IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

IN AND FOR NEW CASTLE COUNTY

JOHN A. MORAN and THE DYSON-KISSNER-MORAN CORPORATION,

Plaintiffs,

v.

HOUSEHOLD INTERNATIONAL, INC., a Delaware corporation, DONALD C. CLARK, THOMAS D. FLYNN, MARY JOHNSTON HEAD, 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.

Civil Action No. 7730

CONFIDENTIAL - FILED UNDER SEAL

HOUSEHOLD INTERNATIONAL, INC.,

Counterclaim-Plaintiff,

v.

JOHN A. MORAN, CHARLES H. DYSON and THE DYSON-KISSNER-MORAN CORPORATION,

Counterclaim-Defendants.

PLAINTIFFS' PRE-TRIAL MEMORANDUM OF POINTS AND AUTHORITIES

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DATED: September 17, 1984

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PRELIMINARY STATEMENT

This case presents the Court with a new anti-takeover device called a "Poison Pill Right." It is admitted that the device was designed and adopted to make takeovers not approved by the Board of Directors significantly more difficult and expensive and, thus, to forestall tender offers for Household International, Inc. ("Household" or the "Company").

The device was designed to be complicated because confusion among potential acquirors as to how it works was viewed as useful in itself in deterring tender offers. The Poison Pill Right Plan (the "Plan") was adopted by Household's Board on August 14, 1984 over the objections of directors John Whitehead, Co-Chairman of Goldman, Sachs & Co. ("Goldman Sachs"), Household's investment banker, and John Moran, who represents the Company's largest shareholder group with over $130 million invested in Household. Each is a sophisticated, experienced businessman. Both asked that the Board defer action on the Plan until it could be further considered. Neither would claim to understand the Plan or all of its ramifications. There is overwhelming evidence that the other directors also did not have sufficient information to understand how the Plan worked and, had been advised that Delaware counsel had opined on the legality of the entire Plan when, in fact it had not, and therefore could not have exercised informed business judgment in adopting the Plan.

The essential elements of the Plan are as follows:

1. Household announced and, on August 28, 1984, distributed a dividend to its common shareholders of one non-voting, non-dividend paying right (a "Right") per each common share. The Rights are currently scheduled to expire in ten years.

2. The Rights are currently non-exercisable and may never become exercisable. The Rights, when exercisable, entitle the holder to purchase 1/100th of a preferred share of Household stock for an initial exercise price of $100. As 1/100th of a preferred share carries the same dividend rate as the Household common stock (now trading for about $30), the exercise of Rights into preferred shares for $100 makes no economic sense. This was a conscious design. If Rights were converted into preferred shares, the Poison Pill device which inheres only in the Rights would be given up. Thus, the preferred was designed intentionally to be out-of-the-money. Thus, the Rights have no present economic value.

3. The Rights become exercisable if (a) a tender offer for 30 percent or more of Household's common shares is made (the "30 Percent Offer Trigger"); or (b) if one person or group acquires 20 percent of Household's common shares or the right to vote or acquire 20 percent of such shares pursuant to any arrangement, agreement or understanding

(the "20 Percent Triggering Events"). These are all events thought to pose a threat to management's continued control of Household.

4. The Poison Pill aspect of the Rights, which is the sole reason for their creation, operates as follows. If Household is acquired in a merger or other business combination after the Rights became exercisable, the Rights may be exercised to purchase $200 worth of the acquiror's common stock for $100. This is called a "poison pill" provision because it forces the acquiror to sell his common shares to Rights holders at one-half their value, thereby materially and adversely affecting the economic interests of his own stockholders. An offeror who proceeded with a 100 percent takeover in the face of this Poison Pill would cause massive dilution to his company's value and reduce its earning per share. No prudent management could do that; rather the acquisition of Household would be abandoned -- or, more likely, never begun.

5. The Rights may not be redeemed by action of Household's stockholders. Household's Board may redeem them at a price of $.50 per Right prior to the occurrence of a 20 Percent Triggering Event. Thus, if the Board is in favor of a takeover proposal, it can foster it by redeeming the Rights; if the Board wishes to discourage the proposal, it

can refuse to redeem the Rights and force the offeror to swallow the Poison Pill if it wishes to proceed. No offeror would willingly suffer that penalty.

6. Significantly, once a 20 Percent Triggering Event has occurred, until the Rights have expired a 100 percent takeover of Household is virtually impossible. Although the Rights by their terms expire in 1994, they can be amended by the Household Board, without stockholder approval, to extend their term or otherwise change them as long as the Rights agent (a bank chosen by Household) agrees. Thus, by way of example, the Poison Pill could be changed at any time to increase the value of the acquiror's stock the Rights holder can buy from two times the exercise price to twenty or even two hundred times that price, or to extend their life indefinitely, all without a stockholder vote.

* * *

The Poison Pill Rights were designed and are effective to create very substantial impediments to any takeover of Household. They shift the decision on whether to accept a tender offer from the stockholders, in whom it has heretofore resided under Delaware and federal law, to the Board. This effect is admitted by Household's witnesses and documents.

There have been prior attempts to interpose boards between tender offerors and stockholders. Numerous states adopted so-called anti-takeover laws which permitted boards of directors to interfere with tender offers by requiring hearings before state agencies. These statutes delayed some tender offers and forestalled others. They were struck down in 1982 as unconstitutional by the United States Supreme Court.

There are a number of vices in shifting the decision to the Board and away from the stockholders. As a legal matter, the Delaware General Assembly has determined that the board of directors has no role in approving a tender offer. That right resides solely in the stockholders. In contrast, a merger or sale of substantially all of the corporation's assets must be approved first by the board and thereafter by the stockholders. This legislative choice is changed by the Poison Pill Rights device.

Similarly, Congress and the Securities and Exchange Commission have designed a federal scheme of regulation for tender offers which grants stockholders the exclusive decision-making role. Management may advise but cannot decide. That federal policy decision is also reversed by this device.

The device is unnatural. It does not result from arm's-length negotiations with a third party or from a stockholder vote. It is purely a paper creation. It is created by a "dividend" which confers no value on the stockholders and thus is not really a dividend. The fraction of a preferred share a Right holder can buy is so far 'out-of-the-money' as to make it illusory. The Right itself only exists as a springboard for the Poison Pill. The Delaware General Assembly, moreover, has not authorized rights convertible into some other corporation's common stock. Thus, there is a non-dividend dividend of an illusory right to buy preferred stock, all in order to force an unidentified (and presumably unwilling) company in the future to sell its shares at half price.

The most dangerous aspect of the scheme is the ability of the board to unilaterally create rights at any time with whatever anti-takeover terms the board wishes. If this scheme is sanctioned by this Court, stockholder votes on charter amendments would never again be necessary to enact shark repellents. This surely was not the use the Delaware General Assembly contemplated for dividends or rights when it authorized directors to issue them. The General Assembly did not intend to permit directors to change the rules of takeovers for Delaware corporations at any time without the necessity of legislative action or stockholder vote. This extraordinary power to change the rules at will is intended to and will insure that offerors will not proceed without the approval of the target company's board.

The Rights are an effective anti-takeover device. Tender offers are very expensive undertakings. The transaction costs alone can easily exceed $10 million. In some cases they have exceeded $25 million. Household, with 60 million common shares on a fully diluted basis, has a market value of more than $1.8 billion. Only a limited number of companies in the world could afford to buy Household or would be willing to risk $10-$20 million trying. If Household is permitted by this Poison Pill plan to drastically reduce the number of companies willing or able to take it over, the device will have been successful, and its stockholders will pay the price.

The device makes Household a much less attractive takeover prospect. Because a 100 percent transaction cannot be accomplished without the acquiror suffering unacceptable dilution through operation of the Poison Pill, any company which wishes to have access to the assets, cash flow or earnings of Household to help retire its acquisition financing will be eliminated as a prospective offeror. The number of companies able to compete in an open market auction for Household will thus be dramatically reduced.

Paradoxically, Household apparently now intends to argue that this anti-takeover device is not really very effective at all. Several of its directors say that any tender offeror need only agree to pay a price the Board approves and the Board will redeem the Rights. Since tender offers are a method by which the law allows acquirors to take offers directly to stockholders when boards prove recalcitrant, the elimination of this tender offer function hardly seems an ineffective anti-takeover device.

The Household directors also say that if they do not approve an offer, the offeror can solicit consents to remove them from office or run a proxy contest to replace them and then redeem the Rights. Thus, a prospective offeror is invited not only to incur the millions of dollars in expenses necessary to make its tender offer, but also to incur additional millions and months of delay running a proxy contest before it can buy shares which Household's stockholders may wish to sell immediately. Few, if any, offerors facing that prospect would proceed; rather, another company less resembling a porcupine will be pursued. That result works to the benefit of no one but management.

These obstacles make the Rights Plan an effective anti-takeover device; when they are combined with the Board's ability unilaterally to expand or modify these obstacles by the amendment of the Rights or the issuance of new rights, it becomes inevitable that prospective offerors will forget their designs on Household.

The Rights have yet another troublesome aspect. Once a 20 Percent Triggering Event occurs, the Board's ability to redeem the Rights is lost forever. At that point, because of the Poison Pill, it is impossible as a practical matter for the Board to effectuate a merger of Household with anyone, even if the price offered is unquestionably fair, because the Rights also have to be paid off. With 60 million Rights outstanding, that adds $6 billion to the acquisition cost.

The non-redeemability of the Rights after a 20 Percent Triggering Event will preclude major stockholders from joining together to replace management, one stockholder from buying enough shares to have a substantial chance of replacing management, or any person or group from obtaining the power to vote over 20 percent of the shares pursuant to a proxy or some other arrangement or understanding. These are all 20 Percent Triggering Events. Thus, the Rights severely interfere with the exercise of voting rights by Household's stockholders and with their ability to replace management through a proxy contest.

