Rights, the "put" feature of the Enstar and Superior Oil preferred stocks was also triggered by formation of a "group" (although the ownership percentages at which the "put" was triggered were somewhat higher than the 20% trigger in the Plan) (DX 37 at 9, 10, 12, B967, 968, 970; DX 16 at 7, B831).

Yet the record is clear that there were proxy fights, and *successful* proxy fights, at *both* companies.** The Enstar experience in

*The Court below correctly recognized that the 20% triggering event includes the formation of a beneficial ownership "group" as well as an outright purchase to avoid leaving a gaping loophole in the Plan. In the absence of such a "group" concept, persons could acquire a joint investment far larger than would otherwise "trigger" the Rights simply by making sure that each individual holding fell below the threshold. Accordingly, the "beneficial ownership" and "group" provisions of the Plan are taken virtually *in haec verba* from the federal regulations under Sections 13(d) and 14(d) of the Securities and Exchange Act, which are also intended to prevent evasion of a numerical threshold by the tactic of dispersing ownership (or the incidents of ownership) among a number of individuals (Op. 48, B50).

**At Enstar, Mr. Huffington was able to mount and win a proxy contest for control of the board of directors, owning about 9½% of the outstanding stock, and he did not form a group or share expenses with other shareholders

(Footnote continued on following page)

particular confirms Mr. Wilcox's opinion, based on Georgeson's study of all verifiable proxy contests in the last three years, that there is no correlation between the number of shares held by a dissident and his chances for success in a proxy contest at ownership levels having any conceivable relevance to Household's shareholder population.* The overwhelming percentage of successful contests were waged by insurgents with less, and usually much less, than 20% of the stock, and the rate of insurgent success was actually *higher* when insurgents owned between 5% and 9.9%—the level of DKM's ownership of Household stock—than at the 10-19.9% levels. Wilcox IX 35-39, 101, B592-96, 614; DX 39, Tab 4, A1099-1100. See also Wilcox IX 33, B590 (Heyman victory in GAF proxy contest holding less than 5% of the stock), 34-35, B591-92 (Day victory in Superior Oil proxy contest holding only 3%); Higgins VII 170, B498.

Wilcox testified without contradiction that the key variable in proxy contest success is the merit of an insurgent's issues, not the size of his holdings (Wilcox IX 25-27, B585-87; see also Higgins VII 170, B498).** Indeed, even very large holdings are no guarantee of success, as Greenberg testified (Greenberg IV 102-03, B212-13) (defeat of Pabst dissident Irwin Jacobs holding 16-17%), and as Wilcox also illustrated from his experience, again without contradiction (Wilcox IX 34, B591) (defeat of Ronson dissidents holding 36%).

Plaintiffs' proxy contest claims are simply unsupported by the record. Moreover, events since the trial—including Icahn's consent

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(Footnote continued from previous page)

(Troubh VII 244, B521, VIII 15-16, B543-44). At Superior Oil, the mere initiation of a consent contest by Mr. Keck, after the board had authorized the "poison pill" preferred stock, induced the directors not to issue it, but rather to put the company up for sale (Higgins VII 71, B435; DX 18, B841-43).

*The record showed that at the time the Rights Plan was adopted, and at the time of trial, DKM held approximately 6.9% of Household's outstanding voting securities (PX 288 at 9, B737).

**Plaintiffs' assertion (POB 27) that the witness's testimony lacked "competent evidential support" is absurd. Wilcox is the head of Georgeson's proxy group and testified that he has been directly involved in 50 to 100 contested proxy solicitations (Wilcox IX 14-15, B574-75).

solicitation at Phillips (see Exhibit J)—confirm that record. Indeed, at this moment, a proxy contest is actually being conducted at another company that adopted a rights plan, and one is threatened at yet a third. See Exhibits L and K. The various hypothetical cases plaintiffs conjure up could not have supported a finding that the Rights Plan will prevent or impede a proxy fight by Household shareholders.*

D. The Independent Household Board of Directors Acted Properly in Adopting the Rights Plan.

1. The Household Board is independent.

Household has a predominantly independent Board of Directors, subject to annual elections, which consists of ten outside directors and six who are members of Household's management (Clark V 165-66, B266-67; Whitehead VI 25-28, B329-32; Kartalia IX 109-18, B616-25; DX 2 at 4-7, 8-10, B759-62, 763-65). John Whitehead, then co-chairman of Goldman, Sachs and now Deputy Secretary of State-designate—whose "clear independence," judgment and integrity were acknowledged by plaintiffs (Moran II 44, B104)—testified that his fellow Household directors comprise a "very independent board" which has had "sharp disagreements" with management (Whitehead VI 25-27, 35, B329-31, 335; see also Kartalia IX 111-12, 118, B618-19, 625).**

The independence of the Household Board reflects the implementation of carefully considered policies. The evidence showed

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*The intervenor and the SEC claim (IOB 19-20; SECB 26-27) that the Rights could become non-redeemable merely by a solicitation of proxies or consents. They are wrong. The Rights Agreement has no such provision; Household expressly disclaimed at trial that the Rights Plan has any such effect (Clark VI 85-86, B359-60); and Troubh testified without contradiction that the "poison pill" preferred had had no such effect in practice (Troubh VIII 15, B543).

**Any contention that the directors who approved the Rights Plan were "entrenchment-minded" is further weakened by the evidence that within the month two outside directors will leave the Board upon reaching mandatory retirement age and that two inside directors will leave the Board in the near future on their retirement from Household (Clark V 166-67, B267-68; Kartalia IX 106, B615; Tait Dep. 4, B78; Hendry Dep. 8, B74).

that, in early 1983, the directors unanimously adopted the report of an Ad Hoc Committee to review the role of the Board, which had recommended that a preponderance of the directors should consist of individuals who are not members of management and that the Chairman of the Executive Committee, and all other members thereof except the Chief Executive Officer, be non-management directors. Household's Board operates under these guidelines (Kartalia IX 109-18, B616-25; DX 9 at 2, 3, B803, 804; DX 10 at 2, B813; Moran II 40, B103).

Nevertheless, plaintiffs argue that the Board was not adequately informed or sufficiently diligent in adopting the Rights Plan. The evidence was to the contrary, and fully supported the Vice-Chancellor's finding that the Board's action satisfied the requirements of the business judgment rule.*

2. The events leading up to the adoption of the Rights Plan by the Household Board of Directors.

The record established that the directors had ample grounds to believe that Household was vulnerable to the coercive acquisition techniques described above (*e.g.*, Kartalia IX 125-26, B628-29; Tower X 69-70, B718-19; Clark V 183-84, 190, 219-27, B269-70, 271, 280-88; Moran I 66-67, B86-87; PX 203 at 7, A796). Household is a holding company for a number of discrete businesses; its disparate "pieces" could lend themselves to a highly-leveraged "bust-up" transaction (McMahon IX 193-94, B675-76; Clark VI 103-05, B364-66). As the Vice-Chancellor noted (Op. 10, B12), on August 14, 1984, when Household adopted the Rights Plan, a company in Household's own industry (Avco) was the subject of a "creeping" stock accumulation program by a company several times smaller (Leucadia); Household had actually been offered "pieces" of Avco that might become available in a "bust-up" of the company by Leucadia. Avco ultimately made a $100 million buyout of Leucadia to end its stock accumulation program and forestall further

*Five of the directors testified at trial (Whitehead, Tower, Kartalia, Clark and Moran). All of the directors testified either at deposition or at trial, and four of them gave testimony in both forms. In addition to the trial evidence, the deposition transcripts were all made part of the record below.

disruption. Clark V 211, B275, VI 199-200, B369-70; Whitehead VI 29-30, B333-34; Moran I 109-10, B-89-90, II 91-93, B110-112; PX 203 at 3, A792.*

Household's exposed position had also been forcefully brought home to the directors at a special meeting on June 12, when the Board approved the acquisition of a controlling interest in Jewel Companies to rescue Jewel from an unwanted takeover by American Stores. While the acquisition ultimately fell through, the fact that Jewel—another Chicago-area company—had been forced to scramble at the eleventh hour in order to maximize shareholder values caused the Household directors to reexamine Household's own vulnerability. Clark V 209-211, B273-75, VI 259, B379; McMahon IX 152-54, B642-44; Tower X 64-65, B715-16; PX 97 at H1170A, B730.**

At the urging of the Chairman of Household's Executive Committee, a non-management director, the Board concluded "that management better get busy and get some shareholder protection measures studied and come back with a recommendation" (Clark V 213, B277). It was following these events that Household retained Goldman, Sachs and special counsel Wachtell, Lipton, Rosen & Katz; and Household's Chairman and Chief Executive Officer, Donald Clark, appointed a management committee to develop recommendations to bring to the Board (Clark V 213-15, B277-79; McMahon IX 155-57, B645-47; PX 97 at H1171, B731).

The record showed that management carefully considered the

*Avco was later acquired by Textron at a much higher price than Leucadia had proposed.

**Plaintiff Moran's own conduct in proposing that he and other insiders could make a "bundle of money"—which he estimated at $415 *million*—by buying out Household shareholders on a low-priced, "break-up" basis also supported the directors' judgment about Household's vulnerability (Clark V 183-84, 190, 219-27, B269-70, 271, 280-88; DX 22, B844-69). Even accepting that Moran would not have made a "hostile" bid, as the Vice-Chancellor found, the fact remains that if Moran can see $415 million to be made at the expense of his own shareholder constituents, the Board was entitled to conclude that other promoters could readily spot the opportunity (see, *e.g.*, Kartalia IX 126, B629).

Rights Plan before submitting it to the Board. On July 31, 1984, Clark, Rod Dammeyer (Household's Chief Financial Officer) and Richard Hull (Household's General Counsel) met with Martin Lipton of Wachtell, Lipton and with Goldman, Sachs to discuss takeover preparedness. Clark explained his concerns about Household's vulnerability to a low-priced takeover or to greenmail and asked what steps could be taken to reduce it. The Rights Plan was suggested as a means of doing so and much of the meeting was devoted to discussion of it. Clark V 236-38, B289-91; McMahon IX 164-65, 168-69, B648-49, 652-53; DX 44, B984.

Clark was not seeking a device to prevent all takeovers. In fact he was told that the Rights Plan would not do that. Lipton pointed out that the Plan was a means of strengthening the Board's bargaining position while, because the Rights can be redeemed at nominal cost, preserving flexibility for the Board to accept a tender offer bid or an alternative tender offer bid. He advised Clark that the Plan would have no adverse impact on Household's ongoing business. Clark V 237-38, B290-91; Dammeyer X 13-15, 43-44, B696-98, 709-10; see also Tower X 71, B720.*

During the following week, Goldman, Sachs ascertained that the market price of Crown Zellerbach's stock had not been adversely affected by its earlier adoption of a similar rights plan. Goldman, Sachs verified that the Plan would not restrict Household's ability to raise capital and consulted their outside legal counsel, Sullivan & Cromwell, with respect to the Plan. Goldman, Sachs then advised Household that the firm would recommend adoption of the Plan, assuming the directors were willing to assume the risk of drawing attention to the company by issuing a novel security. Clark V 242, B293; McMahon IX 170-75, 177-78, 180-81, B654-59, 660-61, 662-63; Dammeyer X 22-23, B699-700; Whitehead VI 15-17, 37, B320-22, 337; DX 13, B824.

