

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

IN AND FOR NEW CASTLE COUNTY

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JOHN A. MORAN and THE	:	
DYSON-KISSNER-MORAN	:	
CORPORATION,	:	
Plaintiffs,	:	Civil Action No. 7730
v.	:	
HOUSEHOLD INTERNATIONAL, INC.,	:	
a Delaware corporation, DONALD C.	:	
CLARK, THOMAS D. FLYNN, MARY	:	
JOHNSTON EVANS, WILLIAM D. HENDRY,	:	
JOSEPH W. JAMES, MITCHELL P.	:	
KARTALIA, GORDON P. OSLER,	:	
ARTHUR E. RASMUSSEN, GEORGE W.	:	
RAUCH; JAMES M. TAIT, MILLER	:	
UPTON, BERNARD F. BRENNAN and	:	
GARY G. DILLON,	:	
Defendants.	:	

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HOUSEHOLD INTERNATIONAL, INC.,	:	
Counterclaim-Plaintiff,	:	
v.	:	
JOHN A. MORAN, CHARLES H. DYSON	:	
and THE DYSON-KISSNER-MORAN	:	
CORPORATION,	:	
Counterclaim-Defendants.:	:	

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PLAINTIFFS' POST-TRIAL REPLY MEMORANDUM
OF POINTS AND AUTHORITIES

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DATED: December 5, 1984

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I. INTRODUCTION

The Plan should be struck down because it rests on a misuse of Section 157. The plain language of that Section does not authorize the flipover and the Rights were not enacted as a financing device. Rather, the Plan was intended to transfer from stockholders to the board control over the ultimate destiny of the company. Its effects are unprecedented in their impermissible interference with fundamental stockholder rights to alienate their shares and to protect and enhance their investment through proxy contests and tender offers. These effects are directly contrary to the laws and legislative policies adopted by the General Assembly and Congress. The business judgment rule, as heretofore interpreted by the courts, provides no sanction for the legislative decision made by the Household directors to solidify their power against takeover efforts through a wholesale invasion of stockholder rights.

A decision voiding the Plan will place Household stockholders in the same position as the stockholders of every other United States public corporation. They neither sought nor voted for its alleged protections. A decision upholding the Plan will validate the alteration of the fundamental relationship between the stockholders and the professional managers of their corporation accomplished by the Plan. It will wholly change acquisition practices long recognized as lawful and beneficial by Congress, the General Assembly and the courts.

II. THE RIGHTS ARE NOT AUTHORIZED
BY SECTION 157 AND ARE
ILLEGAL UNDER TELVEST.

- A. The Supreme Court Has Held And The Parties Agree
That The Business Judgment Rule Does Not Grant
Household's Board The Power To Enact The Plan.

All parties agree that the business judgment rule did not authorize the Board to adopt the Plan.* The business judgment rule is not a source of power for acts of a board of directors. Zapata Corp. v. Maldonado, Del. Supr., 430 A.2d 779, 782 (1981). The rule creates a rebuttable evidentiary presumption that an authorized act which has been challenged on the basis of propriety was, in fact, properly done. Id. Since the rule applies only to those acts which were authorized by the DGCL, the Household board's power to adopt the Plan must, if it exists at all, be found in a specific section of the code.

- B. Household Cites § 157 As Its Source Of Power
But The Plain Language Of The Statute Does
Not Authorize The Plan And Its Adoption Is
Contrary To The Purpose Of The Section.

1. Section 157

When challenged to pinpoint the source of its board's power to issue the Rights, Household relied exclusively on § 157:

The Rights were issued pursuant to DGCL § 157, and the certificate of designation of the underlying preferred stock was filed pursuant to DGCL § 151(g).** These statutes authorize the issuance of securities pursuant to the Rights Plan (DTB 36,*** footnote added)

* The defendants "do not claim that the business judgment rule authorized the transaction" (DTB 36; emphasis in original) As defendants also recognize, § 141(a) provides no source of board authority to issue the Rights. Section 141(a) is a source of "managerial decision making power." Zapata Corp. v. Maldonado, Del. Supr., 430 A.2d 779, 782 (1981). See also Aronson v. Lewis, Del. Supr., 473 A.2d 805, 812 (1984).

** Section 151(g) is a procedural section dealing with the procedures for filing certificates containing resolutions with regard to issuance of preferred shares of stock.

*** Trial testimony and exhibits will be cited as in Plaintiffs' Post-Trial Mem-
(Footnote continued)

Household carefully avoided any exercise in statutory construction. A plain reading of § 157 demonstrates that its provisions simply do not authorize the Plan. Section 157, in pertinent part, reads as follows:

Subject to any provisions in the certificate of incorporation, every corporation may create and issue, whether or not in connection with the issue and sale of any shares of stock or other securities of the corporation, rights or options entitling the holders thereof to purchase from the corporation any shares of its capital stock of any class or classes, such rights or options to be evidenced by or in such instrument or instruments as shall be approved by the board of directors. (emphasis added).

In the central operative provision of the Plan (the "flipover"), the Rights purport to grant the holder the extraordinary power to buy the stock of an as yet unknown "raider" corporation for one-half of its market value. Section 13 of the Rights Agreement provides that "[i]n the event . . . the Company shall consolidate with, or merge with and into any other Person . . . each holder of a Right shall thereafter have the right to receive . . . shares of Common Stock of such other Person" (PX 204 at 27-28, emphasis added)

Section 157 authorizes no such extraordinary result. It only authorizes Household to issue "rights or options entitling the holders thereof to purchase from the corporation any shares of its capital stock of any class or classes. . . ." (emphasis added)* When first faced with this clear statutory language in our pre-trial brief, Household argued that its flipover provision was identical to anti-destruction clauses found in certain convertible securities. (DPTB

(Footnote **** continued from previous page)

orandum of Points and Authorities ("PTB"). Defendants' Post-Trial Brief will be cited as "DTB"; Defendants' Pre-Trial Memorandum will be cited as "DPTB" and Plaintiffs' Pre-Trial Memorandum of Points and Authorities will be cited as "PPTB."