Although the Rights as constituted are complicated and are subject to infinite variation, their gross impact on Household's stockholders was quickly perceived. In addition to Moran, who branded them illegal and anti-stockholder at the

August 14 meeting, a number of other stockholders, large and small, have written Household to complain about the Rights. Such stockholders have included long-term holders as well as financial institutions. They all have the same complaint. Their right to receive and consider tender offers has been interfered with and they were given no chance to vote on the matter.

There is good reason why the Household Board is unwilling to permit the Company's stockholders to vote on the Poison Pill. This year the Board was advised that the Household stockholders had been surveyed to see if they would vote for a milder anti-takeover device, a fair price charter amendment. The report was negative.

The Household stockholders have no other recourse but this Court. Last week Moran introduced a resolution before the Household Board that the Rights Plan be presented to Household's stockholders for ratification or rescission. It failed for want of a second.

NATURE AND STAGE OF THE PROCEEDINGS

On August 17, 1984, plaintiffs John A. Moran, a Household director of long standing, and The Dyson-Kissner-Moran Corporation ("DKM"), Household's largest stockholder, filed this action to declare the Rights plan void and permanently enjoin Household from pursuing it or anything like it.

On September 10, defendants answered and filed a Counterclaim. They denied the material allegations of the complaint and asserted affirmative defenses. We have since been told that the defendants do not intend to "press" the Counterclaim at trial. This course is no surprise because, as one of the Household witnesses testified, Household's shocking and baseless attack on Moran derived from "Mr. Clark's surmising." (Kartalia 31) The Counterclaim allegations are unsupported by a scintilla of record evidence.

Trial is scheduled for September 24, 1984. This is Moran's and DKM's pre-trial memorandum.

STATEMENT OF FACTS

The Rights Plan culminates a long history of Household management's study of measures intended to prevent a change in control of Household. The Plan is best understood in the context of that history.

The Household Management's
Fear of "Unwanted Takeover Bids"

Household management has historically displayed a seige mentality with regard to unsolicited bids for control of "their" company. Management calls offers to Household stockholders, whether in their interest or not, raids or "challenge[s]." (App. 15 at H5971)* Anyone with the temerity to make such an offer is called a "raider." (App. 16 at H5974) Household, in such a scenario, is a "target." (Id.) The "raider's" activities are called "subversion" by management's special takeover counsel (App. 17 at H1557) or a "dawn raid." (Id. at H1562) Household executives keep lists of key management ready to respond to raids on documents called "war lists." (Id. at H1557)

At least as early as 1974, Household was considering "pre-bid defensive measures" (App. 18 at H5960) aimed at reducing "vulnerability to a takeover" and providing "takeover protection." (App. 16 at H5976) These measures included

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* All documents are incorporated as exhibits in the Appendix to this memorandum. For ease of reference, documents are also identified by title where possible.

classic "shark repellent" charter amendments (all of which require a vote of stockholders to adopt) such as staggered boards of directors, removal of directors only for cause, limitations on special shareholder meetings, a "supermajority" vote requirement for mergers, and a "fair price" provision for non-tendering stockholders. (Id. at H5976-77)

Household's documents dwell little on the question of maximizing stockholder returns should an offer be made. Rejection of the proposals is a foregone conclusion. For example, the Household plan of defense recited:

> Once [not "if"] the decision has been made to reject a tender offer, the target company can consider a variety of defensive actions.

(Id. at H5981)

By November 1982, Household's examination of defensive alternatives had progressed to such a degree that defendant Donald C. Clark, now Chief Executive Officer of Household, was temporarily satisfied that in the economic climate then prevalent Household had sufficiently prepared itself to "move quickly enough to respond to any challenge." (App. 15 at H5973)

The Board's Initial Approach to Takeover Defense -- The Fair Price Charter Amendment

With the quickening of merger activity in late 1983, Household's management began a thorough examination of whether it should seek its stockholders' approval of an amendment to its the certificate of incorporation, commonly called a "fair price" amendment. (Upton 123-124)*

Such an amendment is designed to ensure that, in two-tier offers, second-tier sellers are paid at least the highest price paid during the first-tier unless the board decides otherwise.** (James 50-51; Upton 121-23) Since such a provision alters the balance between the stockholders and the board and may deter certain offerors from making any offer at all, fair price amendments to the certificate of incorporation must be submitted to stockholders, supported by full disclosure of all of their favorable and unfavorable aspects, and may only be put into effect if a majority of the stockholders favor it. 8 <u>Del. Ch.</u> § 242.

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* Reference to deposition testimony is by the deponent's name followed by the applicable page number. All such deposition testimony is included in the Appendix, arranged alphabetically by the names of the deponents.

** A two-tier offer contemplates first, the making of a tender offer for a company's stock and second, a statutory merger to eliminate non-tendering stockholders. There are sound business reasons, such as tax and finance matters, which commonly lead offerors to seek 100 percent of a company's stock in this manner. None of the Household directors have testified that such two-tier offers are necessarily undesirable for stockholders, even though the consideration paid stockholders in the first and second steps may vary in kind and value. In this regard, federal law requires an offeror to fully inform stockholders about its second-step plans at the time a tender offer is commenced. Delaware law further affords stockholders, who are dissatisfied with the second-step consideration, the right to a statutory appraisal of their stock interest.

The Household Board Discovers That
It Cannot Push the Fair Price Shark
Repellent Past Its Stockholders

An *ad hoc* committee of the Board was formed to consider the "advisability of asking Household's stockholders to approve a fair price provision with respect to takeover attempts." (App. 19)

Management and the *ad hoc* committee concluded that the fair price amendment was unlikely to pass. In connection with the examination of the fair price amendment, the committee consulted with the proxy solicitation firm of Georgeson & Company ("Georgeson") and conducted an informal survey among Household's largest institutional stockholders. (App. 20) In February 1984, Clark informed the committee that the reaction of Household's largest institutional stockholders had been "uniformly negative" toward the concept of a fair price charter amendment. (*Id.*) That is, *every single large holder* of Household stock whom Household management approached stated that they would vote against the provision.

Two Household executives warned in a March 6, 1984 memorandum that if the proposal were to fail "it is essentially an 'announcement' that *our shareholders would be receptive* to a takeover. Failure to adopt the fair price provision would also be a public-relations disaster...."

(Id. (emphasis added)) Thus Household management's view of tender offers had become one of a conflict between "us" (management) and "them" (the stockholders). Management, for whatever motives, did not want unsolicited tender offers. On the other hand, Household's stockholders, had sent a clear signal that they could be expected not to support management in that position. At the same time, the Household executives warned that a fair price provision "would not prevent a takeover of Household by a determined and well financed bidder." (Id.) Accordingly, they concluded, the benefits of a fair price provision (i.e., stockholder protection, without an effective management entrenchment component) would not exceed the risks (i.e., encouragement of the very result which the amendment was designed to avoid -- a takeover of Household). (Id.)

Two days later, Clark reported to his fellow committee members that because of the "short period of time" in which to solicit proxies, the timing was not right for submission of the fair price charter amendment to Household's stockholders that year. (App. 22 at H6094) Clark's recommendation was adopted by the executive committee of Household on March 13, 1984 (App. 23 at H1538), and by the full Board at its meeting on May 8, 1984. The Household Board did not swallow Mr. Clark's "lack of time" rationale for the decision.

The Board well understood that the real reason the amendment was not to be submitted to the stockholders was because it might not pass:

> Q. But, was it not your understanding that the committee determined that for whatever reason, if the fair price amendment were submitted to the stockholders, at the 1984 meeting, the outcome of the vote was in doubt; that is, it was questionable as to whether it would have passed?
>
> A. I think our feeling was it would be relatively close, but it would have passed, but it wasn't worth the risk.
>
> Q. The risk of what?
>
> A. Of not passing.

(James 40-41)

Clark himself briefed the Board on May 8 that the decision not to submit was made because "THE OUTCOME WAS TOO QUESTIONABLE." (App. 24 at H370)

Household Receives a "Pass" --
<u>The Murchison Buy-Out Approach</u>

Six days after the recommendation to abandon the fair price amendment had been approved by the Board, Clark received a letter from Ralph J. Bachenheimer, Executive Vice President of Corland Corporation, writing on behalf of a group including the Murchison family of Dallas, Texas, requesting a meeting with Clark "to discuss a matter which might be of mutual interest." (Clark 41-43; App. 25) In fact, Bachenheimer wanted to talk about a leveraged buy-out of Household.*

Clark reported the Murchison overture to the Board. (Rauch 46-47) On June 11, 1984, nearly a month after getting the letter, Clark called Bachenheimer and told him "we have absolutely no interest in talking about an LBO or any other change in current ownership of HI." (App. 25 (emphasis added); *see also* Clark 43)

In the interim, on May 24, 1984, Household management met with lawyers from the New York firm of Cadwalader, Wickersham & Taft to discuss leveraged buy-outs. (Clark 111) Clark said at his deposition that the meeting had nothing to do with Household management or an LBO involving management, but rather was solely intended to brief him on the Bachenheimer contact. (Clark 115) The notes for the May 24 meeting show evidences of the real concern management had with regard to a leveraged buy-out:

> difficulty of effecting:
> Co. put up for auction
> Future of mgt. -
> if competing bid succeeds, you are out;
> wide disclosure
> "10-K" on every lender's desk to
> obtain financing --
> leads to shopping the deal
> Announces Co is for sale.