Dammeyer, Household's Chief Financial Officer, prepared a fi-

*The 20% control threshold used in the Plan was discussed with Wachtell, Lipton and Goldman, Sachs. It was recognized as a familiar measurement of when stock ownership translates into practical control (Dammeyer X 13-15, B696-98).

nancial evaluation which led to the $100-a-share valuation for the new preferred stock. As he testified at trial, the study was based on Household's annually revised 5-year plan, and represented an attempt to value the worth of an equity interest in Household over a 10-year period. The methodology was discussed with Goldman, Sachs, and Dammeyer testified that Household's finance staff used conservative assumptions in developing the valuation. Clark V 242, B293; Dammeyer X 26-29, B703-06; DX 46, B1025-28. Although plaintiffs now attack the valuation (*e.g.,* POB 43-44), they did not cross-examine Dammeyer on the subject.

3. The deliberations at the August 14, 1984 meeting of the Household Board of Directors.

The evidence did not support plaintiffs' attacks on the quality of the Board's deliberations. In accordance with customary practice, a "board book" of relevant material, including a detailed summary of the Rights Plan, had been sent out by courier a week or so before the August 14 meeting so that the directors could consider the proposals in advance (Clark V 242-44, B293-95; PX 191, B689-789). The directors then present in the Chicago area had also had the Plan explained to them at a meeting held at 3:00 P.M. the prior afternoon, before a social dinner for the directors (Clark V 244-54, B295-305; PX 191 at H384, A689). The Board's discussion at the meeting occupied about two hours of the morning session and continued in an afternoon session that Moran chose to skip to attend a committee meeting at another company (Clark V 259, B306; Whitehead VI 19, 23, B323, 327; Moran I 138, B91).

There is no record basis for the SEC's assertion (SECB 6) that the Board's discussion was "brief." An outside director, defendant Kartalia, testified that the August 14 meeting was one of the longest he has attended in his 12 years on the Board (Kartalia IX 123, B626). Whitehead squarely testified that he had had enough time to consider the Rights Plan (Whitehead VI 22, 46-47, B326, 341-42). And Dammeyer—who in his seventeen years at Arthur Andersen attended between 50 and 100 different companies' board meetings (Dammeyer X 3-6, B692-95)—stated that:

> [T]he combination of the extensive presentations by both Wachtell, Lipton and by Goldman, Sachs, and then what I would describe as a very free flowing give and take discussion of the plan and the four recommendations and the various issues associated with that was as extensive, or more extensive, than any that I have witnessed in complex mergers and acquisitions or financing transactions at companies that I have attended their board meetings.
>
> —Dammeyer X 32-33, B707-08.

During the morning session, Lipton described much of what has been set forth above as to the current takeover climate. He discussed possible actions that Household might take. He explained each of the proposals management was recommending for Board approval (PX 203 at 2-4, A791-93). McMahon of Goldman, Sachs also made a detailed presentation. He stated that the company was vulnerable to a low-priced takeover proposal, and endorsed Lipton's analysis of the current takeover climate. He advised the Board that Goldman, Sachs and Wachtell, Lipton had worked closely together in developing the Rights Plan. He told the directors that Goldman, Sachs believed that the proposed takeover preparedness measures, including the Rights Plan, would discourage two-tier offers and other harmful takeover activity.* He confirmed Lipton's statements that the Plan would not prevent a takeover of the company. McMahon IX 181-208, B663-90; DX 45, B985-1024; PX 203 at 5, A794; see also Dammeyer X 13, B696.

The Board then reviewed management's recommendations one by one (PX 203 at 5-10, A794-99).** When discussion turned to

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*The intervenor claims (IOB 56) that McMahon testified that he was aware of disadvantages of the Rights Plan but did not see it as his role to so advise the Household Board. No such testimony appears at the page the intervenor cites (McMahon IX 174, B658)—or anywhere else.

**Before considering the Rights Plan itself, Moran and the other directors unanimously adopted bylaw amendments designed, *inter alia*, to strengthen the hand of the Board in a takeover contest. Moran did not suggest that these admittedly defensive measures be submitted to a shareholder vote (Moran II 85-87, B106-08; PX 203 at 6, A795).

the Rights Plan, Moran made a strong statement of his negative views and raised a number of pointed questions. His questions were answered and his views considered by the directors. Whitehead VI 19-20, B323-24; PX 203 at 6-9, A795-98.*

However, Moran won no support. After hearing his objections, several directors expressed approval of the Rights Plan (PX 203 at 10, A799). As they testified on deposition and at trial, they believed that Household was a strong company with a bright future but undervalued in the market and therefore vulnerable to a low-priced takeover attempt (*e.g.,* Clark V 205, 261, B272, 307; Kartalia IX 125, 126, 141, B628, 629, 634; Tower X 69-70, B718-19; see also Whitehead VI 10-12, 31, B317-19, 334A; Moran I 82, B88). They wanted to deter unfair two-tier front-end loaded and low-priced bust-up tender offers, and to reduce the risk of demands for greenmail, through a Rights Plan that would encourage offers for all the shares. They were informed, and believed, that the Plan would not make Household takeover-proof or impede a proxy contest (Clark V 262, 266-67, B308, 312-13, VI 78, B354; Kartalia IX 123-24, B626-27; Tower X 71-72, B720-21; PX 203 at 7-9, A796-98; PX 313 at 3, B740).

The directors wanted to create a "path of least resistance" which would encourage prospective acquirors to negotiate with the Board so that the directors could try to maximize shareholder values (Kartalia IX 125, B628; Clark V 265-68. B311-14; Tower X 71-73, B720-22). They were impressed with the flexibility of the Plan which provides for redemption of the Rights at nominal cost (Clark V 263, B309). They believed that its adoption would have a positive effect on employee morale (see Clark V 199, B271A; PX 203 at 10, A799). And they believed that, while the Rights Plan has both

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*The record is clear that Moran did not quarrel with the 20% "control" threshold (including the "voting group" aspect) in the Plan, although he concededly was aware of it (Moran I 143, B92, II 166, B120; Clark VI 87-88, B361-62). Moran testified that he understood from the materials sent to the directors that the Rights would be triggered by, among other events, the "formation of a group of stockholders that have the right to vote 20 percent" (Moran I 143, B92).

advantages and disadvantages, it was reasonably calculated to achieve its objectives (Clark V 271, B315, VI 75-76, B352-53).*

When the vote was taken, Moran lost 14 to 2. While Whitehead voted against adoption, he did not do so on the same grounds as Moran. As he testified at trial:

> [A]s I explained at the meeting, my reasons for voting against the plan as I did were different from Mr. Moran's. Mr. Moran voted against it on the substance of the plan, which he felt was undesirable, but I voted against it not because I disapproved of the substance, because I was sympathetic to the objectives of the plan, but because I knew that the plan was somewhat untested, novel and would be controversial, and that for Household to adopt it would bring publicity to the company as a company that was worried about being raided by unfriendly suitors.
>
> —Whitehead VI 20-21, B324-25; see also DX 13, B824.

Whitehead stated at trial that he would now support the Plan. As he testified, since his reason for voting against adoption no longer applies, "I would today vote in favor of the plan, or vote to keep the plan in effect" (Whitehead VI 41, B340).

4. Events after the August 14, 1984 Board meeting.

Subsequent to the Board meeting, the Rights were accepted for listing on the New York Stock Exchange (DX 23, B866-69; see Troubh VIII 33-40, B558A-564). Also, at a Board meeting on

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*So far as the mechanics of the Plan are concerned, the directors were familiar with the flip-over provisions, which are a conventional term in a wide variety of equity securities (although the 50% purchase price is concededly novel) (PX 183 at 1, 3, A686, 688; Higgins VII 115-17, B478-80). Indeed, the Household convertible preferred stock held by plaintiff DKM has a flip-over feature so that DKM can convert that stock into shares of the acquiring corporation in the event of a merger. Similarly, Household's executive incentive compensation plan, which plaintiff Moran voted for, also makes provision for option holders to acquire shares of the acquiring corporation in the event of a merger. Moran II 34-36, B100-02; DX 5, 7, B783-94, 795-800.

September 10, after this action had been brought, Moran asked the directors to reconsider their action in adopting the Rights Plan without a shareholder vote. Although many of the directors had by then been deposed, and pointedly confronted with Moran's litigation positions, the Board adhered to its earlier decision (Moran I 180-84, B93-97).

On September 21, 1984, Clark sent a letter to Household's shareholders explaining the Rights Plan. That letter stated in part:

> The Board reconfirms its intention that if anyone makes an attractive acquisition offer that treats *all* shareholders equally and fairly and asks that the Board redeem the outstanding Rights, the Board *will do so.*
>
> —PX 313 at 3, B740 (emphasis in original).

The Board fully intends to honor this commitment (Clark V 267, B313, VI 78, B354; Kartalia IX 126-30, B629-33; see also Moran II 189-90, B121-22).

Both before and after the Household Board acted, other companies adopted similar rights plans. The record showed that other companies adopting such plans also had predominantly outside boards, and acted on the advice of three different investment banking firms (Higgins VII 113-17, B476-80; DX 27, 29, 30, B920, 921-36, 937-58).

E. The Opinion Below

The Court below was not persuaded that the Rights Plan would prevent a hostile tender offer or impede a proxy contest at Household. So far as tender offers are concerned, the Vice-Chancellor did *not* find, as plaintiffs repeatedly state (*e.g.*, POB 1-2), that the Plan would prevent them. He stated that "[i]ts impact is upon the prospective purchaser of shares and only such a prospective purchaser who wishes to pursue a hostile two-tier offer" (Op. 44, B46). That is as far as the evidence permitted him to go. So far as proxy fights are concerned, he did *not* find, as plaintiffs state, that the Plan restricts shareholders' rights "to change corporate policies or management" (*e.g.*, POB 3). He stated that "it is highly conjectural to assume" that the Plan will have any such result (Op. 48, B50).

The Vice-Chancellor's opinion recognized that, in adopting the Rights Plan, the Board has "taken upon itself the responsibility for assuring that the rights are not triggered in such a fashion as to inflict harm upon the corporation by rendering it acquisition-proof" (Op. 56, B58). He made it clear that the courthouse doors would be open in the event of "misuse of directorial authority" (Op. 55, B57). He did not fail to "appreciate" the significance of his own findings, as plaintiffs charge (*e.g.*, POB 3).

The Vice-Chancellor properly refused to accept the derogatory assumptions about Household's directors on which so much of plaintiffs' case rested. He refused to base his decision on their "examples of possible arbitrary power by the Household Board in using the Rights Plan" (Op. 55, B57). He correctly concluded that "[t]hese risks cannot be measured in the absence of specific acquisition approaches. Nor can it be assumed that the Board will act contrary to the interests of the shareholders. Those events and plaintiffs' fears must await another day" (Op. 56, B58).

His determination that, "on the evidence presented, the adoption of the Rights Plan is an appropriate exercise of managerial judgment under the business judgment rule" was fully consistent with the record (Op. 56, B58). As will now be shown, it was also fully consistent with the controlling legal principles.

ARGUMENT

I. The Household Board of Directors adopted the Rights Plan in good faith for rational business purposes and, accordingly, its action is fully protected under the business judgment rule.

The business judgment rule applies where, as in the present case, directors have taken action pursuant to statutory authority (see Argument II *infra*) absent a finding of illegality (see Argument III *infra*). It requires the courts to defer to the business decisions of disinterested directors acting in good faith, on an informed basis and for a rational business purpose.

The business judgment rule is applicable to takeover-related actions as to all other business decisions. That settled rule reflects judicial recognition that the analysis of takeover matters—the economics of a particular offer, or the vulnerability of a particular company in today's economic environment, or the desirability of coercive front-end loaded tender offers, or the strategy best calculated to maximize shareholder values—calls for the exercise of business judgment within the directors' competence and authority.

Plaintiffs are unable to suggest any principled legal distinction that would permit this Court to invalidate the Rights Plan while upholding other defensive tactics as proper exercises of business judgment. The courts have repeatedly upheld board decisions, in non-takeover and takeover situations alike, that are every bit as "fundamental" in their impact as the Rights Plan, if not more so. There is no separate rule in Delaware law, or that of any other state, for corporate actions having effects that a plaintiff labels "fundamental" or "structural." Plaintiffs' (and the *amici*'s) various "public policy" arguments that the Delaware courts should create such a rule are contrary to sound judicial doctrine, and improperly seek legislative action from the courts.

The Vice-Chancellor correctly applied the business judgment rule as the courts have consistently applied it.* His careful scrutiny of the evidence showed that the Rights Plan does not represent any "revolutionary" departure from accepted corporate norms. The clear weight of the evidence presented to him showed that the Plan does not render Household takeover-proof or impede proxy contests. It does protect shareholders from coercive, unfair offers and provides the Board with bargaining leverage. The evidence showed that Household's Board acted diligently and in good faith and that the Plan was adopted for rational business purposes and not for entrenchment.

A. Standard and Scope of Review

Whether the Household Board acted in good faith, on an informed basis and for rational purposes in adopting the Rights Plan, thereby entitling the actions of the board to the presumption of propriety afforded by the business judgment rule, is a mixed issue of fact and law. *See Smith* v. *Van Gorkom,* Del. Supr., No. 255, 1982, Horsey, J. (Jan. 29, 1985) (Exhibit M). Accordingly, the standard and scope of review to be applied by this Court are as follows:

> If [the findings of the trial court] are sufficiently supported by the record and are the product of an orderly and logical deductive process, in the exercise of judicial restraint we accept them, even though independently we might have reached opposite conclusions. It is only when the findings below are clearly wrong and the doing of justice requires their overturn that we are free to make contradictory findings of fact.

Slip op. at 21, *quoting Levitt* v. *Bovier,* Del. Supr., 287 A.2d 671, 673 (1972). This Court will apply the above standard and the gov-

*There is no basis for the Moran plaintiffs' suggestion (POB 5) that the lower Court erroneously concluded that the business judgment rule constituted independent authority for the Household Board's adoption of the Rights Plan. The Court below expressly recognized that "[t]he business judgment rule is primarily a tool of judicial review and only indirectly a standard of conduct for corporate management" (Op. 35, B37). Indeed, defendants did not even contend that the business judgment rule independently authorized the Rights Plan.

erning principles of law to the decision below and will reverse that decision only if it is contrary to the record and not the product of a logical and deductive reasoning process. *Smith* v. *Van Gorkom, supra,* slip op. at 21-22.*

B. The Household Board's Adoption of the Rights Plan is Protected by the Business Judgment Rule.

1. The business judgment rule is fully applicable in the takeover context.

This Court has consistently held that the decisions of disinterested corporate directors must be upheld if the decisions were made in good faith, on an informed basis and for any rational business purpose. *E.g., Aronson* v. *Lewis,* Del. Supr., 473 A.2d 805, 812 (1984); *Sinclair Oil Corp.* v. *Levien,* Del. Supr., 280 A.2d 717, 720 (1971); *Warshaw* v. *Calhoun,* Del. Supr., 221 A.2d 487, 492-93 (1966).

Plaintiffs argue (POB 64) that the business judgment rule applies only to "*managerial* acts of directors" (emphasis in original), suggesting that a different rule applies where takeover matters are concerned. To the contrary, this Court has specifically held that the business judgment rule applies not only to the day-to-day conduct of a corporation's business but "is equally applicable . . . in the context of a takeover." *Pogostin* v. *Rice,* Del. Supr., 480 A.2d 619, 627 (1984). *See also, e.g., Panter* v. *Marshall Field & Co.,* 646 F. 2d 271, 295 (7th Cir.), *cert. denied,* 454 U.S. 1092 (1981) (applying Delaware law); *Treadway Cos.* v. *Care Corp.,* 638 F.2d 357, 383 (2d Cir. 1980); *Crouse-Hinds Co.* v. *InterNorth, Inc.,* 634 F. 2d 690, 701-03 (2d Cir. 1980). *See generally* Note, *Protecting Shareholders Against Partial and Two-Tiered Takeovers: The "Poison Pill" Preferred,* 97 Harv. L. Rev. 1964, 1969 (1984).

**Cf. Warren* v. *Goldinger Brothers, Inc.,* Del. Supr., 414 A.2d 507, 509 (1980), *citing Lank* v. *Steiner,* Del. Supr., 224 A.2d 242 (1966) ("this Court's standard of review as to findings of facts and conclusions of law of the Court of Chancery permits reversal only if there be no substantial evidence to support such ultimate findings so as to demonstrate them to be 'clearly wrong.'").

The courts of this State and other jurisdictions have uniformly applied the business judgment rule to actions by which target companies have sought to forestall takeover activity they considered unfair or undesirable. As Chancellor Brown observed:

> The test, loosely stated, is whether the board is fairly and reasonably exercising its business judgment to protect the corporation and its shareholders against injury likely to befall the corporation should the tender offer prove successful.
>
> —*GM Sub Corp.* v. *Liggett Group, Inc.*, Del. Ch., C.A. No. 6155, Brown, V.C. (April 25, 1980), slip op. at 3 (Exhibit N).

Indeed, the courts have repeatedly made clear that once the board concludes that a takeover proposal is detrimental to the corporation and its shareholders, it is the directors' *duty* to oppose it. *E.g., Panter* v. *Marshall Field & Co., supra,* 646 F.2d at 298-99; *Heit* v. *Baird,* 567 F.2d 1157, 1161 (1st Cir. 1977); *Northwest Industries, Inc.* v. *B.F. Goodrich Co.,* 301 F. Supp. 706, 712 (N.D. Ill. 1969). *See generally* Note, *Protecting Shareholders Against Partial and Two-Tiered Takeovers, supra,* 97 Harv. L. Rev. at 1968. The Court below properly deferred to the Household Board's fulfillment of this duty (Op. 41, B43).

The courts have applied these basic principles by refusing to invalidate a wide variety of defensive measures. Thus, by way of example, the courts have rejected attacks on such defensive actions as:

— adopting "shark repellent" by-law amendments and agreeing to purchase an acquiror's holdings, ending one takeover attempt, *Edelman* v. *Phillips Petroleum Co.,* Del. Ch., C.A. No. 7899, Walsh, V.C. (Feb. 12, 1985) (Exhibit O), and thereafter engaging in a complex multi-billion-dollar exchange offer, by which the company was restructured, ending a second one. *Lowenschuss* v. *The Option Clearing Corp.,* Del. Ch., C.A. No. 7972, Brown, C. (March 27, 1985) (Exhibit P);

— buying in more than half the outstanding common stock, while issuing a new preferred stock, thereby frustrating a tender offer and materially altering the composition of the shareholder body, *Carter Hawley Hale Stores, Inc.* v. *The Limited, Inc.*, C.A. No. 84-2200-AWT (C.D. Cal. April 17, 1984) (Exhibit Q);

— making a self-tender offer for the target's own shares, *Pogo Producing Co.* v. *Northwest Industries, Inc.*, No. H-83-2667 (S.D. Tex. May 24, 1983) (Exhibit R) (applying Delaware law);

— consummating a counter-tender offer for the stock of an offeror that already owned a majority of the target's shares, *Martin Marietta Corp.* v. *Bendix Corp.*, 549 F. Supp. 623 (D. Md.), *stay pending appeal denied,* (4th Cir. 1982);

— issuing "springing" warrants in order to dilute a raider's position and thereby try to deter a hostile takeover bid, *Gearhart Industries, Inc.* v. *Smith International, Inc.*, 741 F.2d 707 (5th Cir. 1984);*

— selling "prize" assets of the target corporation, *Whittaker Corp.* v. *Edgar,* 535 F. Supp. 933, 951 (N.D. Ill. 1982), *aff'd,* Nos. 82-1305, 82-1307 (7th Cir. March 5, 1982); *GM Sub Corp.* v. *Liggett Group, Inc., supra* (denying temporary restraining order);

— issuing a block of stock to a prospective "white knight," *Treadway Cos.* v. *Care Corp., supra,* 638 F.2d at 381-83; *Buffalo Forge Co.* v. *Ogden Corp.*, 555 F. Supp. 892, 903-04 (W.D N.Y.), *aff'd,* 717 F.2d 757 (2d Cir.), *cert. denied,* —— U.S. ——, 104 S. Ct. 550 (1983);

— paying "greenmail" to eliminate the threat posed by a dissident shareholder, *Cheff* v. *Mathes,* Del. Supr., 199 A.2d 548, 555-56 (1964);

— entering into a "standstill agreement" whereby a prospective offeror agreed not to make a tender offer at all, *Enterra Corp.* v.

*The warrants issued by Gearhart had a "springing" feature keyed to a takeover attempt: the exercise price to purchase Gearhart stock would drop from $33 to $24.60 per share in the event of a hostile tender offer such as the one Smith International had announced.

SGS Associates, [Current] Fed. Sec. L. Rep. (CCH) ¶91,919 (E.D. Pa. Jan. 9, 1985); and

— making acquisitions for the purpose of creating an antitrust obstacle to a takeover, *Panter* v. *Marshall Field & Co.*, *supra*, 646 F.2d at 297 (applying Delaware law).

None of these decisions supports plaintiffs' assertions (*e.g.*, POB 55; IOB 41-43) that the courts decide challenges to defensive actions based on whether or not they alter the corporate "structure" or are in some sense "extreme." Most if not all of the anti-takeover measures sanctioned in these cases resulted in significant alterations to the "structures" of the target companies; many altered the relationship between the shareholders and the directors (see pp. 10-14, *supra*). As the Vice-Chancellor correctly noted (Op. 44, B46), most if not all of these measures made a particular takeover attempt impossible or impractical, with the result that the ability of shareholders to determine the ultimate fate of these companies was limited.*

These cases do not compel the courts to endorse the wisdom of every defensive measure a board decides to employ: courts are in no better position to endorse those decisions than to condemn them. Rather, these cases require only that the courts defer to the business judgment of directors once they are satisfied that the directors acted in good faith "to protect all corporate constituencies and not simply to retain control" (Op. 44, B46). The decision below is fully consistent with these principles.

Furthermore, the courts have recognized that the business judgment rule is applicable to pre-planned strategies as well as to responses to a particular offer. As Judge Wright observed in *Warner Communications, Inc.* v. *Murdoch*, 581 F. Supp. 1482, 1490-91 (D. Del. 1984), corporations frequently develop "pre-planned" de-

*Contrary to plaintiffs' suggestion, the courts have not required proof that any such transaction was "beneficial" to shareholders apart from its effect upon a particular takeover controversy, or that the terms of the transaction were "dictated in part by real market considerations" (POB 74). Plaintiffs do not point to a single decision that so holds. And no court has ever invalidated a defense merely because the board might have used some other defense that might be deemed less "extreme" (see IOB 41-43).

fensive strategies which "may serve a positive function" and are unlawful only if adopted for the "primary purpose of entrenchment." Thus, the Court of Chancery refused to enjoin the issuance by a Delaware corporation of the so-called "poison pill" preferred stock described above (pp. 23-24, *supra*). *National Education Corp.* v. *Bell & Howell Co.*, Del. Ch., C.A. No. 7278, Brown C. (Aug. 25, 1983) (Exhibit S). And two federal courts within the last month have refused to grant injunctive relief with respect to rights plans similar to, and modeled after, the Household Rights Plan. *Horwitz* v. *Southwest Forest Industries, Inc.*, CV-R-84-67-ECR (D. Nev. March 19, 1985) (Exhibit T) (finding no probability of success on the merits and denying preliminary injunction), *notice of appeal filed* (April 16, 1985); *APL Corp.* v. *Johnson Controls, Inc.*, 85-C-990 (E.D.N.Y. March 25, 1985) (Exhibit U) (same).