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* In discussing "a leveraged buy-out" or "LBO" we shall be referring to "the most common of going-private schemes, the so-called leveraged buy-out [in which] the management borrows enough cash [on the credit of the company's assets] to buy out the shareholders." (App. 26 at H4011)

(App. 27 (emphasis added)) This is but one of several documents that demonstrate management's concern that any offer made to its stockholders, even one by management itself, might well lead to a loss of management control of the company, because if a competing bid succeeds "you are out." Or, as an article from Fortune magazine which was included in the Board book for the August 14 meeting said, "Oops! My Company is on the Block." (App. 26 at H4009)

Clark's Request to Moran to Close Ranks -- Moran's Leveraged Buy-Out Analysis

In a telephone conversation with Clark on May 18, 1984, Moran told Clark that DKM was buying about one-half million shares of Household stock as an investment. (Clark 118-19) Moran also told Clark that Bear, Stearns & Co., a New York investment banking firm, had approached DKM and asked whether DKM would sell its position in Household. (Clark 120; App. 28) DKM had declined. (App. 29; Moran 91-92, 101; Clark 120)

During the conversation, Clark told Moran about the Murchison overture, and asked for Moran's help in formulating Household's response. (Clark 121; Moran 97-100) Among the defenses they discussed was a management-led leveraged buy-out, and it was agreed that Clark and Moran would meet later to discuss such a transaction. (Moran 99-100)

Together with other representatives of DKM, which had earlier done some very preliminary analyses of Household, Moran undertook a substantial evaluation of Household from the point of view of a possible leveraged buy-out. (Moran 99-100, 109) Quite secretly, and unknown to any Household director (see, e.g., Osler 131-32), Household management contemporaneously agreed to pay Goldman Sachs $150,000 to perform the same task. (Fahey 13, 15)

On May 29 and July 16, 1984, Moran and other representatives of DKM met with Clark and Rod Dammeyer, Household's Chief Financial Officer. (App. 30; Clark 122-23) At the second meeting, Moran outlined a proposal which contemplated that the Household Finance Division would be sold after the buy-out, and the rest of the Company would be kept by the buyers. DKM provided Dammeyer and Clark with their work product consisting of about twenty pages of analytical work. (Clark 123)

The materials provided by Moran, though still very preliminary, provided some detail. There was no mention of a hostile or "unfriendly" approach. To the contrary, under the DKM analysis a number of members of current Household management would have participated as members of the buy-out group. Clark conceded that the DKM proposal included Household management. (Clark 124) Clark did not report this discussion to the Household Board. There is a contradiction in the record as to why the Board was not told. Moran testified that rather than meeting in the Chicago headquarters of Household, Clark suggested that he come to New York in order to keep the matter confidential from others at the Company and, in addition, told Moran not to discuss it with anyone. (Moran 123) Clark says Moran asked <u>him</u> not to tell the Board. (Clark 132) Since Clark kept his own management/Goldman Sachs study secret from the Board, Moran appears to have the better side of the argument.

Clark and Dammeyer met with Goldman Sachs on July 16. At that meeting Clark asked Goldman Sachs partner Fahey, "How [to] insulate management's buyout from being topped?" They told him the only method was by paying a high price. (Fahey 145; App. 31 at 3)

Clark thereafter told Moran in the July 16 meeting that neither the Board nor management was interested in starting a leveraged buy-out, and to illustrate his point gave Moran a copy of the recently published <u>Fortune</u> magazine article entitled "Oops, My Company is on the Block." The thesis of that article is well summed up in its lead:

> [I]f you really want buyers to come running, announce that you're taking the company private. Then stand back.

(App. 26 at H4009)

Clark's only interest in an LBO was as a defensive maneuver:

> A. Well, I told Moran that as far as management was concerned, I was willing to entertain a program to be ready to react in the event we did get an offer in an effort to top that offer in price and, therefore, benefit the shareholders.
>
> Q. You were willing to work with him, that is with Mr. Moran, on that; is that right?
>
> A. I was trying to convince him, not to initiate the transaction, but to work -- I would be willing to work with him if he took it as a defensive posture, yes.

(Clark 135) Clark's assignment to Goldman Sachs and his remarks to Moran show that Clark wanted the option of a leveraged buy-out in his back pocket as a defensive measure that would preserve management's control should an unfriendly third party open an auction for Household. He did not want, however, to risk putting "his" Company "on the block" (and thereby "risk" gaining a substantial premium over market for his stockholders) by starting the process himself.

In his deposition, Clark called Moran "greedy" and anxious to make a "bundle of money." Of course, the Moran proposal at $35-40 per share would have given stockholders a 40 percent premium over the then market price and by Clark's own testimony, would in all likelihood have achieved an even higher price for them when it was outbid by a competitor who had, as Fortune predicted, "come running."

Pursuant to Clark's request, Moran agreed to consider an LBO proposal only as a contingency plan. He told Clark he would not do anything unless management approved. (Moran 118; App. 32; App. 33)

Clark Fans the Flames of the Directors' Fears of a Hostile Takeover

A management leveraged buy-out is, by definition, a "friendly" proposal which contemplates not only the inclusion of members of current management in the purchasing group but also the approval of the board of directors. Moran had no intent to "go around the board"; his plan required their acquiescence. (Moran 118) Clark, however, behind Moran's back, proceeded to tell the directors of Moran's proposal in such a way as to lead members of the Board to believe that Moran was planning an unfriendly takeover of Household. (Osler 122-23)

Clark did not tell the directors that Moran had disclosed to him DKM's purchases of Household common for purposes of investment. (Rauch 45-46) Clark did not tell the directors that Moran's meeting with Clark resulted from Clark's request for help regarding the Murchison pass. (Rauch 47) Clark did not tell the Board that he agreed to work with Moran and DKM to analyze a management LBO as a defensive measure to an unfriendly third-party offer to acquire Household. (*See* Clark 132, 135) What Clark told the Board was that Moran had proposed a transaction which was not "in the best interest" of the stockholders of Household. (Rauch 53) Clark's recitation persuaded Osler that Moran was "seeking a hostile takeover of Household." (Osler 122-23) Osler testified that he would have voted to defer action on the Plan had Clark not spoken to him:

> A. . . . I felt it was a sense of urgency. John Whitehead happened to be sitting beside me [at the August 14 meeting]. I said to him, "If I hadn't been here last night, I might have voted with you."
>
> Q. What had happened last night, that is the night of the 13th?
>
> A. I told you I had been informed by Mr. Clark of Mr. Moran's activities.

(Osler 109)

The Goldman Sachs Presentation Regarding Household's Vulnerability to a Raid

When it was seeking employment by Household as a member of the "anti-raid" team, Goldman Sachs submitted a report to Household dated May 29, 1984, entitled "Discussion of Raid Preparedness and the Merger and Acquisition Market." (App. 34) In the report, Goldman Sachs touched on a number of factors that made Household "vulnerable to raids." After it was hired for an additional $100,000 fee, Goldman Sachs made the same points to the Board at the August 14 meeting.

As a result of the Goldman Sachs presentation, Household's directors were led to believe that Household was ripe for a takeover. (See, e.g., Upton 139-40; James 155-56) Among the factors pressed upon them which led to that impression were:

- The high percentage of Household stock owned by institutional investors (Upton 139-40, 148-49);
- The low current stock value in relation to recent earnings and prospective earnings (id.);
- The lack of significant insider holdings (Upton 148-49).

Management recognized, however, that their stockholders would not vote for anti-takeover measures in the Household certificate of incorporation. As a result, they began casting about for a device which would accomplish their entrenchment objectives without shareholder approval.

Wachtell Lipton is Retained and
Gives Household Management a War Plan

To provide legal advice, Household management hired the New York firm of Wachtell, Lipton, Rosen & Katz ("Wachtell Lipton"), who provided on June 29, 1984 a "Takeover Response Checklist." (App. 35) This checklist is vivid in its import. It urges secrecy ("No or few notes"), security ("Golden Parachutes ... we continue to recommend ... executive [and] severance agreements..."), solidarity ("Directors must guard against subversion by raider"), stonewalling ("most raiders go away if rebuffed at the outset"), and legal maneuvers ("the antitrust defense is alive and well and in some cases can be a showstopper"). The checklist culminates in the following recommendation. "Warrant Dividend Plan. We believe this to be the best takeover protection. A copy is attached." The warrant dividend referred to in the check list, with minimal changes, is the Poison Pill Right adopted by Household and challenged in this case.

Household's Acts to Deter Takeovers and Entrench Management By Adopting Measures Not Requiring Stockholder Approval

So advised, Household took a number of actions designed solely to deter any offer directed to the stockholders which was not first approved by the Board. In that effort Household:

- Formed a management "team," chaired by Clark, containing "a small group of key officers";
- Prepared the Rights Plan, based on the Warrant Dividend Plan, which Wachtell Lipton had called "the best takeover protection";

- At the August 14 Board meeting, passed a resolution declaring that it was in the stockholders' best interests that Household remain an independent corporation;

- At the August 14 meeting, amended the Company's by-laws to establish (i) a substantial notification period for non-management nominations to the Board or other non-management proposals for consideration at stockholder meetings, and (ii) a substantial minimum time period for the solicitation of written consents to take corporate action under 8 Del. C. § 228;

- At the August 14 meeting, amended Household's employee benefit plans to provide that shares of Household stock held in such plans cannot be tendered to a person making a tender offer for the shares of Household without the express authorization of the individual plan participant for whose benefit they are held;

- At the August 14 meeting, adopted a director's retirement benefit plan, which afforded protection to sitting directors in the event that they were replaced by some action of the stockholders; and

- At the August 14 meeting, adopted the Poison Pill Rights Plan.