The *Southwest Forest* and *Johnson Controls* cases, applying Nevada law and Wisconsin law respectively, rejected similar attacks to those plaintiffs make here. The *Southwest Forest* court, for example, like the Court below, reasoned that the rights plan serves the beneficial purpose of providing the directors with "leverage" to represent the interests of all of the shareholders in a takeover situation. The Court stressed that directors have "wide latitude" in devising defensive strategies, that such strategies are unlawful only if adopted for the "primary purpose" of management "entrenchment," and that the directors are "presumed" to be acting in good faith unless and until the plaintiff proves the contrary. Slip op. at 9-12. Plaintiffs' claims that the Rights Plan violates accepted corporate norms not only are against the weight of the evidence below but ring particularly hollow now that three different judges have rejected similar contentions.

2. Plaintiffs' proposed changes to the business judgment rule are unsound.

Plaintiffs and the *amici* seek to escape the implications of the business judgment cases by suggesting that this Court introduce into Delaware law a distinction between corporate actions generally and those effecting what they characterize as "fundamental" changes in the corporate "structure" (*e.g.*, POB 52-56; ICIB 7-11). Plaintiffs and the *amici* ask this Court to be guided by considerations of "public policy" (*e.g.*, POB 7).

The proposed distinction between "structural" or "fundamental" changes and other corporate steps cannot withstand analysis. It has no judicial support. To the contrary, in non-takeover and takeover cases alike, courts have refused to apply different rules in adjudicating the propriety of corporate action merely because the plaintiff characterized the action as "fundamental" or "structural." *See, e.g., Gimbel* v. *Signal Cos.,* Del. Ch. 316 A.2d 599, *aff'd,* Del. Supr., 316 A.2d 619 (1974); *Lowenschuss* v. *The Option Clearing Corporation, supra* (Exhibit P), discussed further at pp. 64-65, *infra.*

Moreover, the proposed distinction between "fundamental" changes and other corporate steps is conceptually unsound. The very purpose of the business judgment rule is to place in the hands of corporate directors the responsibility for making decisions about corporate policy which courts are ill-equipped to make. *Aronson* v. *Lewis, supra,* 473 A.2d at 812; *Auerbach* v. *Bennett,* 47 N.Y.2d 619, 630-31, 393 N.E.2d 994, 1000 (1979). This purpose applies whether or not a particular corporate step can be characterized as "fundamental." The decision the Household Board made to adopt the Rights Plan for example, turned upon the directors' analysis as to whether Household is vulnerable to a takeover in today's economic environment, whether front-end loaded tender offers are coercive, whether the Rights Plan is reasonably calculated to serve the best interests of the Household shareholders and whether the benefits of the Rights Plan outweigh the disadvantages. These questions call for the exercise of business judgment no less than decisions relating to the day-to-day conduct of Household's affairs.

Indeed, decisions with respect to takeover matters necessarily implicate the ongoing business and affairs of the company. As the SEC's own figures show, tender offers are relatively rare events (approximately 100 a year). See Exhibit A to Exhibit H hereto. The primary source of shareholder wealth comes from the strength of a company's ongoing business. Familiarity with the business such as directors possess is therefore a necessary element in takeover-related decisions, as plaintiffs' expert Abbott testified (Abbott III 156-57, B174-75).

If the proposed distinction between "fundamental" changes and other corporate steps were adopted, every bidder would argue that the defense adopted by its target was "fundamental"—and the courts of this State would be required to decide whether it was or was not and whether the target should have used some less "extreme" defense.* Since corporate directors would be exposed to the risk of personal liability if a defense were found to be "fundamental"—even though their actions served rational business purposes and their motives and diligence were beyond question—target company shareholders could no longer expect that directors would vigorously protect their interests.

Such a standardless judicial test would be at odds with sound judicial doctrine, *see, e.g., Pogostin* v. *Rice, supra,* 480 A.2d at 627, and should not be adopted. No amount of rhetoric about shareholder "rights" to receive tender offers, no quantity of citations to the partisans of a particular economic theory, can hide plaintiffs' inability to articulate any principled *legal* distinction between the case at bar and the long line of cases applying the business judgment rule to takeover defenses. There simply is no tenable basis for permitting courts to override the business judgment of directors who adopted the Rights Plan yet requiring judicial deference to directors who

*A Wisconsin court recently gave cogent expression to the undesirability of such a change in the business judgment rule. Plaintiffs there sought to enjoin Johnson Controls, which had adopted a rights plan similar to Household's, from acquiring Hoover Universal by the issuance of a substantial block of Johnson stock in a forward triangular merger. In rejecting contentions that the stock issuance should be subjected to a shareholder vote—although the relevant statutes did not require one—the court stated:

> [T]he business judgment rule [does not] set judges up as super directors whose zeal in running this nation's businesses would be propelled . . . by the same sort of "omnicompetent arrogance" which has led some judges to supervise the day-to-day operations of a whole host of endeavors outside their own areas of responsibility and expertise. In the long run, that would be a far greater vice than an occasional bad decision made in good faith by those whose business *is* business.
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> —*Wanvig* v. *Johnson Controls, Inc.,* No. 663-487 (Wisc. Cir. Ct. March 29, 1985), slip op. at 18 (emphasis in original) (Exhibit V).

approve other measures which may deny shareholders access to tender offers—sale of "crown jewel" assets, issuance of "springing" warrants, placement of stock in friendly hands, purchase of a company to create a regulatory block, or execution of a "standstill agreement" which precludes an offer even being made.

The positions of plaintiffs and the *amici* boil down to an attempt to persuade this Court that, since tender offers are always made at a price higher than market, directors should not have discretion to decide upon defensive measures which may deprive shareholders of access to above-market prices. This line of argument not only lacks intellectual coherence, but flies in the face of this Court's recent decisions in *Pogostin* v. *Rice, supra,* and *Smith* v. *Van Gorkom, supra.* Thus in *Pogostin,* this Court recognized that directors should *not* be put to what this Court called a "Hobson's choice" between "accepting any tender offer or merger proposal above market, or facing the likelihood of personal liability if they reject it." 480 A.2d at 627.

Likewise in *Smith,* which was decided the same day as the present case, this Court rejected the notion that the relationship of an offering price to the pre-existing market entitles directors to acquiesce in a takeover proposal, stating:

> A substantial premium may provide one reason to recommend a merger, but in the absence of other sound valuation information, the fact of a premium alone does not provide an adequate basis upon which to assess the fairness of an offering price.
>
> —Slip op. at 32.

This Court also rejected the theory that the momentary market price of a company's stock necessarily reflects the full value of the enterprise:

> Using market price as a basis for concluding that the premium adequately reflected the true value of the Company was a clearly faulty, indeed fallacious, premise, as the defendants' own evidence demonstrates.
>
> —*Id.*

The evidence about Household adduced in the Court below demonstrates the soundness of these conclusions. The evidence showed a conscientious, independent Board of Directors which believed that Household's long-term values were materially higher than what the market reflected, and accordingly took steps to enable the Board to obtain full value for shareholders in a takeover situation. The directors acted consistently with this Court's recognition in *Pogostin* and *Smith* that there is more to responsible corporate governance than momentary stock premiums.

By their various appeals to "public policy," plaintiffs and the *amici* ask this Court to subordinate all other relevant factors to the pursuit of above-market stock prices. That would be to make precisely the kind of legislative policy judgment which the Court of Appeals for the Ninth Circuit correctly *refused* to make in its recent decision in *Jewel Cos.* v. *Pay Less Drug Stores Northwest, Inc.*, 741 F.2d 1555 (9th Cir. 1984) (applying California law). There, the District Court had invalidated a provision in a merger agreement which precluded the board from seeking a higher price pending a shareholder vote. In reversing, the Court of Appeals stated:

> [T]he district court's policy premise, that the sole aim of corporate law in these matters is to promote active competition among corporate conglomerates interested in acquiring new targets is a highly controversial point of view and by no means represents the consensus of courts and commentators that have considered the question. No authority has previously suggested that the market for corporate acquisitions is unbounded by traditional principles of contract and corporate law. *It is not the function of the courts to fashion so novel a rule or to resolve the policy disputes that have divided the economic experts. That task, if it is to be performed at all, is best left to the California legislature.*
>
> —*Id.* at 1568 (emphasis added) (footnote omitted).

This reasoning is a complete answer to the various policy arguments which permeate the briefs of plaintiffs and the *amici*.

3. The Household Board of Directors was not an "interested" board.

Plaintiffs contend (POB 66-69; IOB 26-31) that the Household Board is not entitled to the protection of the business judgment rule because the directors had an "interest" in adopting the Rights Plan and that defendants therefore were required to demonstrate the Plan's fairness. But this claim turns the law upside down. The clear weight of the evidence was that self-perpetuation or some other improper purpose was *not* the "sole or primary purpose" of the Board's action. The Vice-Chancellor's decision that the directors were not "interested" was fully supported by the record. See pp. 18-42, *supra.*

Under settled Delaware law, directors are entitled to a presumption that they act disinterestedly. As the Third Circuit, speaking through Chief Judge Seitz, declared in the frequently cited case of *Johnson* v. *Trueblood,* 629 F.2d 287 (3d Cir. 1980), *cert. denied,* 450 U.S. 999 (1981):

> The business judgment rule . . . achieves . . . [its] purpose by postulating that if actions are arguably taken for the benefit of the corporation, then the directors are *presumed* to have been exercising their sound business judgment rather than responding to any personal motivations. . . .
>
> . . . *[U]nless the plaintiff can tender evidence from which a factfinder might conclude that the defendant's sole or primary motive was to retain control, the presumption of the rule remains.* . . . In short, we believe that *under Delaware law, at a minimum the plaintiff must make a showing that the sole or primary motive of the defendant was to retain control.*
>
> —629 F.2d at 292-93 (emphasis added).

Plaintiffs do not even attempt to distinguish this seminal decision.*

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*The Moran plaintiffs and the *amici* do not even cite *Johnson*. The intervenor asserts (IOB 31) that Chief Judge Seitz' opinion rests upon a "highly questionable" reading of *Cheff* v. *Mathes,* Del. Supr., 199 A.2d 548 (1964), and other cases. However, *Cheff* made clear that Delaware law imposes a

(Footnote continued on following page)

Furthermore, as the trial Court held (Op. 32, B34), the presumption of good faith embodied in Delaware law is *heightened* where, as here, the board has a majority of independent directors. *See, e.g., Panter* v. *Marshall Field & Co., supra,* 646 F.2d at 294; *Puma* v. *Marriott,* Del. Ch., 283 A.2d 693, 696 (1971).*

To the same effect is this Court's recent decision in *Pogostin* v. *Rice, supra,* where directors' action in opposing a tender offer was alleged to entrench management. This Court held that a complaint which failed to plead specific facts showing an entrenchment purpose was defective, stating:

> [P]laintiffs seek to establish a motive or primary purpose to retain control only by showing that the City board opposed a tender offer. Acceptance of such an argument would condemn any board, which successfully avoided a takeover, regardless of whether that board properly determined that it was acting in the best interests of the shareholders.
>
> —480 A.2d at 627.

In this case, the Vice-Chancellor's appraisal of the record led him to conclude that plaintiffs had failed to rebut the presumption of sound business judgment and good faith. He recognized, however, that defensive measures can sometimes be used for entrenchment. He

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burden of proving fairness only upon directors who have a "personal and pecuniary interest" in the transaction in question (199 A.2d at 554-55) and that the directors' burden in other cases is merely to go forward with evidence that they acted in good faith after reasonable investigation and that the transaction "appeared reasonable at the time" (199 A.2d at 555). That is the standard to which the Vice-Chancellor held Household and the defendant directors (Op. 36-37, B38-39).