The Rights Plan was adopted over the objections of two directors: Moran and Whitehead (the Co-Chairman of Goldman Sachs). The Plan is intended by its authors to have and in fact does have a far greater deterrent effect on takeovers than the fair price charter amendment would have had. Thus by adopting the Plan the Board not only "end runs" a stockholder vote on the fair price amendment but also grants management even more drastic entrenchment protection than they would have received from the fair price amendment.

* * *

Defendants will doubtless argue that their unilateral adoption of the Poison Pill Rights Plan is completely insulated from any scrutiny on its merits by the application of the business judgment rule. Because they were ill-informed, ill-advised and hopelessly confused regarding the operation and effects of the Plan, however, their hasty adoption of the Plan is not entitled to the protection of the rule.

<u>The Director-Defendants' Inadequate Information Regarding the Poison Pill Rights Plan</u>

Household's management provided the directors with information on the Rights Plan by three avenues: (1) a brief, inaccurate summary of its principal terms comprising three pages of the 91-page "Board book" distributed before the August 14, 1984 meeting (App. 26 at H4031-H4033); (2) Clark's presentation to an informal meeting on August 13, 1984 of directors he considered to be particularly loyal;* and (3) the presentation at the August 14 Board meeting.

Prior to their vote to approve the Poison Pill Rights Plan, the directors were <u>not</u> furnished the proposed resolutions concerning the Plan (App. 36 at H4114-H4119) or the Rights Agreement. (App. 37; Clark 96)

The Plan is intended to be complex and confusing; indeed, its authors boast that its very complexity creates "rather complicated situations ... difficult ... to evaluate ... [that] may deter a takeover." (App. 26 at H4031) It is not, therefore, surprising that the directors had only the most superficial understanding of the Plan for which they voted.

<u>The Poison Pill Rights Plan and the Director-Defendants' Fundamental Misunderstanding of Its Terms and Operation.</u>

<u>The Terms and Operation of the Plan</u>

The Plan purports to authorize for Household's common stockholders a "dividend" of one "Right" for each

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* The August 13 meeting appears to have been little short of a sales pitch by Clark to directors he viewed as sympathetic to the Plan and its entrenchment result. Although Rauch intimated that the meeting was an informal, "if you are in town" kind of thing, he himself was called in Nantucket and invited to attend. (Rauch 55-56) Moreover, the fact remains that Moran and Whitehead were not present, nor were they invited. (Clark 99-100) Nor was defendant Evans. Even Clark conceded that it would have been better to have all of the directors in attendance in view of the importance and complexity of the matter to be discussed. (Clark 99)

common share held. Each Right is said to entitle the holder, upon its exercise, to buy, for $100, one hundredth (1/100) of a share of a new series of participating preferred stock. The Right may be exercised only upon the occurrence of either of two types of "triggering events". These are: (i) acquisition by any person of 20 percent of Household's common shares or the right to vote 20 percent of such shares, or agreement by persons holding 20 percent of Household's outstanding stock to act together; or (ii) announcement by anyone of an intention to make a tender or exchange offer for 30 percent of the outstanding Household common stock. (App. 37 at H2187-H2190)

The anti-takeover aspect of the Plan is centered in the "poison pill" contained in the flip-over provision. The flip-over provision of the Right becomes operable when a person who has acquired control of Household in a manner not approved by the Household Board merges or otherwise combines with the Company. Upon such a merger, each Right "flips over" to become a right to buy, for $100 cash, $200 in market value of the common stock of the acquiror (or, if Household is the surviving corporation, $200 worth of Household's participating preferred).* (Id. at H2214)

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* The Rights Agreement provides for adjustment of the exercise price under certain limited circumstances. (App. 37 at H2195, H2199-H2212) For simplicity, all descriptions of the operation of the Rights in this brief are in terms of the original exercise price of $100.

The "poison" in the "pill" thus swallowed by the acquiror is the dilution of its capitalization, which it suffers when the holders of the Rights buy a major portion of his stock for half its market price. As Kartalia noted, by exercising the pill "we can eat the acquiror for 1/2 market value." (App. 38)

The Rights are redeemable by Household's Board for $.50 each at any time before the occurrence of a 20 Percent Triggering Event -- in simple terms, at any time before any person or group obtains the right to acquire, or the right to vote, 20 percent or more of Household's common stock.

The new preferred stock would carry a quarterly dividend of (a) $25 per share or (b) 100 times Household's common dividend, whichever is greater. Thus, under today's conditions, the preferred dividend would be $175 annually (100 times the present $1.75 common dividend) for a yield of 1.75 percent. Since one share of preferred, if outstanding today, could only be bought for 100 Rights and $10,000, the preferred is as Household candidly agrees "out of the money." Since Household's stock, now trading at $30, would have to rise to $100 for the preferred to have life, the preferred is likely to be "out of the money" for some time to come.

The Plan is an artificial construct. It has no financing function and no economic basis. As director Evans testified:

Q. Assuming the rights were exercisable today, is there any economic reason for someone to exercise his rights and acquire the preferred stock?

A. I wouldn't think an economic reason, no.

Q. Is there any other reason one would do ... [so?]

A. I wouldn't think so.

(Evans 94)

The sole purpose of the new series of preferred is to provide a "hat rack" on which to hang the Rights. The purpose of the Plan -- plain, simple and for all intents and purposes admitted -- is to expose potential acquirors (or "raiders," as Household management prefers to call them) to the <u>in</u> <u>terrorem</u> threat of having their capitalization "eaten" for one-half market value. Director-defendant Flynn, a former partner of Arthur Young and Company, testified that the Plan was intended solely as a "deterrent:"

Q. Traditionally, then, rights to purchase stock are intended to provide a vehicle whereby people buy stock, perhaps at a lower price than they are sold ordinarily on the market; isn't that correct?

A. That is correct.

Q. And that's not the function of these rights, is it?

A. That's not the function of this. That's not the primary function.

Q. And, indeed, it would not be a reasonable function unless the preferred stock were to be valued at approximately $10,000 a share?

A. Which it could be over a ten-year period. I suspect that the value will be there.

Q. But these rights would not appro[x]-imate or be similar to traditional rights unless they got in the money; isn't that right?

A. That is correct.

Q. So that this plan itself has no financing function, does it?

A. No.

Q. Indeed, its only function is, or its only intended function was a deterrent function; isn't that right?

A. Deterrent function in the context of our discussion today.

(Flynn 85-86)

<u>The Director-Defendants' Misunderstanding of the Terms and Operation of the Plan</u>

The director-defendants who adopted the Plan did not (and still do not, even after extensive preparation by their lawyers) understand many of its pivotally important provisions. Such provisions include how the Rights are triggered, what the effect of triggering may be, how the flip-over operates, what security contains the "pill" and when the Rights become non-redeemable.

Dillon testified that the Rights would be triggered upon the acquisition of <u>100</u> percent of Household common stock by a third party -- not 20 percent, as the Rights Agreement provides.* (Dillon 33-34) Evans, when asked whether the formation of a group holding in excess of 20 percent of the shares would constitute a triggering event, responded:

> It's hard to say. The announcement would not trigger it. It's the ownership of 20 percent that triggers it. I don't know. The answer is: I don't know.

(Evans 40) Kartalia testified that only a "<u>single</u> entity owning 20 percent" would trigger the Rights. Obtaining consents from 51 percent of the outstanding shares would have "nothing to do with triggering the rights." (Kartalia 68-69, 72-73) These directors appear not to have known that (i) "groups" fall within the reach of the Plan,** and (ii) the right to <u>vote</u> shares is literally enough to satisfy the 20 Percent Triggerig Events.***

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* No director but Clark was ever provided with a copy of the Rights Agreement prior to the vote. Clark believed they would have been burdened by the "legal" and "technical" nature of the agreement. (Clark 96-97) The flip-over provision, somewhat to James' surprise when prompted by his counsel (James 64-65) and contrary to Kartalia's belief (Kartalia 79-80), appears nowhere else but in the Agreement, so no one read its terms before they voted.

** <u>See</u> Rights Agreement, Section 1(c)(iii) (App. 37).

*** <u>See</u> <u>id.</u>, Section 1(c)(ii).

Evans thought that the 30 Percent Offer Trigger only applied to an offer for exactly 30 percent, and not, for example, to an offer for any and all of the shares. (Evans 89) She also candidly conceded that she did not know what additional protection was purportedly conferred on Household stockholders by inclusion of the 30 Percent Offer Trigger in the Plan: "I don't know. I haven't tried to think that through." (Evans 88)

Along with a number of her fellow director-defendants, Evans had no idea why the 30 Percent Offer Trigger was included in the Plan.

> As I said a while ago, there was never discussion about why the 30 percent was chosen. As my understanding of the total motivation that we had in adopting the total plan, this seemed to me to make sense. It's just common sense on my part and not knowledge of why it was done the way it was done.

(Evans 89)

Rauch admitted that he did not know the reason why there is a triggering mechanism based on the making of a tender offer and not just the acquisition of shares: "I don't know that I do. Obviously there has to be one." (Rauch 85)

Brennan testified that he doesn't recall any discussion at the August 14 Board meeting of the reason for the 30 Percent Offer Trigger, and conceded that he himself has never formed an opinion about it. (Brennan 107-108; see also Evans 84)

Several of the directors misunderstood the effect of a triggering event. For example, Upton first testified that even after acquisition by a third party of 20 percent of the outstanding shares of Household, the Rights would only be tradeable in conjunction with the common stock with respect to which they were originally issued.* (Upton 35-36) Later, he conceded that he did not know whether the Rights could trade separately from the shares once a 20 percent block was acquired. Finally, after having been shown Clark's August 14 letter to Household stockholders regarding the Poison Pill Rights Plan (App. 39), and counsel having read him a portion of the letter which indicates that the Rights could be transferable apart from the common stock, he changed his mind:

> Q. Do you see there where it says "The rights will not be exerciseable or tradeable aside from the common stock until somebody acquires 20 percent of the common stock or makes an offer for 30 percent of the common stock"?

> THE WITNESS: Yes.

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* In effect, Upton's testimony is that the Rights do not become exercisable nor detach from the common shares even upon the acquisition of a 20 percent block, which is plainly incorrect.

BY MR. WARD:

Q. Separate certificates for the rights will be mailed to common stockholders as of such a date?

A. Yes.

Q. Is this the first that you learned that these rights are transferable apart from the common stock and separate certificates will be issued?

A. It's not the first time at all, and I've read the statement many, many times.

Q. You just forgot?

A. I just forgot.

(Upton 45-46) Having "recalled" that on the occurrence of a 20 Percent Triggering Event the Rights could trade separately from the stock, however, Upton persisted in asserting -- incorrectly -- that the Rights would not be exercisable for the purchase of the new preferred until a merger took place:

Q. Did you authorize at the August 14th meeting the creation of a series of preferred stock called Series A Junior Participating Preferred Stock?

A. Yes.

Q. How many shares of such stock did you authorize?

A. 600,000.

> Q. When was that preferred stock to be issued and under what circumstances?
>
> A. The preferred stock, at the time of a merger, the rights were eligible to subscribe to the issue of preferred stock. And that is when the preferred stock would become issuable.

(Upton 98-99)

There was thus serious lack of comprehension of the triggering mechanisms of the Plan. Similarly, even on something so fundamental as the flip-over provision, Upton firmly -- but incorrectly -- testified that if Household were to seek a merger with another company, taking the initiative on its own, the flip-over provision of the Rights would not be operative and they would "have no meaning."* (Upton 28) And Kartalia thought that the flip-over was a feature not of the Right, but of the preferred:

> Q. Your understanding is that the right must be exercised for the preferred share in order to obtain the flipover result; is that correct?
>
> A. Unless both parties agree that you didn't have to go through that step. But I think the answer is, to have a clear availability of purchasing $200 worth of raider stock, I would prefer going the

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* The flip-over provisions would, of course, continue to exist. To make them "meaningless" the Board would have to redeem them at a cost of at least $24 million.

route of what the plan says, you get your preferred share and it's available for the flipover.

Q. The flipover is inherent in the preferred share in your judgment; is that correct?

A. Yes.

(Kartalia 79-80)

The Board members misunderstood or were confused as to when they, as directors, would have the power under the Plan to redeem the Rights. The directors' confusion as to what constitutes a 20 Percent Triggering Event reflects, as well, a misunderstanding of the Board's power to redeem, as the two are, by definition, interrelated. Flynn testified that the Rights become unredeemable upon separation from the common stock. (Flynn 31) In fact, such is the case only if the separation is pursuant to a 20 Percent Triggering Event. The 30 Percent Offer Trigger does not affect the power to redeem until 20 percent has been acquired. Brennan testified that Rights are "redeemable up until a purchase of 20 percent of ... [Household] <u>and</u> within ten days after notification of the redemption is made." (Brennan 59 (emphasis added)) The "Brennan ten-day lapse" is one of the few complexities Household stockholders have been spared.

These are not trivial or irrelevant mistakes. The deterrent effects of the Poison Pill on changes of control flow directly from the Plan's trigger, flip-over and redemption provisions. A misunderstanding of these provisions indicates a fundamental misunderstanding of the deterrents that are at the heart of the Plan.

The confusion every director showed was generated by the intentional complexity of the Plan and enhanced by its haste of adoption. Clark, himself, said the "complexity" of the Plan would cause an acquiror (presumably fully advised both legally and financially) "to take the time and make the effort to understand the Plan and its various ramifications before he would move forward." (Clark 62) If Clark thought the Plan required extensive time and study for understanding by Wall Street professionals, he could hardly have thought his Board at a three-hour meeting could fully comprehend what they were voting on.

The Inaccuracy of the Presentations at the August 14, 1984 Board Meeting Regarding the Effects of the Plan and the Director-Defendants' Misunderstanding of Those Effects

The Plan was presented to the Household Board at its August 14 meeting as one more part of an "anti-raid" program the Company was developing. Prior to the meeting, the directors were advised, not that they were to vote on the Plan, but rather that they would hear an "overview" by "[a]ttorney Martin Lipton ... of takeover activity." (App.

26 at H4006) Lipton, the Board was advised, would "briefly comment on [certain] proposals (four in number) only one of which was a "Share Purchase Rights Plan." (Id.) Goldman Sachs was also to make a presentation to the Board concerning the vulnerability of the Company to a "raid" and their recommendations as to what the directors could do to discourage any acquisition efforts which did not meet with Board approval. Director-defendant Tait, for one, testified he did not know the Plan was intended to be presented for a vote. (Tait 24)

Lipton did not review with the Board the specific provisions and likely effects of the Plan adverse to the interests of the Company and its stockholders. His presentation was simply a sales pitch for the Plan. Specifically, Lipton said the Plan would:

- discourage partial bids for Household's stock (8/14/84 minutes at pp. 3, 7, App. 40); and

- channel takeover proposals for Household into cash for all the stock type proposals (Id. at p. 7); and

and would neither:

- restrict, inhibit or make more expensive a proxy contest to elect a new Board of Directors (Id. at p. 8); nor

- restrict the ability of the Board to accept any acquisition proposal it desired to accept (Id. at p. 8).

In every respect, the Poison Pill Rights Plan fails to deliver on Lipton's promise. Moreover, as to each of these items, the testimony of Household's directors indicates that the Board did not understand the Plan's potentially irreversible and adverse effects.

Finally, it now appears that the opinion of Richards, Layton & Finger regarding the legality of the Poison Pill Rights Plan -- which several directors testified was important to them in voting to approve the Plan (see Upton 135; James 147; Clark 51-52) -- was severely limited in its scope, assumed the Board exercised business judgment, and expressed no opinion whatsoever on the legality of the pivotal "flip-over" provision. (App. 49) Shockingly, the presentation of the Richards opinion at the August 14 meeting by counsel other than Richards omitted entirely any mention of the limitation and reservation of the opinion, and affirmatively stated that the Richards firm had opined on the legality of the entire Plan. (8/14/84 Minutes, App. 40 at 4, 9) In short, the opinion was mischaracterized to the Board.

The Plan Does Not Discourage Partial Offers For Household's Stock to Any Greater Extent than It Discourages Other Types of Change of Control Transactions.

One benefit promised for the Plan was the prevention of partial tender offers. Lipton told the Board that such offers were undesirable because "[t]he partial offer generates fear among shareholders that, if they do not tender shares, they will be locked into a minority position." Mr. Rauch went so far as to describe partial tenders as a type of "immoral corporate activity we have going on in the world today." (Rauch 21-22)

Yet the Poison Pill device insures that no person desiring to own 100 percent of Household's shares will tender without Board approval. Thus, the stockholders will be relegated to the few, if any, offerors willing to make a partial offer without hope of obtaining 100 percent of Household for an extended period of years, if not forever. Thus, the very evil feared by Rauch and Lipton is fostered by their Rights Plan.

The Plan Will Tend to Restrict and Inhibit a Proxy Contest to Elect a New Board of Directors

Household's directors consistently testified that Lipton's statement that the Plan would not affect voting rights or inhibit a proxy contest was significant in their decision to adopt the Plan.

> Q. Is that point in your view a significant one in evaluating the rights plan?
>
> A. Absolutely. From the shareholders standpoint of view I think it is extremely significant.

(Clark 91-92; see also Hendry 58-59, 61-62)

In fact, the Rights Agreement does interfere with proxy contests in three ways. First, the 20 Percent Triggering Events effectively prevent any insurgent from first taking a position of 20 percent or more, as is often done. Second, the Plan discourages stockholders from banding together in a group to solicit proxies if, collectively, they own 20 percent or more of the stock. Thus, a person soliciting proxies would be discouraged from seeking out others to join in his effort. Finally, read literally, the Rights Agreement makes the Rights nonredeemable upon the acquisition of <u>the right to vote</u> 20 percent or more of the shares through a proxy solicitation or some other arrangement or understanding. Several directors have indicated that knowledge that the Plan would inhibit proxy contests might have caused them to vote against the Plan.

For example, Hendry stated:

> Q. Did you consider at all the question -- and this is at the time you made your decision to vote in favor of this rights plan at the Board meeting on the 14th -- did you consider at all the question of whether or not the rights plan would have an effect upon the ability of stockholders to engage in proxy contests?
>
> A. Yes, I considered it.
>
> Q. Was it important to your decision to vote in favor of that plan?
>
> A. Yes, that's why I voted for it.

Q. Do you recall Mr. Lipton saying that the plan does not effect voting rights?

A. Yes.

Q. Did you consider that important in deciding to support this plan?

A. Yes.

Q. Would you have supported the rights plan if you had been told that the plan would inhibit stockholders from soliciting proxies to replace the Board of Directors?