*This Court recently defined disinterested directors as those who "neither appear on both sides of a transaction nor expect to derive any personal financial benefit from it in the sense of self-dealing, as opposed to a benefit which devolves upon the corporation or all stockholders generally." *Aronson* v. *Lewis, supra,* 473 A.2d at 812. The minority of Household's directors who are employed by the company are the only members of the Board who could even be claimed to have had such an interest. And as noted above, two of them will shortly retire (see p. 34 n.**, *supra*).

imposed on defendants the burden of going forward with evidence that adoption of the Plan was in fact motivated by a *bona fide* desire to protect Household from perceived threats to the welfare of its shareholders, consistently with *Cheff* v. *Mathes, supra* (Op. 36-37, B38-39). Defendants fully discharged this burden by establishing that the purpose and effect of the Rights Plan is to protect shareholders from unfair and coercive acquisition techniques and to enhance the Board's ability to negotiate for their benefit.

Plaintiffs' reliance on *Norlin Corp.* v. *Rooney, Pace Inc.*, 744 F.2d 255 (2d Cir. 1984), to establish that the Household directors had an "interest" is wide of the mark. There, in a holding carefully limited to the facts before it, *see id.* at 269, the court invalidated stock issuances to a subsidiary and an ESOP by which the target company's directors got control over *49%* of the company's voting power. These transactions had caused the New York Stock Exchange to delist Norlin's stock. The court held that the share issuance to the subsidiary was illegal under New York and Panamanian statutes similar to DGCL § 160(c), *id.* at 262-64, and affirmed the trial court's specific factual finding that the ESOP had been "created solely as a tool of management self-perpetuation," *id.* at 266.

Defendants will agree that directors' acquisition of 49% voting control for purposes of self-perpetuation gives them an interest. But what *Norlin*'s extreme facts have to do with the present case plaintiffs do not explain. What *is* relevant here is that the *Norlin* court, consistent with the *Jewel* decision, *supra,* expressly noted that:

> Although we are cognizant that takeover fights, potentially involving billions of dollars, profoundly affect our society and economy, *it is not for us* [*i.e.*, courts] *to make the policy choices that will determine whether this style of corporate warfare will escalate or diminish.* Our holding here is *not* intended to reflect a more general view of the contest being played out on this and other corporate battlefields.
>
> —*Id.* at 269 (emphasis added.)*

*It should also be noted that *Norlin* was not decided under Delaware law and, indeed, relied in part on the *dissenting* opinion in *Johnson* v. *Trueblood*,

(Footnote continued on following page)

The Vice-Chancellor's conclusion that Household's directors were not subject to an interest such that they were required to prove the fairness of the Rights Plan was correct.

4. The Household Board of Directors was not "uninformed."

Plaintiffs' attempts to disparage the quality of the Household Board's consideration of the Rights Plan fare no better. At trial, plaintiffs simply failed to prove that the directors were guilty of "gross negligence" and thus failed to rebut the presumption that the Household Board acted on an informed basis. *Smith* v. *Van Gorkom, supra,* slip op. at 23-25. The evidence was overwhelming that, as the lower Court concluded (Op. 43, B45), the Board's adoption of the Plan was based upon extensive discussions between Household and its outside investment banking and legal experts, and the Plan was fully considered by an independent Board (pp. 34-42, *supra*).

Plaintiffs' principal attack upon the Board's deliberations consists of arguments that Household's advisors misled the Board concerning "crucial facts" about the Rights Plan (POB 32, 74-76), *i.e.,* that the Plan prevents tender offers and impedes proxy fights. But as detailed above, these "facts" are not facts: the evidence demon-

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supra. See 744 F.2d at 262-65. Moreover, the *Norlin* court's finding of irreparable harm was based solely upon the threat of delisting by the New York Stock Exchange. *Id.* at 267-69. Here, in sharpest contrast, the Rights have been *accepted* for listing by that Exchange. See DX 23, B866-69; p. 41, *supra.*

Seibert v. *Harper & Row, Publishers, Inc.,* Del. Ch., C.A. No. 6639, Berger, V.C. (Dec. 5, 1984) and *Good* v. *Texaco, Inc.,* Del. Ch., C.A. No. 7501, Brown, C. (May 14, 1984) (POB 66-67), are also inapposite. Each arose in the context of a motion to dismiss for failure to adequately plead demand futility. *Seibert* involved allegations that the board had obtained "voting control over approximately 30%" of the corporation's stock (slip op. at 9). Similarly, *Good* involved allegations that the directors had secured control over 5% of the company's voting power (slip op. at 7-8). Nothing of this kind was alleged or proven here.

strated that the Rights Plan neither makes Household takeover-proof nor impedes proxy fights. Neither the directors nor their advisors warrant any criticism for failing to adopt plaintiffs' argumentative contentions to the contrary.

Plaintiffs also attack the directors for relying upon counsel's summary of the Rights Agreement rather than reading the document themselves (POB 32-33, 77). Plaintiffs ignore the extensive record evidence that corporate directors do not, and are not generally expected to, read complex legal documents, as the Court below correctly held (Op. 42-43, B44-45; Whitehead VI 24-25, B328-29; Troubh VIII 3-5, B533-35; Clark 88-89, B362-63; Abbott IV 42, B196), and as this Court noted in *Smith* v. *Van Gorkom, supra,* slip op. at 49 n.25.*

In the last analysis, plaintiffs' groundless attacks on Moran's fellow directors represent an attempt to dress in "business judgment" garb their substantive disagreement with the Rights Plan. Plaintiffs' professed concerns about the "integrity" of corporate governance (POB 78) conceal an effort to restrict directors' recognized authority to adopt defensive measures which they believe in good faith are necessary and appropriate.

5. The Rights Plan is fair to the Household shareholders.

The Rights Plan would have to be sustained even assuming, *arguendo,* that defendants were required to prove its fairness. If defendants had that burden, they met it.

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*While plaintiffs also charge that Delaware counsel's opinion as to the Plan was misrepresented to the Board (POB 76-77), they fail to mention the clear deposition testimony of General Counsel Hull that he understood that the Richards, Layton opinion, like the Wachtell, Lipton opinion, *did* stand for the proposition that the Rights are enforceable (Hull Dep. 8, B76). Moreover, both opinions state or assume on their face that adoption of the Rights Plan is a transaction to which the business judgment rule applies, if its requirements of due care and good faith are met (PX 238 at 3, A891; PX 243 at 2, B733).

First, the evidence showed that the Rights Plan treats all shareholders equally and creates incentives for bidders to treat shareholders equally by offering for all shares (see pp. 35-41, *supra*). Second, the Plan puts the Board in a position in which it can "extract concessions from an acquiror which it otherwise would not secure" (Op. 56, B58). The Rights Plan thereby tends to assure that the Household shareholders will receive the *highest* possible price for their shares. Also, the Plan protects shareholders from being squeezed out of their investments on unfair terms by the use of unfair takeover techniques.

The Rights Plan achieves the foregoing benefits without preventing changes of control by proxy contest, tender offer or otherwise. It does so without adversely affecting Household's business structure, earnings or financial condition. Moreover, the Plan is not "irrevocable" (Tower X 73, B722): the Rights can be redeemed at nominal cost. The balance of benefits and burdens, therefore, clearly leads to the conclusion that the Plan is "fair."

* * *

As the Vice-Chancellor noted (Op. 55, B57), plaintiffs' evidence at trial was predicated largely upon the speculative assumption that the Household Board will misuse the bargaining power that the Rights Plan affords. Plaintiffs now ask this Court to invalidate the Rights Plan on "public policy" grounds and thereby *strengthen* the hand of a prospective purchaser seeking to pay the *lowest* possible price. Any such action could make sense only on the assumption that the Household Board cannot be trusted tc act responsibly and to redeem the Rights in appropriate circumstances in order to obtain the *highest* possible price. But that assumption is directly contrary to the presumption of good faith embodied in Delaware law.

As the Chancery Court stated in one of the *Enstar* cases:

> The "worst scenario" suppositions of the Plaintiffs are based on speculation. For instance, they want the Court to assume that there will be a sale and yet there is no guarantee that a sale will occur. They want the Court to assume that the Board will breach its fiduciary duties and conclude a sale

> that is not in the best interests of the stockholders or which is not fair. Should we speculate that this would occur? Even if it did occur, would not the stockholders have an opportunity to either seek an injunction to prevent the sale or to vote it down?
>
> —*Huffington* v. *Enstar Corp.*, Del. Ch., C.A. No. 7543, Longobardi, V.C. (April 25, 1984), slip op. at 8 (Exhibit W).*

The Vice-Chancellor properly refused to engage in such speculative assumptions. After hearing testimony from fifteen witnesses, including John Whitehead and four other Household directors, and based on his appraisal of the record, he correctly held that plaintiffs' charges that the Household Board will not act responsibly to meet its continuing fiduciary obligations were not proven and "must await another day" (Op. 56, B58). The judgment of the trial Court should be affirmed.

II. The Household Board acted pursuant to the statutory authority of DGCL §§157 and 151(g) in adopting the Rights Plan.

The Household Board acted pursuant to the statutory authority contained in DGCL §§ 157 and 151(g) in adopting the Rights Plan. The Court below correctly held that the Rights Plan was "properly adopted under Delaware law" (Op. 54, B56). It correctly held that the Rights and the underlying preferred stock contemplated by the Rights Plan have "economic substance" and are not "sham" securities of the sort involved in *Telvest, Inc.* v. *Olson*, Del Ch., C.A. No. 5798, Brown, V.C. (March 8, 1979) (Op. 37-39, B39-41). Plaintiffs' arguments to the contrary are unsound.

A. Standard and Scope of Review

Whether the issuance of the Rights was authorized by the General Corporation Law, or whether instead the Rights constitute

*See also *Gearhart Industries, Inc.* v. *Smith International, Inc., supra*. 741 F.2d at 72 n.10 ("When and if" an anti-takeover device is abused, "the courthouse doors will be open.").

"sham" securities and are not so authorized, presents a mixed issue of fact and law. Accordingly, the standard and scope of review to be applied by this Court are as stated in Argument I A, *supra.*

B. Sections 157 and 151(g) of the DGCL Authorize the Rights Plan.

1. The Rights Plan complies with the requirements of Sections 157 and 151(g).

DGCL § 157 authorizes a corporation to issue "rights" entitling the holders of such rights to purchase "shares of its capital stock of any class or classes" upon such terms and at such prices as provided "in a [board] resolution providing for the creation and issue of such rights." This is what Household did: it issued Rights entitling Household's shareholders to purchase shares of a series of Household participating preferred stock upon the terms and at the prices provided in the authorizing resolution. See PX 203 at H 4854, A800; H 4860-65, A806-11. Household also filed a certificate of designation of the rights and preferences of the new issue of preferred stock underlying the Rights, pursuant to the statutory authority in DGCL § 151(g). See PX 203 at H 4866-72, A812-18.

Consequently, the Chancery Court's conclusion that the Rights Plan was "properly adopted under Delaware law" (Op. 54, B56) is entirely correct.

2. Plaintiffs' statutory construction arguments lack merit.

Plaintiffs' contention that the Household Board lacked statutory authority to adopt the Rights Plan is largely predicated upon arguments that this Court should read limitations into DGCL § 157 that are neither expressed nor implied in the statutory language. There is no merit to these arguments.

a. There is no "corporate financing" limitation or "takeover defense" prohibition in DGCL §157.