* * *

A. No, I would not have. The answer is clearly no. I would not have.

(Hendry 61-63)*

The Plan Discourages Cash Offers for All of Household's Stock

In adopting the Rights Plan, the Board relied strongly on their mistaken understanding that the Plan does not discourage "any and all" cash offers for Household's stock. (See, e.g., Brennan 73-74; Dillon 44) In his presentation to the Board, Lipton discounted any deterrent effect on any and all cash offers and said that if only 95

* One director testified: "I think proxy contests are inherently disruptive to the company and to the normal day-to-day functions of the company. And I certainly wouldn't want to see a lot of proxy battles and fights going on." (Hendry 58)

percent of the stock and Rights were tendered in response to a tender offer for all shares, "the prospect of having as many as 5% of the rights ... outstanding would [not be likely to] stop someone from making such a tender offer in the first place." (8/14/84 minutes at p. 9, App. 40)

The testimony shows that the directors enacted the Rights Plan in part due to their misunderstanding of the Plan's effect on an offer of cash for all of the stock:

> Q. Do you know whether the rights plan as adopted by the board would deter someone from making an any and all cash offer for the shares of Household?
>
> A. It's my understanding that it was one of the fine features of the plan that it did not deter any and all cash offers.
>
> * * *
>
> Q. By your answer, are you referring both to offers that are presented to the board of directors and to offers that are not presented to the board of directors?
>
> A. It's my understanding that it is not necessary to submit an all cash offer to the directors at all, and go directly to the stockholders.
>
> Q. Is it your understanding that the plan does not discourage or deter anyone from doing that?
>
> A. That is my understanding.

(Rauch 81-82)

The Plan strongly discourages cash tender offers for all of Household's stock, by imposing, through the operation of the flip-over provision of the Rights, extremely onerous dilution in any second-step merger. Peter Fahey, a Goldman Sachs partner who took part in the presentation to the Board at the August 14 meeting, testified clearly as to the obstacles a 100 percent cash offeror would need to surmount in order to complete his acquisition of 100 percent of Household's stock:

> Q. And in factoring in the effects or the impact of any of the rights that might be left outstanding [after the tender offer], what would the offeror have to consider?
>
> A. If an offeror were making a tender offer for all of the stock and all of the rights, he would, first of all, as I said, have an incentive to negotiate with the board of directors and not take action unilaterally; and secondly, if he nonetheless decided to take action unilaterally, he would likely condition his offer on the obtaining in a tender offer of some high percentage of the stock and the rights in the offer.
>
> Q. In other words, he would put a very high minimum in his offer so he wouldn't have to buy any stock or rights in the minimum number of shares and rights tendered?
>
> A. Yes.
>
> Q. What do you think that minimum would be, if somebody were trying to protect himself against the effects of this rights plan?
>
> A. Something in excess of 90 percent.

(Fahey 37-38)

As to the likelihood of over 90 percent of Household's stock being tendered in response to a 100 percent cash offer where the offeror has indicated an intention to pursue a second-step merger, Fahey stated:

> Q. Indeed, wouldn't it be a rather strong disincentive for people to tender if they knew they could get three times as much in the second step?
>
> A. Some people might think that way.
>
> Q. Indeed, it would be rather difficult to get 95 percent or 90 percent of the stock in those circumstances?
>
> A. It would no doubt be difficult.*

(Fahey 41-42)

As several directors have recognized, the 100 percent offeror would thus have a compelling incentive to seek the Household Board's approval of the offer and

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* The 95 percent of stockholders who tendered their shares in the front end would be twice-disadvantaged: first, they would receive a lower price for their shares and, second, they would, unlike the holdouts, be unable to "eat the acquiror for one half his market value." Thus, the alleged unfairness in two-tier, front end loaded offers, which the Household Board purportedly solved in adopting the Rights Plan, is not solved at all. To the contrary, the difference in consideration received by stockholders in the front end and back end of a two tier offer is far more dramatic under the Rights Plan. Incredibly, James showed complete indifference to this unfair treatment of the vast majority of stockholders, remarking that "[i]n an aggregate, the shareholders [in that situation] would be treated fairly." (James 130)

redemption of the outstanding Rights.* (See, e.g., Brennan 113; Flynn 68; James 120) If the Board determined not to redeem the Rights, the offeror's alternative, according to Fahey and others, would be to try to replace the Board via a proxy solicitation or consent procedure, and redeem the Rights. (Fahey 42-43; Kartalia 73) In actual fact, no offeror would enter the fray at all recognizing that the solicitation would leave his offer exposed for an extended period of time and that his transaction costs would soar.

In light of the massive potential dilution of the acquiror's stock -- even Lipton conceded that "the prospect of having as many as 10% of the rights remaining outstanding after a tender offer with the resultant dilution of about $600 million could be a significant deterrent to some offerors...." (8/14/84 minutes at p. 9, App. 40) -- a 100 percent offeror's only theoretical alternative, if he determined not to withdraw from the transaction, might be to wait until the expiration of the Rights to execute a merger. The result of that alternative, however, would be that many of the legitimate reasons for seeking 100 percent

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* Impossible, of course, if a 20 percent investor had already pulled the acquisition trigger.

control -- greater flexibility in financing, management, risk-taking, leverage -- would be lost.*

In view of the problems an offeror would have if he were unable to convince the Board to redeem the Rights or if the Rights were unredeemable as a result of a triggering event, the Plan is intended by its authors to bring about its natural and probable consequence and, thus, will discourage all cash offers for all of Household's shares which are not blessed by the Board before they begin. As Fahey stated:

> Q. Do you think ... [the Plan] would limit the number of companies that would be willing to make a cash offer for Household?
>
> A. Well, I think there is a chance some company considering -- if they were to look at Household and consider whether to make an offer for Household, might see the plan and might go on to another case and not make an offer.
>
> Q. Indeed, one of the purposes of the plan, as Mr. Lipton describes it, is to create a situation so confusing that it will deter offerors, isn't it? Do you recall reading that?
>
> A. Yes, I think that that -- that is one objective of the plan, to lower the probability of any unilateral action being taken by a third party.

(Fahey 161)

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* The Board has retained for itself the power to amend the Rights Agreement at any time. Thus, even the 1994 expiration date will be seen by a potential acquiror as a provisional termination date subject to extension.

The Plan Severely Restricts the Ability of Household's Board to Accept Attractive Acquisition Proposals

Turning the coin over, it is clear that the Plan actually ties the hands of all future Household directors by robbing them of the discretion to consider acquisition proposals on their merits.

If, for example, an investor were to acquire 20 percent of Household's stock for an entirely legitimate purpose, the Rights would thereby be triggered and the Board's power to redeem terminated.* Brennan conceded that the Board's discretion in considering offers would be severely limited:

> Q. ... I am asking you whether the Board would have any ability to structure a merger transaction in those circumstances in which the rights would not take effect?
>
> A. To my knowledge, it would not.

---

* Director-defendant Miller Upton, a former professor of corporate finance, stated that such a 20 percent triggering purchase could be made for a variety of good reasons:

> Q. So that you would recognize that there are a number of circumstances where a legitimate investor without a public be damned or corporation be damned attitude might wish to invest in 20 percent --
>
> A. Surely.

(Upton 33)

(Brennan 99) Evans agreed, stating that "[s]omeone would find it difficult to effect a merger with the board if the rights are no longer redeemable." (Evans 83)

The Board apparently did not even discuss the effect of the existence of outstanding non-redeemable Rights on an attempt to acquire Household:

> Q. Was there any discussion at the board meeting of how the rights plan would affect an attempt to acquire control of Household after the rights were no longer redeemable?
>
> A. I don't recall that there was a discussion about that.

(Evans 71)

The minutes bear out Evans' recollection.

* * *

Thus the record as developed discloses that there was and is enormous doubt and confusion among Household's directors as to each of the principal points made by Household's counsel in his presentation to the Board. The record is replete with examples of the directors' ignorance of the mechanics of the Plan and their utter lack of understanding of its intended effect on <u>all</u> acquisition attempts. The record makes clear that even as to the points made by counsel at the Board meeting, they failed to describe the dramatically detrimental purpose or effect of the Plan on the stockholders of Household.

The outrage expressed in numerous letters from Household stockholders -- large and small -- already received by the Company (App. 48) is no more than the natural result of such hasty and ill-considered action of the Board and the basic inequity and illegality of the Plan.

ARGUMENT

I. THE BUSINESS JUDGMENT RULE PLAYS NO ROLE IN THIS CASE.

We assume that defendants will claim that their adoption of the Rights Plan is insulated from the Court's scrutiny under the business judgment rule. However, as the foregoing discussion demonstrates, the Household directors acted without sufficient information and with unnecessary speed at the August 14 meeting. Even after preparation by their attorneys, the director-defendants were seriously confused, if not bewildered, by the terms of the Plan and offered utterly inconsistent descriptions of the effect of the Plan on acquisition offers. In addition, testimony to date illustrates how the Rights Plan has materially strengthened management's control over Household's destiny, vesting them, as demonstrated more fully below, with an "interest" in the Rights Plan that far exceeds the traditional balance of decision-making between management and stockholders.

Decisions of a board are not accorded any presumption of propriety if, as here, its members fail to consider carefully the consequence of their actions or if its members are "interested." See, e.g., Norlin v. Rooney Pace, Inc., [Curren Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 91,564

(2d Cir. 1984). The Supreme Court recently stated in Aronson v. Lewis, Del. Supr., 473 A.2d 805, 812 (1984), that the business judgment rule's "protections can only be claimed by disinterested directors whose conduct otherwise meets the test of business judgment" and "to invoke the rule's protection directors have a duty to inform themselves, prior to making a business decision, of all material information reasonably available to them." Accord Andresen v. Bucalo, Del. Ch., C.A. No. 6372, Hartnett, V.C., (March 14, 1984) (slip op. at 7-8) (App. 41); Good v. Texaco, Inc., Del. Ch., C.A. No. 7501, Brown, C. (May 14, 1984) (slip op. at 9) (App. 42); Weinberger v. United Financial Corp., Del. Ch., C.A. No. 5915, Hartnett, V.C., (Oct. 13, 1983) (slip op. at 18-20) (App. 43).