There is no basis for plaintiffs' argument that the Rights Plan is invalid because DGCL § 157 only authorizes securities which serve a "corporate financing" function (POB 34-35). Plaintiffs cannot point to any statutory language that even implies that rights can be issued pursuant to DGCL § 157 only for financing purposes, and they fail to cite any case holding or suggesting that the statutory authority is so limited. Plaintiffs' argument ignores the fundamental rule of statutory construction that primary consideration must be given to the language of the statute itself. *Chrysler Corp.* v. *State,* Del. Supr., 457 A.2d 345, 349 (1983); *Opinion of the Justices,* Del Supr., 352 A.2d 406, 408 (1976); *Federal United Corp.* v. *Havender,* Del. Supr., 11 A.2d 331, 337 (1940).*

Similarly, there is no merit to plaintiffs' contention that DGCL § 157 does not authorize the Rights because certain unspecified "legislative history" fails to show that the statutory purpose "had anything to do with corporate control in general or takeover defense in particular" (POB 38). Plaintiffs misstate the issue: the question is whether the general legislative grant of power must be narrowly construed to *exclude* authority to issue securities for takeover-related purposes.

Plaintiffs cannot point to any principle of construction that would justify reading the General Corporation Law in that fashion. Its various statutory authorizations are all silent about takeover-related use. For example, DGCL §§ 160 and 122(4) are silent about takeover-related use, yet plaintiffs correctly noted below that these sections authorize defensive measures against takeovers. Plaintiffs' Post-Trial Memorandum 52-53. Indeed, DGCL § 160 was recently held

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*Indeed, the structure and wording of DGCL §157 suggest that a financing purpose is *not* required. DGCL §157 includes the authority for the issuance of rights in the same section authorizing the issuance of options (which are generally not designed to serve a financing purpose) and provides in so many words that both rights and options can be issued "*whether or not in connection with the* issue and *sale of* any shares of stock or other securities of the corporation" (emphasis added).

In *Aldridge* v. *Franco Wyoming Oil Co.,* Del. Supr., 14 A.2d 380 (1940), cited by plaintiffs (POB 39), this Court relied upon "*the language of the statute*" itself in determining that the statutory authority for conferring affirmative voting rights upon classes of stock did not encompass the power to confer negative rights to veto corporate action (14 A.2d at 381 (emphasis added)).

to authorize Phillips Petroleum's defensive exchange offer for its own securities. *Lowenschuss* v. *The Option Clearing Corp., supra* (Exhibit P). DGCL §§ 157 and 151(g) authorize the issuance of takeover-related securities no less than DGCL § 160 authorizes takeover defense by means of repurchase programs or self-tenders, like those in Carter Hawley and Pogo, and DGCL § 122(4) authorizes defensive sales of "crown jewel" assets—to cite only the examples plaintiffs relied on below. Plaintiffs' Post-Trial Memorandum 52-53.*

b. There is no shareholder vote requirement in DGCL §157.

Neither DGCL § 157 nor DGCL § 151(g) requires a shareholder vote on the Rights Plan. Nonetheless, plaintiffs contend that the requirement of a shareholder vote is somehow implicit in every statute authorizing corporate action of a "fundamental" or "structural" nature even though the statutory language imposes no such requirement (POB 52-65). This argument is meritless.

The Chancery Court made this point well in *Gimbel* v. *Signal Cos., supra,* rejecting the claim that shareholder approval was required before a corporation could sell all the stock of a subsidiary that constituted an "important" part of its business. As Chancellor Quillen stated:

> It is important to note in the first instance that the statute does not speak of a requirement of shareholder approval simply because an independent, important branch of a corporate business is being sold. The plaintiff cites several non-Delaware cases for the proposition that shareholder approval of such a sale is required. But that is not the language of our statute. Similarly, *it is not our law that shareholder approval is required upon every "major" restructuring of the corporation.* Again, it is not necessary to go beyond the statute. The statute requires shareholder approval upon the sale of

*In *Gearhart Industries, Inc.* v. *Smith International, Inc., supra,* the court expressly relied on a Texas statute substantially identical to DGCL §157 (Tex. Bus. Corp. Act art. 2.14-1) as authorizing the defensive "springing warrants" issued by Gearhart. *See* 741 F.2d at 722, 724.

> "all or substantially all" of the corporation's assets. That is the sole test to be applied.
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> —316 A.2d at 605 (emphasis added).

This reasoning is equally applicable to the case at bar.

Moreover, as the Court of Chancery just recently ruled in rejecting the contention that a shareholder vote was required on "fundamental" or "structural" changes in the corporation—rather than when specifically required by the General Corporation Law—such a vague standard would subject Delaware law to undesirable uncertainty and unpredictability. *Lowenschuss* v. *The Option Clearing Corp., supra* (Exhibit P). In *Lowenschuss,* the Chancery Court held that Phillips Petroleum was not required to obtain shareholder approval of an exchange offer to purchase up to 50% of its own common stock, made pursuant to the authority of DGCL § 160. The Court stated:

> Since § 160 empowers a corporation, through its board of directors, to repurchase its own shares, acceptance of the plaintiff's argument would mean that this statutory power is nonetheless subject to the condition that shareholder approval is also required in any case where the proposed repurchases would work a *fundamental change* in the capital structure of the corporation. *In addition to reading into § 160 a limitation which the General Assembly has not seen fit to express* (compare 8 Del. C. § 271 for example), this would mean that in many cases a determination as to whether or not such a repurchase would actually constitute a fundamental or significant change in the corporate financial structure would be required before those involved could be sure that the repurchase was legal. In effect, *this would probably require a determination on a case-by-case basis by this Court, and it would work into our corporation law an aura of uncertainty and unpredictability which is undesirable.*
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> —*Id.* at 11-12 (emphasis added).

See also Wanvig v. *Johnson Controls, Inc., supra* (Exhibit V), slip op. at 4-7, 16-17.

A shareholder vote would have been required if Household had sought to act by means of adding a "fair price amendment" or other "shark repellent" provision to its certificate of incorporation. But the requirement of a shareholder vote in such cases did not preclude the Household Board from adopting the Rights Plan under provisions of the General Corporation Law which do not contain such a requirement.*

As the lower Court correctly held (Op. 39-40, B41-42), plaintiffs' argument to the contrary ignores this Court's doctrine of independent legal significance, which teaches that "[t]he mere fact that the result of actions taken under one section [of the General Corporation Law] may be the same as the result of action taken under another section does not require that the legality of the result must be tested by the requirements of the second section." *Orzeck* v. *Englehart,* Del Supr., 195 A.2d 375, 377 (1963); *accord Rothschild International Corp.* v. *Liggett Group, Inc.,* Del. Supr., 474 A.2d 133 (1984); *Field* v. *Allyn,* Del. Ch., 457 A.2d 1089, 1097-98, *aff'd,* Del. Supr., 467 A.2d 1274 (1983).

With limited exceptions required by statute, business corporations in this country do not decide policy by single-issue referenda any more than governments do. Business corporations are managed by their directors, not their shareholders. Directors are chosen by the shareholders once a year on the basis of their entire record of service. Between elections, however, it is the responsibility of the board to decide issues of corporate policy such as those presented by the Rights Plan.** If the shareholders disapprove of the board's

*Moreover, the evidence showed that, when the directors considered a fair price amendment shortly before the 1984 shareholders' meeting, they were assured by Georgeson that the measure would receive shareholder approval. The record fully supported the Vice-Chancellor's finding (Op. 3, B5) that the decision not to propose the fair price amendment reflected uncertainty about whether there was sufficient time before the meeting to win over institutional shareholders. Clark V 167-171, B268-268D; Wilcox IX 97, B612A; PX 41, B728A-F.

**The Chancery Court has recently held that the business judgment rule applies to board action even if the directors believe the action is *contrary* to

(Footnote continued on following page)

record, they have every right at the next election to choose new directors whom they think can do better. But until the incumbent Household directors are replaced, they bear the non-delegable responsibility for making decisions about takeover matters as about all other business matters. *See Pogostin* v. *Rice, supra,* 480 A.2d at 627.*

c. The "flip-over" feature of the Rights does not violate DGCL §157.

Plaintiffs' argument (POB 42) that the "flip-over" feature of the Rights Plan—the feature that protects Household shareholders in the event of a merger or other business combination—violates DGCL § 157 is based on the premise that Household has granted rights to purchase securities of a future acquiror rather than rights to purchase Household's own securities. This is simply incorrect.

Household has *not* issued rights to purchase shares of any other company's stock. The Rights Agreement (PX 204, A819-81) has no such provision. The Rights Agreement entitles shareholders to

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(Footnote continued from previous page)

the wishes of a majority of the shareholders. *American International Rent A Car, Inc.* v. *Cross,* Del. Ch., C.A. No. 7583, Berger, V.C. (May 9, 1984), slip op. at 7-8 (Exhibit X). *See also Wanvig* v. *Johnson Controls, Inc., supra,* slip op. at 17 (directors' authority to manage corporation "must encompass a decision whether to seek shareholder approval *unless* a shareholder vote is otherwise required" by law) (emphasis in original) (Exhibit V).

**In Re Osteopathic Hospital Association,* Del. Supr., 195 A.2d 759 (1963), *aff'g,* Del. Ch., 191 A.2d 333 (1963), which the ICI stresses in its brief (ICIB 10-11), is totally irrelevant. That decision turned upon the "unique" nature of a particular medical membership corporation (195 A.2d at 764). There, non-physician trustees of a corporation with a membership consisting primarily of physicians, unilaterally made themselves full voting members and thereby deprived the physician members of control over a board of trustees for the most part composed of laymen (*id.*). The decision has little bearing upon the actions of directors of business corporations who have undoubted authority under several sections of the General Corporation Law to affect the composition of the "members" of the corporation by issuing securities. And the decision has nothing whatever to do with the case at bar in which the Household directors did not issue securities to themselves, but rather issued Rights carrying no voting rights whatever to the Household shareholders generally.

purchase shares of a series of Household participating preferred stock upon specified terms and conditions (PX 204 at 9-11, A828-30). The Rights Agreement protects the value of these Rights from destruction in the event of a merger *not* by issuing Rights to purchase securities of the future merger partner, but rather by requiring appropriate commitments from such merger partner. Specifically, the Rights Agreement provides that Household will not consummate any future merger transaction without first making "proper provision" to protect the value of the Rights by obtaining a "supplemental agreement" whereby the acquiring entity (rather than Household) will permit the Rights to become exercisable to purchase common stock of that acquiring entity (PX 204 at 27-29, A846-48).

The evidence at trial demonstrated that "anti-destruction" or "flip-over" provisions are customary features of a wide variety of corporate securities, including securities issued by Household (*e.g.*, Higgins VII 115-17, B478-80; Moran II 34-36, B100-102; DX 5, 7, B783-94, 795-800).* The purpose of such provisions is to protect the economic value of the underlying securities. *See Broad* v. *Rockwell International Corp.*, 642 F.2d 929, 943-46 (5th Cir.), *cert. denied*, 454 U.S. 965 (1981). In the absence of such provisions, conversion or purchase rights would terminate automatically in the event of a merger. The validity of anti-destruction provisions is beyond question. *See, e.g., Wood* v. *Coastal States Gas Corp.*, Del. Supr., 401 A.2d 932, 937-39 (1979); *B.S.F. Co.* v. *Philadelphia National Bank*, Del. Supr., 204 A.2d 746, 750-51 (1964).**

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*Higgins testified that the only thing unusual about the Rights Plan provision is its "two-for-one" exercise ratio (Higgins VII 116-17, B479-80).

**Plaintiffs contend (POB 43) that the flip-over or anti-destruction feature of the Rights Plan is unauthorized because the Rights were issued as a dividend rather than for financing purposes. But insofar as the validity of anti-destruction provisions is concerned, there is no legal basis for distinguishing between securities issued for financing purposes and those issued as dividends. Contrary to plaintiffs' suggestion, DGCL §121(a) does not draw any such distinction and, indeed, grants directors of Delaware corporations "all powers incidental" to any "powers and privileges" granted by statute—including §157—or by the company's certificate of incorporation.

There was ample evidence below to support the Vice-Chancellor's finding that the Rights have significant economic value to Household shareholders (Op. 39, B41). They provide shareholders with the ability to purchase Household preferred stock at $100 a share, a price representing the directors' view as to the long-term value of the company. Plaintiffs' challenge to that valuation at trial was wholly inadequate: they did not even cross-examine Household's chief financial officer on his valuation study, predicated on Household's five-year business plan, from which the $100 figure is derived (see Dammeyer X 26-29, B703-06; pp. 37-38, *supra*). The Rights also have economic value to Household shareholders in that they provide protection against the adverse consequences of unfair and coercive acquisition techniques.

The Rights thus represent a means of assuring that shareholders will get full value—whether in a negotiated transaction, in an attractively-priced tender offer or, if a low-priced offer succeeds, when the bidder squeezes out the public shareholders to get unrestricted access to the assets of their company. There is no reason in law or public policy why provision should not be made for Household shareholders to receive substitute value, in the form of stock of the acquiring corporation, if the bidder seeks to extinguish their equity interest in the company.

d. DGCL §203 has no bearing on the construction of DGCL §157.

Plaintiffs' contention (POB 45) that the "policy" underlying DGCL § 203 somehow supports a narrow construction of DGCL § 157 is without merit. DGCL § 203 does not purport to enact rules of statutory construction, and plaintiffs cite no case holding that it has any bearing whatever on directors' conduct in issuing securities, or adopting a takeover defense.* What *is* noteworthy is

*DGCL §203 provides for *state* regulation of tender offers whereas DGCL §157 merely authorizes securities issuances by private parties, to wit, directors, for corporate purposes. The determination whether interstate tender offers are a proper subject for state regulation, and the degree of governmental intrusion in the private sector that is appropriate, present quite different questions than the determination whether directors should be allowed to issue securities for purposes they deem advantageous to shareholders.

that the Delaware legislature has not enacted any legislation to limit the authority of corporate directors to adopt defensive measures, whether by issuance of securities or otherwise.

e. DGCL §157 is constitutional if construed as authorizing the Rights Plan.

Finally, there is plaintiffs' newly-minted claim (POB 46-50)—neither briefed nor submitted below—that DGCL § 157 would be rendered unconstitutional under the Commerce and Supremacy Clauses if construed as authorizing securities whose issuance might deter tender offers. This argument is plainly lacking in merit.*

The cases cited by plaintiffs involve statutes such as DGCL § 203, which purport to impose the burden of *state* regulation upon interstate tender offers. However, neither the United States Supreme Court nor any other court has ever held that constitutional limitations upon such state regulation have any bearing on the private conduct of corporate directors who issue securities under DGCL § 157 or take other steps having anti-takeover implications. *See*, to the precise contrary, *Data Probe Acquisition Corp.* v. *Datatab Inc.*, 722 F.2d 1, 4-5 & n.3 (2d Cir. 1983), *cert. denied*, ____ U.S. ____, 104 S. Ct. 1326 (1984) (holding that the Williams Act is not intended to federalize matters traditionally committed to state law and that the rationale of *Edgar* v. *Mite Corp.*, 457 U.S. 624 (1982) does not apply to the acts of private parties); *Mesa Partners* v. *Phillips Petroleum Co.*, C.A. 84-718 (D. Del. Dec. 7, 1984), slip op. at 4-5 (Exhibit Y) (state and federal courts have power to enforce private contracts such as "standstill agreements" that prohibit a potential bidder from even commencing an interstate tender offer). Indeed, the Supreme Court has been careful to protect state jurisdiction over matters traditionally governed by state corporate law. *See Santa Fe Industries, Inc.* v. *Green*, 430 U.S. 462, 479

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*It also is not properly before this Court. Plaintiffs presented a constantly shifting array of legal contentions below, including the claim that the Rights Plan violated some ill-defined federal "policy." However, neither plaintiffs' post-trial brief nor its post-trial reply brief argued that §157 would contravene the Commerce Clause, or that it would be pre-empted by the Williams Act, if construed to authorize the Rights Plan.

(1977) (Supreme Court "reluctant to federalize the substantial portion of the law of corporations that deals with transactions in securities").*

Moreover, plaintiffs' argument would render constitutionally suspect all of the judicial decisions upholding corporate steps which block takeover attempts. So far as the impact upon interstate commerce or the pre-emptive effect of the Williams Act are concerned, there is no basis for distinguishing the issuance of rights pursuant to DGCL § 157 from any other corporate steps which directors take to deter or defeat takeover attempts. Yet the courts have consistently rejected attacks on such defensive measures without even a hint that any federal constitutional considerations were involved.**

Under the circumstances, defendants doubt that plaintiffs' constitutional argument is seriously intended.

3. The evidence does not support plaintiffs' contention that the Rights Plan is proscribed by the Telvest decision.

Plaintiffs attempt to create the erroneous impression (POB 37-40) that Household issued "sham" securities and hence that this case is controlled by one of the rulings in *Telvest, Inc.* v. *Olson, supra.* This argument lacks factual and legal merit. The evidence presented to the

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*The SEC's brief does not argue that the Rights Plan violates the Constitution or federal law.

**It is hardly surprising, therefore, that plaintiffs can do no better than to reach back to the nineteenth century (POB 47) for their only "authority." Both cited cases, however, actually stand for the proposition, which has nothing to do with this case, that a state is *permitted* to authorize private parties to construct bridges over, or dams across, navigable waters within its jurisdiction unless and until Congress intervenes and supersedes that authority. *Cardwell* v. *American Bridge Co.,* 113 U.S. 205 (1885); *Wilson* v. *Black Bird Creek Marsh Co.,* 27 U.S. 245 (1829). Congress has made the express determination *not* to supersede state regulation of the issuance of securities by private corporations. *See* 15 U.S.C. §78bb; *Edgar* v. *Mite Corp., supra,* 457 U.S. at 641. Nor does such regulation violate the Commerce Clause. *Hall* v. *Geiger-Jones Co.,* 242 U.S. 539 (1917).

Vice-Chancellor demonstrated that the new Household preferred stock underlying the Rights is a true preferred stock that enjoys dividend and liquidation rights that are superior to those of the Household common stock. See PX 191 at H 421-22, A726-27. Similarly, the Rights are instruments that, upon satisfaction of their terms and conditions, entitle the holder to purchase shares of the new series of preferred stock at the stated exercise price.* The Rights have been accepted for listing by the New York Stock Exchange and have therefore satisfied that Exchange's stringent listing standards, as the lower Court noted (DX 23, B866-69; Troubh VIII 35-40, B559-64; Op. 10, B12).

The fact that the Rights are currently "out of the money" in no way proves that they are "sham" securities (POB 36). They were specifically priced to reflect the *long-term* value of an equity interest in Household, so that by definition their price would not bear any necessary relation to current market. The record shows that the directors' judgment of *long-term* value was reasonable. Indeed, as the lower Court observed (Op. 39, B41), plaintiff Moran's own estimate that Household had a *present* "break-up" value of $52 per share demonstrated that the Board's selection of a $100 per share value ten years down the road was "not without economic justification."

Telvest has no application here, whatever, its precedential weight on its own facts.** At most, *Telvest* stands for the proposition that a

*Plaintiffs' contention (POB 36-37) that the distribution of the Rights as a dividend was a "sham" because the Rights do not represent a distribution of earnings is unsound. The distribution of the Rights was no more a "sham" than any declaration of a stock dividend or a stock split—neither of which represents a distribution of earnings and both of which merely increase the number of shares representing ownership of the same underlying assets.

**The precedential value of *Telvest* is questionable. Chancellor Brown himself has stated that, while he believes "that that decision was a proper one on its facts," it "[is] an unreported decision on an emergency injunction application" that was, by necessity, prepared "hastily." *National Education Corp.* v. *Bell & Howell Co., supra,* slip op. at 5, 9 (Exhibit S). Moreover, as the lower Court noted (Op. 38, B40), one of the principal alternative bases for the decision—namely, Chancellor Brown's conclusion that a board could not amend the certificate of incorporation by board resolution pursuant to a "blank check" stock power—was promptly overruled by the General Assembly in a clarifying amendment to DGCL §151(g).

board cannot employ its power under a certificate of incorporation to create a new class of preferred stock that is indistinguishable from the existing common stock except for a special feature designed to alter voting rights to the disadvantage of an existing substantial shareholder. Unlike the securities involved in *Telvest,* the Rights have no voting power and do not affect the voting rights of any Household shareholder.

As the trial Court noted (Op. 38, B40), Chancellor Brown's later opinion in *National Education Corp.* v. *Bell & Howell Co., supra* (Exhibit S), sheds further light on the meaning of *Telvest.* That case concerned the legality of a so-called "poison pill" preferred stock with special voting and redemption rights. Unlike the "preferred" stock at issue in *Telvest,* however, the Bell & Howell preferred also enjoyed certain fixed dividend, liquidation and other rights not enjoyed by the common stock. Chancellor Brown *refused* to enjoin issuance of the Bell & Howell preferred stock, finding that the plaintiff had failed to demonstrate probable success on the merits. The Chancellor expressly confirmed that *Telvest* turned on the facts that the "preferred" stock at issue there "was nothing more than an attempt by a board of directors, by resolution, to change the existing voting rights of the common shareholders without their consent so as to make a hostile acquisition of the corporation more difficult to achieve," and, moreover, was an "action taken in direct response to an ongoing hostile takeover attempt." Slip op. at 10.

Chancellor Brown has thus made clear that his decision in *Telvest* does not condemn the issuance of every security designed to protect shareholders against the dangers of an unfair takeover. *Telvest,* whatever its limited precedential value, simply has no application to a pre-offer measure such as the Rights Plan that has economic substance and does not affect voting rights at all—much less alter voting rights to the disadvantage of an existing substantial shareholder.

* * *

Plaintiffs' attempts to have this Court engraft limitations upon DGCL §157 should be rejected. If §157 is to be amended, that is the province of the General Assembly, not the courts. As this Court stated in rejecting another plaintiff's invitation to rewrite a section of the General Corporation Law:

> To attempt to write into the law a limitation of this sort would inevitably create uncertainty in its application and invite litigation. If the statute is to be limited in its scope as a matter of law, the legislature must determine the limitations.
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> —*Adams* v. *Clearance Corp.*, Del. Supr., 121 A.2d 302, 306 (1956)

This bed-rock principle is particularly apposite here since plaintiffs' arguments run counter to Delaware's long-established practice of construing the General Corporation Law to provide maximum flexibility to directors. *E.g., Baker* v. *Providence & Worcester Co.*, Del. Ch., 364 A.2d 838, 848 (1976), *rev'd on other grounds,* Del. Supr., 378 A.2d 121 (1977) ("great flexibility . . . is generally a salutary feature of our corporation law" which must "give way [only] to the manifest language of the statute"). *See also* E. Folk, *The Delaware General Corporation Law,* at xii (1972). The need for flexibility with respect to takeovers was clearly shown in the record below. As Higgins testified, for example, the Rights Plan is only one of many mechanisms developed in an area that is dynamic. There has been an "evolving potpourri" of strategies devised on behalf of both bidders and target companies (Higgins VII 16-17, 35-39, 51, 187, B387-88, 405-09, 421, 501). Boards of directors need flexibility to be able to respond appropriately to the constantly changing tactics of bidders. Shareholders of Delaware corporations would not be benefitted if directors' discretion were restricted as plaintiffs want.