Furthermore, the Poison Pill Rights Plan is not authorized under federal and state law, and the Board's motivation is therefore irrelevant. Cf. Triplex Shoe Co. v. Rice & Hutchins, Inc., Del. Supr., 152 A. 342, 345 (1930). The Board simply cannot argue that it violated federal and state law yet properly exercised its business judgment. Abercrombie v. Davis, Del. Ch., 123 A.2d 893, 896 (1956), modified, Del. Supr., 130 A.2d 338 (1957).

II. THE PLAN CONTRAVENES THE STRONG POLICY OF BOTH FEDERAL AND STATE LAW GIVING STOCKHOLDERS A RIGHT TO RECEIVE AND CONSIDER OFFERS FOR THEIR STOCK.

Unlike mergers, tender offers are regulated by a comprehensive federal scheme -- the Williams Act and regulations promulgated pursuant to it. State laws that interfere with or pose obstacles to the accomplishment of the full purpose and effect of this comprehensive regulatory scheme repeatedly have been invalidated under the Supremacy and Commerce Clauses of the United States Constitution or both. See, e.g., Edgar v. MITE Corp., 457 U.S. 624, 102 S. Ct. 2629 (1982); Esmark, Inc. v. Strode, 639 S.W.2d 768 (Ky. 1982); Great Western United Corp. v. Kidwell, 577 F.2d 1256 (5th Cir. 1978), rev'd on other grounds sub. nom, Leroy v. Great Western United Corp., 443 U.S. 173, 99 S. Ct. 2710 (1979).

The federal scheme is premised on the Congressional determination that stockholders, not directors, should have the right to decide whether to accept or reject tender offers. State laws that have transferred power over tender offers from stockholders to directors routinely have been declared unconstitutional under the Supremacy Clause because they obstruct the operation of the Williams Act. For example, in Great Western United Corp. v. Kidwell, 577 F.2d at 1279, the Court stated:

> Idaho's statute is preempted, because the market approach to investor protection adopted by Congress and the fiduciary approach adopted by Idaho are incompatible.... Congress intended for the investor to evaluate a tender offer; Idaho asks the target company management to make that decision on behalf of the shareholders.

Accord Martin-Marietta Corp. v. Bendix Corp., 690 F.2d 558, 567 (6th Cir. 1982).

Delaware law also provides that stockholders -- and not directors -- have the right to choose whether to accept or reject a tender offer. Under the DGCL, directors are given the right to consent to mergers or consolidations (Sections 251-258), sales of assets (Section 271), and dissolution (Section 275). They are not, however, given the right to consent to changes in voting control or ownership of a company's stock. In those crucial matters affecting the control over the management of the corporation, shareholders are free to act without the Board's prior agreement.

Moreover, public policy favors an unfettered auction market for corporate stock. As the Supreme Court stated in Edgar v. MITE Corp., 457 U.S. at 643, 102 S. Ct. at 2642:

> The effects of allowing the Illinois Secretary of State to block a nationwide tender offer are substantial. Shareholders are deprived of the opportunity to sell their shares at a premium. The reallocation of economic resources to their highest-valued

> use, a process which can improve efficiency and competition, is hindered. The incentive the tender offer mechanism provides incumbent management to perform well so that stock prices remain high is reduced.

Cf. Pennsylvania Co. v. Wilmington Trust Co., Del. Ch., 186 A.2d 751, 756, 778 (1962), aff'd, Del. Supr., 200 A.2d 441 (1964) (board has "overriding duty to sell at a maximum price" and "trustee should do his best to secure competitive bidding") Accord Thomas v. Kempner, Del. Ch., C.A. No. 4318, Marvel, V.C. (March 22, 1973) (App. 44).

The stockholders' right to receive offers is simply a corollary of their right to sell their stock. Under Section 202(b) of the DGCL, no restriction on the sale of stock is valid with respect to prior issued securities unless the holders of the securities are parties to an agreement or voted in favor of the restriction. See Joseph E. Seagram & Sons, Inc. v. Conoco, Inc., 519 F. Supp. 506, 514 (D. Del. 1981) (court invalidated by-law provision that restricted the transfer of stock ownership to aliens which, if enforced, would have foreclosed Conoco stockholders from tendering to Seagram). Here, no stockholders' vote was held. Rather, the Board unilaterally acted to deter any tender offers from being made to Household's stockholders.

Courts have repeatedly struck down efforts by directors to limit the range of tender offers presented to stockholders. As stated by Judge Weinfeld in Conoco, Inc. v. Seagram Co., Ltd., 517 F. Supp. 1299, 1303-4 (S.D.N.Y. 1981), in rejecting an attempt by corporate directors to prevent a partial tender offer:

> [The corporate directors] may be right; they may know what is best for the corporation, but their judgment is not conclusive upon the shareholders. What is sometimes lost sight of in these tender offer controversies is that the shareholders, not the directors, have the right of franchise with respect to the shares owned by them.... The Directors are free to continue by proper legal means to express to the shareholders their objection and hostility to the Seagram proposal, but they are not free to deny them their right to pass upon this offer or any other offer for the purchase of their shares.

Accord Jewel Companies, Inc. v. Pay Less Drug Stores Northwest Inc., 550 F. Supp. 770, 772 (N.D. Cal. 1982); Martin-Marietta Corp. v. Bendix Corp., 549 F. Supp. 623, 635 (D. Md. 1982).

By its unilateral action, Household's Board has violated Household's stockholders' federal and state guaranteed right to receive and decide on tender offers. See Kennecott Corp. v. Smith, 637 F.2d 181, 189 (3d Cir. 1980) (stockholders have the "right to make a choice about the governance of their corporation and the disposition of their shares"). Enforcement by this Court of the Board's unilateral action, as a valid exercise of authority conferred on the Board by the DGCL, would be an improper obstruction of the purpose of Congress embodied in the Williams Act and would be violative of the Supremacy Clause of the United States Constitution. See National City Lines, Inc. v. LLC Corp., 687 F.2d 1122, 1131 (8th Cir. 1982) ("State statutes which can be used to unduly delay tender offers are pre-empted by the Williams Act"). Enforcement would also run counter to Delaware law. Cf. Wylain Inc. v. TRE Corp., Del. Ch., 412 A.2d 338, 344 (1980) (stockholders have right to decide on fundamental changes), and set the DGCL squarely against the Congressional purpose of protecting stockholders of all publicly held corporations.

III. THE CREATION OF RIGHTS CONVERTIBLE INTO STOCK OF AN ACQUIRING CORPORATION IS ULTRA VIRES AND SHOULD BE DECLARED UNLAWFUL.

In addition to violating the stockholders' right to receive tender offers, the "flip-over" provision is not authorized under the DGCL and, therefore, is invalid. See Triplex Shoe Co. v. Rice & Hutchins, Inc., Del. Supr., 152 A. 342, 345 (1930) ("no authority or argument is needed to support the proposition that the authority of a corporation to issue stock is fixed by the law of the state which grants the authority, and neither the incorporators or any other officer can change, modify or supplement the law in that regard").

Section 157 of the DGCL governs the extent of the corporation's powers to create and issue rights and options respecting stock. It states, in pertinent part:

> Subject to any provisions in the certificate of incorporation, every corporation may create and issue ... rights or options entitling the holders thereof to purchase from the corporation any shares of its capital stock of any class or classes....
>
> The terms upon which ... and the price or prices at which any such shares may be purchased from the corporation upon the exercise of any such right or option, shall be such as shall be stated....

8 Del. C. § 157 (emphasis added).

The word "the" used twice in identifying "corporation" plainly is meant to refer to the corporation which created and issued the capital stock. Thus, Section 157 authorizes Household to issue rights only to purchase shares of its own capital stock -- not the shares of some other corporation.

Other sections of the DGCL also evidence the fact that statutory references to "the corporation" do not include predecessor or successor corporations. Thus, in Section 145(h), the General Assembly specifically provided that: "for the purposes of this section, references to 'the corporation' shall include, in addition to the resulting corporation, any constituent corporation ... absorbed in a consolidation or merger...." Similarly, where Section 174 creates director liability to "the corporation, and to its creditors" the Legislature did not intend to include the creditors of any successor corporation. See Johnston v. Wolfe, Del. Ch., C.A. No. 6682, Longobardi, V.C. (February 24, 1983), aff'd, Del. Supr., C.A. No. 187, 1983 (June 8, 1984), vacated in part on other grounds (August 30, 1984) (App. 45)

Furthermore, in contrast to Section 157, Section 151(b) of the DGCL specifically allows stock to be made redeemable for "cash, property or rights, including securities of the same or another corporation...." The absence of such an authorization in Section 157 provides compelling evidence that the General Assembly did not intend to authorize the issuance of rights entitling the holder to purchase another corporation's capital stock.

The plain meaning of Section 157 and its relation to other provisions in the DGCL lead to the conclusion that the Poison Pill Rights, insofar as they may be exercised to purchase the capital stock of a corporation other than Household, are unauthorized under Delaware law, and, therefore, void.

IV. **THE BOARD UNLAWFULLY MANIPULATED THE CORPORATE MACHINERY FOR THE SOLE PURPOSE OF RETAINING CONTROL.**

A. **The Board's Actions Were An Unfair And Inequitable Manipulation Of The Corporate Machinery.**

The Poison Pill Rights are a charter amendment masquerading as a "dividend"; they are predicated on a new series of "preferred stock" which has no economic reality; they "flip-over" into the right to acquire shares of stock of some other corporation which Household's Board has no right to sell. Unlike any dividend ever seen, they grant nothing of value to the stockholders but serve only to manipulate. A board breaches its fiduciary duty when it manipulates corporate machinery to retain control. See Schnell v. Chris-Craft Industries, Inc., Del. Supr., 285 A.2d 437 (1971); Lerman v. Diagnostic Data, Inc., Del. Ch., 421 A.2d 906 (1980); Telvest, Inc. v. Olson, Del. Ch., C.A. No. 5798, Brown, V.C. (March 8, 1979) (App. 46).