The determination of the Chancery Court that the Household Board acted pursuant to statutory authority in adopting the Rights Plan and did not issue "sham" securities was amply supported in fact and law. It should be affirmed.

III. The Household Rights Plan does not violate any statutory or common law right of the plaintiffs.

The Chancery Court correctly held that the Rights Plan does not violate any statutory or common law right of plaintiffs. Their arguments to the contrary are without merit.

A. Standard and Scope of Review

Whether the Rights Plan operates in such a manner as to violate any statutory or common law rights of the plaintiffs is a mixed issue of fact and law. Accordingly, the standard and scope of review to the applied to this issue are as stated in Argument I A, *supra.*

B. The Rights Plan is Entirely Lawful.

Contrary to plaintiffs' claims, the Rights Plan does not violate any statutory provision relating to the right of alienation of Household common stock, or violate any other rights of plaintiffs.

1. The Rights Plan does not restrict the free alienability of Household stock.

Plaintiffs' argument (see POB 79-82; IOB 16-19) that the Rights Plan illegally restrains the alienation of Household stock in violation of DGCL §202(b), by supposedly deterring all tender offers, lacks factual and legal merit. As the trial Court correctly held (Op. 44-45, B46-47), nothing in the Rights Plan restricts the alienability of Household common stock.

DGCL §202(b) regulates restraints upon alienation by setting forth the requisites for a valid "restriction on the transfer or registration of transfer of a security of a corporation." DGCL §202 describes the kinds of restrictions on transfer that are permissible, *i.e.,* rights of first refusal, buy and sell agreements, consent restrictions, prohibitions on transfer to designated persons (if not "manifestly unreasonable"), and other "lawful" restrictions. The purpose of DGCL §202 is to "substantively validat[e] a wide variety of stock transfer restrictions" in a manner consistent with the Uniform Commercial Code provisions respecting the negotiation of investment securities. E. Folk, *supra,* at 197.

As used in DGCL §202, the phrase "restrictions on the transfer of securities" refers to restrictions on the transfer of title to the securities and the attendant rights that the securities represent. Nothing in the Rights Plan even purports to impose any such restriction. Adoption of the Rights Plan has had no effect whatever on the negotiability of Household shares: a willing seller can today sell, and a willing buyer can today buy, shares of Household just as he could prior to adoption of the Plan. Indeed, as Jensen conceded, Household shares have remained freely transferable since the adoption of the Rights Plan (Jensen V 86-87, B254-55), and Household shares have in fact continued to trade on the New York Stock Exchange.*

The authority that plaintiffs offer on their DGCL §202 argument is inapposite. The bylaw challenged in *Joseph E. Seagram & Sons, Inc.* v. *Conoco, Inc.*, 519 F. Supp. 506 (D. Del. 1981), expressly provided that certain transfers of shares would "be void and shall be ineffective as against the corporation," and therefore concededly imposed a restriction on transfer within the meaning of the statute. *Id.* at 508, 513. The only question addressed by the court was the narrow one of whether the restriction applied to shares issued prior to, but represented by certificates issued after, adoption of the bylaw. The court held that the restriction was not binding on those shares, a ruling which is totally irrelevant here. It was in this context that the court referred to "restrictions" that circumscribed the "market for selling Conoco stock." Indeed, as is clear on a reading of the entire paragraph from which plaintiffs have cropped these words (see POB 80), there is no basis for plaintiffs' attempt to create the erroneous impression that *Seagram* has some bearing upon the legality of devices, such as the Rights Plan, which do *not* impose direct restraints upon alienation (*see* 519 F. Supp. at 513).

In essence, plaintiffs are arguing that corporate action which may deter the purchase of shares by a potential acquiror is tantamount to a statutorily prohibited restriction on transfer. Plaintiffs' argument is not only unsupported by authority but, as the Court below observed (Op. 44, B46), is also *contrary* to the numerous precedents recognizing the legitimacy of defensive measures taken by target companies to defend against takeovers. Those measures, if successful, may have the effect of decreasing the universe of interested buyers

*The absence of any adverse impact on the negotiability of Household shares is also evidenced by the fact that the volume of trading in Household stock has continued at substantial levels at all times since adoption of the Plan (PX 326, B741-42), and at price levels *above* those prevailing before its adoption (DX 27, B920; Exhibit I).

of the target company's shares and thus arguably "restrict" the alienability of those shares. Yet there is no authority that such an effect contravenes DGCL §202.*

2. Adoption of the Rights Plan did not constitute "inequitable conduct."

There is no factual or legal basis for plaintiffs' claim (POB 60-63) that adoption of the Rights Plan constituted "inequitable conduct" by supposedly insulating the Household Board from effective proxy challenge. At best, as the trial Court concluded, plaintiffs' proxy-related objections to the Rights Plan were "speculative," "strained" and "conjectural" (Op. 46, 47, 48, B48, 49, 50). Contrary to plaintiffs' claim, the evidence adduced at trial demonstrated that the Rights Plan does not insulate the Household Board from an effective proxy challenge and, indeed, that plaintiffs' proxy claims bear little relationship to reality (see pp. 29-34, *supra*). Plaintiffs' reliance upon the decisions in *Schnell* v. *Chris-Craft Industries, Inc.*, Del. Supr., 285 A.2d 437 (1971), and *Lerman* v. *Diagnostic Data, Inc.*, Del. Ch., 421 A.2d 906 (1980), is misplaced.**

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*The charter provision challenged in *Greene* v. *E.H. Rollins & Sons, Inc.*, Del. Ch., 2 A.2d 249 (1938), (POB 81), like that in *Seagram*, expressly provided that shareholders' "rights . . . to dispose of the shares . . . shall be subject to . . . restrictions" (*id.* at 250). This Court invalidated one of those "restrictions" which purported to grant the corporation the right to repurchase the shares at book value and thereby prevented shareholders from transferring title to anyone else (*id.* at 253-54). *San Francisco Real Estate Investors* v. *Real Estate Investment Trust of America*, 701 F.2d 1000 (1st Cir. 1983), (POB 81), involved a direct restraint upon alienation in violation of a real estate investment trust's Declaration of Trust. There, the First Circuit determined that a bylaw purporting to prohibit any person from acquiring more than 9.8% of the shares of a real estate investment trust, and providing that shares held in excess of the 9.8% limit would not be entitled to voting rights or dividends, could not be enforced because the plaintiff had shown a probability of success on the merits of its claim that the bylaw violated the Declaration of Trust.

**The intervenor's ERISA "claim" (IOB 50-53) is also premised on "entrenchment" contentions. Her discussion, however, is totally baffling. She cites a judicially-untested administrator's opinion for the proposition that certain

(Footnote continued on following page)

The evidence demonstrated that the Rights Plan is not remotely comparable to management's attempt in *Schnell* to impede a proxy challenge by manipulation of the corporate machinery. There, the Court found that management's last-minute change of the regularly scheduled annual meeting date had been made "for the purpose of perpetuating [management] in office; and, to that end, for the purpose of obstructing the legitimate efforts of dissident stockholders . . . to undertake a proxy contest." 285 A.2d at 439. Management's actions were invalidated only after the Court found on the evidence presented that management's actions were undertaken for an improper and self-interested purpose. Furthermore, management's actions had made it virtually impossible for the plaintiffs to wage a successful proxy fight. As shown above, that is not remotely the record in the case at bar.

The decision in *Lerman* v. *Diagnostic Data, Inc., supra,* is likewise inapposite. There, management rendered it *literally* impossible for dissidents to mount a challenge by first creating a rule that non-management nominations for board positions be filed 70 days prior to any meeting of stockholders and then giving only 63 days' notice of the meeting. Management's purpose was obviously to avoid a proxy contest and its actions entirely disabled the stockholder from engaging in such a contest to elect his own nominees. No such situation is presented here. Plaintiffs have not shown, and cannot show, that Household's predominantly independent Board of Directors has in

(Footnote continued from previous page)

changes Household made in employee benefit plans were unlawful but then concedes that, as the lower Court ruled (Op. 50, B52), the Delaware courts lack jurisdiction over ERISA claims. She contends that the Household Board failed to consider the legality under ERISA of the benefit plan amendments it approved, but the testimony at trial was to the contrary (Clark VI 250, B378). She asserts that Household acted for purposes of "entrenchment," but the trial Court's conclusion that she had failed to prove that claim (Op. 52, B54) was supported by abundant proof that the benefit plan amendments she attacks were designed to "improve morale of the people of the company [by] giving them an opportunity to have a voice in what their [company's] potential ownership was" (Kartalia IX 145-46, B636-37; see also Whitehead VI 55, B343). Indeed, even Moran voted in favor of the benefit plan amendments because he felt they were a "step for democracy for [the] shareholders who were within the plan" and "not . . . anti-takeover in nature" (Moran I 202, B98, II 87-88, B108-09).

any way sought to perpetuate itself in control, or to deal inequitably with a particular proxy contest, or to preclude a proxy contest altogether.

3. There is no "right" to a tender offer.

The common thread running through all of plaintiffs' arguments is the notion that the Rights Plan unlawfully abridges some alleged "fundamental right" of the Household shareholders to entertain all hostile tender offers, even coercive, two-tier offers. This notion has no evidentiary or legal basis.

The evidence shows that the Rights Plan will *not* prevent the shareholders of Household from transferring control of the company in a tender offer (see pp. 22-29, *supra*). The evidence also shows that the Rights Plan leaves Household attractive to acquirors, unlike other defensive measures which are "much more dramatic . . . to the company . . . [and] to the value of the remaining securities than what has been done or contemplated here" (Higgins VII 80, B444).

But beyond the lack of an evidentiary basis, plaintiffs' argument has no legal substance. Neither plaintiffs nor the *amici* can cite any statute or judicial authority that creates or recognizes any legal "right" of the sort they advocate. Indeed the relevant precedents are to the contrary. Thus, one court has recognized that there is no right of a shareholder to make a tender offer:

> [Plaintiff] suggests that it has suffered "special injury" in that [the corporation] is allegedly attempting to frustrate its right to acquire additional shares by means of a tender offer. . . . *However, the "right" to make a tender offer is not a contractual right owed to the shareholder by the corporation.*
>
> —*Crane Co.* v. *Harsco Corp.*, 511 F. Supp. 294, 304 (D. Del. 1981) (emphasis added).

And in *Gearhart Industries, Inc.* v. *Smith International Inc., supra,* the Fifth Circuit squarely rejected the argument that the issuance of "springing warrants" to impede hostile tender offers improperly interfered with a "right" of shareholders to *receive* a tender offer. 741

F.2d at 724; *see also Enterra Corp.* v. *SGS Associates, supra* [Current] Fed. Sec. L. Rep. (CCH) ¶91,919, at 90,541, 90,543-45.

* * *

In the final analysis, plaintiffs' arguments, and those of the *amici*, rest upon their policy views, not Delaware law. Plaintiffs have failed to articulate any basis for converting their policy preferences into judicial doctrine.

Unlike plaintiffs, defendants do not ask this Court to determine questions of policy. Rather, defendants ask this Court to apply settled standards of review and to affirm the judgment of the Chancery Court which was based on a trial record that clearly established that the Household directors acted properly and in good faith to protect the interests of the Household shareholders.

Conclusion

For the foregoing reasons, the judgment of the Court of Chancery should be affirmed.

Respectfully submitted,

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