The Rights are a gross misuse of the dividend provisions of the DGCL. Directors may pay dividends "in cash, in property, or in shares of the corporation's capital stock." See DGCL Sections 170, 173. These provisions provide a means for the board to give the stockholders a return on their investment. Cf. Fulweiler v. Spruance, Del. Supr., 222 A.2d 555, 558 (1966). However, Household's "dividend" is not, and was not intended to be, a return on an investment. Its intent is solely to create a mechanism to deter unfriendly offers to purchase Household stock. The statutory framework of a dividend may have been used, but the "declaration" was merely a device to create powerful obstacles to acquisition proposals. As the Supreme Court stated in Schnell, "inequitable action does not become permissible simply because it is legally possible." 285 A.2d at 439.

Likewise, the Board has improperly manipulated its power to issue preferred stock pursuant to Section 151, which provides only a limited exception to the general rule that directors cannot alter voting rights and preferences through unilateral action. This limited exception gives the directors ad hoc authority to fix the economic terms of preferred stock to comport with market conditions at the time of issuance. See 11 W. Fletcher, Cyclopedia of the Law of Private Corporations § 5284.1, p. 531 (perm. ed. 1971); Folk, The Delaware General Corporation Law at 114-15 (1972). The Board abused that power in authorizing the new preferred. As many of the directors admitted and as is obvious in any event, the preferred stock authorized by Household's Board has no economic reality. The only purpose for the preferred is to provide a basis for the issuance of the Rights.*

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* Under foreseeable market conditions, no rational person would ever choose to exercise the Rights to

[Footnote continued on next page]

As in Telvest, the creation of the new series of preferred was merely part of a plan to alter the fundamental structure of the corporation without the consent of the stockholders.

Finally, the Board abused Section 157 which gives directors authority to grant rights to purchase "from the corporation any shares of its capital stock of any class or classes." The Rights issued by Household's Board are rights in name only. Their function is not to enable stockholders to purchase shares of the new preferred (because it would be irrational for anyone to do so) or to effect the capital structure of Household in any other way. Rather, the only real function of the Rights is to carry the Poison Pill.

Thus, the Board misused its power to declare dividends, its power to create new series of preferred stock and its power to issue rights -- all for the single, illegal and inequitable purpose of creating the Poison Pill. The manipulative nature of the Board's unilateral action is further revealed by its decision in the spring of this year not to propose a far milder "fair price" charter amendment to its stockholders after learning that its institutional

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[Footnote continued from previous page]

purchase shares of the preferred. The preferred are "out-of-the-money" so long as the common is trading below $100. On September 14, 1984, the common closed at $32, close to its high for the year.

stockholders were unanimously opposed. Rather than risk the chance of losing, the Board chose to act in a way that gives stockholders no effective voice. Even now the Board refuses to put the Plan to a stockholder vote, despite the public displeasure of many large and small stockholders.

It is a fundamental principle of Delaware law that there be stockholder approval before a fundamental change in the corporate structure can be effected. See, e.g., § 242 (changes in article of incorporation); § 251 (mergers and consolidations); § 271 (sales of assets); § 275 (dissolution); and § 311 (revocation of dissolution). See also Wylain Inc. v. TRE Corp., Del. Ch., 412 A.2d 338, 344 (1980) ("The stockholders of a Delaware corporation have certain specific and enforceable rights under their contract with the corporation and the State, for example: to be able to vote on fundamental corporate changes.") The decision to cut off tender offers is surely a fundamental one which should require stockholder approval. In violation of the principle enunciated in Schnell v. Chris-Craft, the Board accomplished this fundamental change by misusing the procedural machinery for paying dividends, issuing preferred stock and distributing warrants for the unlawful purpose of stifling stockholder choice and entrenching themselves in office.

B. The Board's Actions Violate The Principles Stated In Telvest v. Olson.

The illegality of the Poison Pill Rights Plan is also demonstrated by the decision of this Court in Telvest, Inc. v. Olson, Del. Ch., C.A. No. 5798, Brown, V.C., (March 8, 1979). In Telvest the board, acting, as here, without a stockholder vote, declared a dividend on its common stock in the form of shares of a new series of preferred stock having special 80 percent super-majority voting rights in the event of mergers with a 20 percent or more stockholder, unless two-thirds of the directors approved the 20 percent stockholder. Thus, if a hostile acquiror gained control of the board and entered into an agreement to merge with Telvest, that agreement could be approved only if stockholders holding 80 percent of the preferred stock approved. This Court struck down the preferred stock dividend in Telvest, finding that the action of the board was intended only to alter the preexisting right of the common stockholders to approve any mergers by a simple majority. (Slip op. at 9)

The Poison Pill Rights Plan at issue here makes the actions of the Telvest board appear temperate by comparison. The Household Board's Plan not only prevents two-step hostile acquisitions, but discourages all attempts to gain 100 percent of Household in an unfriendly transaction -- even cash tender offers to acquire 100 percent of the Company's stock. Moreover, by the stroke of a pen the Board can create more rights or alter the terms of the existing rights to respond to any challenge to its control. The stockholders have lost more than the right to approve mergers not agreed to by the current Board or their hand-picked successors; they have lost the right to consider any other bid to acquire their company. Telvest demands that those rights be restored to them.

Like the preferred stock issued in Telvest, the Rights have no legitimate business function, such as raising capital or creating incentives for employees and others to increase the issuing corporation's earnings. Moreover, in both cases: (a) a history of anti-takeover activity by the boards preceded the stock issuance; (b) the boards initially considered putting the anti-takeover resolutions to a stockholder vote, but declined to do so; and (c) the illegal paper was issued as a dividend to all common stockholders to foster the illusion that it was beneficial to them. In short, both Telvest and this case evidence a deliberate manipulation by the directors for the sole purpose of deterring bids to acquire control.

V. THE RIGHTS AGREEMENT AND THE PREFERRED STOCK RESOLUTION UNLAWFULLY RESTRICT FUTURE BOARDS WITH RESPECT TO NEGOTIATION AND APPROVAL OF MERGERS.

Section 251 of the DGCL and the other provisions dealing generally with mergers require that directors approve the terms of any merger agreement before the agreement is submitted to stockholders. Directors thus have a duty to consider reasonable proposals and to recommend a merger to the stockholders which the directors believe to be in the stockholders' best interests. Cf. Bastian v. Bourns, Inc., Del. Ch., 256 A.2d 680, 684 (1969), aff'd, Del. Supr. 278 A.2d 467 (1970) (Delaware public policy favors mergers).

The Poison Pill Rights, once rendered non-redeemable by a 20 percent acquisition, wrest the authority to agree to merger terms from future Household boards by making it impossible to effect a merger that does not have a ruinous dilutive impact on the acquiring corporation until the Rights expire.* Such a restriction on future board discretion is plainly contrary to the statutory scheme.

This tactic of limiting the types of mergers which future boards may consider violates Chancellor Seitz's often-cited principle that:

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* Sections 11 and 13 of the Rights Agreement purport to bind Household to include in all future merger agreements a provision that Rights holders be granted the right to buy $200 market value of common stock in the acquiring corporation for the payment of $100.

> So long as the corporate form is used as presently provided by our statutes, this Court cannot give legal sanction to agreements which have the effect of removing from directors in a very substantial way their duty to use their own best judgment on management matters.

Abercrombie v. Davies, Del. Ch., 123 A.2d 893, 899 (1956), modified, Del. Supr., 130 A.2d 338 (1957).

Chapin v. Benwood Foundation, Inc., Del. Ch., 402 A.2d 1205 (1979), aff'd sub nom. Harrison v. Chapin, Del. Supr., 415 A.2d 1068 (1980), is to the same effect. In Benwood the Court found that an agreement among trustees of a non-profit corporation to name certain designated persons to fill future vacancies on the board unlawfully restricted the discretion of future boards of directors:

> I am convinced that the facts of this situation impose upon the trustees of Benwood a duty to use their best judgment in filling a vacancy on the board of trustees as of the time the need arises. To commit themselves in advance -- perhaps years in advance -- to fill a particular board vacancy with a certain named person, regardless of the circumstances that may exist at the time that the vacancy occurs, is not the type of agreement that this Court should enforce....

402 A.2d at 1211. These principles were recently reaffirmed in Rosenblatt v. Getty Oil Co., Del. Ch., C.A. No. 5278, Brown, C., (slip op. at 40-41) (Sept. 19, 1983) (App. 47), and are consistent with the requirement that the board of

directors of a Delaware corporation has a duty at any given time to be in a position fully to exercise its own independent business judgment. See, e.g., Aronson v. Lewis, Del. Supr., 473 A.2d 805, 812 (1984); Field v. Carlisle Corp., Del. Ch., 68 A.2d 817 (1949)

The Poison Pill Rights, when made non-redeemable, make impracticable any merger agreement between Household and any third party. No matter how fair or generous to Household's stockholders, the purported "contract" between Household and the Rights agent precludes the approval of any agreement by the Board which does not provide for the satisfaction of the "flip over" provision of the Rights -- the provision which enables Household's common stockholders to "eat the acquiror for 1/2 market!" The Board's action in authorizing management to enter such a contract is, therefore, unlawful and inequitable.

CONCLUSION

For all of the foregoing reasons, plaintiffs respectfully request that the Court enter judgment against defendants declaring the issuance of the Poison Pill Rights invalid and unlawful and granting such other and further relief as is just and proper under the circumstances.

Respectfully submitted,

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