* Section 151(e), relating to preferred stock, contains the same limitation. Section 151(b), by contrast, expressly provides that stock may be redeemed for "securities of the same or another corporation. . . ." (See PPTB at 62-63)

81-90) Pursuant to these clauses, the issuing corporation guarantees the securityholder that in order to protect the value of the security it will not enter into any merger agreement that does not preserve the current value of its convertibility feature. Such clauses reinforce the financing purpose of the security; their sole purpose is to preserve (not create) value in the event of a merger. (PTB 33-36) Pursuant to § 121(a), these provisions are therefore permissible as "incidental" to the power to issue rights exercisable into a company's own stock under § 157.

The flipover is not intended to preserve the right to buy 1% of a share of Household preferred stock for \$100, which is a right of little or no value. Rather, it would give its holder an altogether different right to buy \$200 worth of another company's common stock for \$100. These two rights have dramatically different values. They could not be equivalent except in the extraordinary circumstance, which even Household does not suggest would occur, that the preferred shares become worth \$200. (DTB 71n***; PX 318)

The Household flipover provision thus bears no resemblance to any heretofore authorized anti-destruction clause. (See PTB 33-36) Since the flipover is not expressly permitted by § 157 and is not necessary to the preservation of a conversion feature authorized by § 157, it is not authorized by the statute and must be struck down. Aldridge v. Franco Wyoming Oil Co., Del. Supr., 14 A.2d 380, 381 (1940).

2. Section 157 is a provision enabling
common practices of corporate finance.

To create a provision that authorizes a Household stockholder to dilute another corporation, the Court would have to read into § 157 a provision that nowhere appears in the language passed by the General Assembly. Such a judicial amendment would be contrary to the Section's legislative history and a cohesive interpretation of the DGCL.

Section 157 was enacted to enable corporations to finance themselves, not to adopt anti-takeover defenses. The Plan, as devised, explained and adopted, relates solely to takeover defense and serves no financing purpose. (See Pt. II.B.4 below) Household concedes that its sole purpose in adopting the Plan is to strengthen the board's control over the destiny of the corporation in the face of the potential for a takeover. (DTB 57-58)

Nothing in the legislative history of § 157 remotely suggests that its enactment had anything to do with corporate control in general or takeover defense in particular. The predecessor to § 157 was the Act of March 22, 1929, ch. 135, § 6, 36 Del. Laws 374-76. See S. Arsht, A History of Delaware Corporation Law, 1 Del. J. Corp. Law 1, 11 (1976). That Act was passed to recognize explicitly the existing practice of granting rights and options to purchase stock. See A. Berle, Investors and the Revised Delaware Corporation Act, 29 Colum. L. Rev. 563 (1929). The warrants and rights statutorily recognized were issued as a "method of financing the capital requirements of a corporation already in existence." 19 W. Fletcher, Cyclopedia of the Law of Corporations, § 8975, at 156 (rev. perm. ed. 1975). None of the law's provisions was intended to relate to the retention of control by the board or provide a defense against unilateral changes in ownership of the corporation.

3. Household's use of § 157 is contrary
to the pattern of the DGCL.

The admitted purpose of the Plan is to set the board up as a "bargaining agent" with prospective tender offerors so that the board may negotiate for stockholders. (DTB 39) Not only is that purpose alien to § 157, it would lead

to a result which is inconsistent with a clear intent of the General Assembly in 1976 when it enacted § 203.*

In adopting § 203, the General Assembly recognized that tender offers are beneficial both to corporations and their stockholders. Section 203 was passed when many other states were considering or had adopted statutes designed to deter tender offers by imposing disclosure and substantive fairness standards which, unless waived by the target company's board, could substantially delay or defeat hostile tender offers.** Delaware chose not to give the board the power to interfere with or deter the making of tender offers. Section 203 is a "notice" statute, the basic requirement of which is to give timely advice to the target of the offeror's intention to make a tender offer. The drafters of § 203 determined that:

[R]egulation . . . discouraging tender offers would not be in the best interests of Delaware corporations or their shareholders. . . .

It was the opinion of the [Corporation Law Committee of the Delaware State Bar Association which drafted the statute] that regulation which would have the effect of discouraging tender offers would not be in the best interests of Delaware corporations or their shareholders, in light of the fact that, when a tender offer is made, it is shareholders in the offeree company who benefit most directly and immediately.

A. Berkowitz, Delaware Tender Offer Regulation, 2 Del. J. Corp. Law 373, 374 (1977) (footnotes omitted); to the same effect, S. Arsht, A History of Delaware Corporation Law, 1 Del. J. Corp. Law 1, 20 (1976).

* Where the General Assembly intended to have the board serve as a bargaining agent, it specifically so provided in the relevant sections of the DGCL. See, e.g., §§ 251 et seq., 271, 275.

** See, e.g., Illinois Business Takeover Act, Ill. Rev. Stat. ch 121-1/2 (1979) ¶ 137.51 discussed in Edgar v. MITE Corp., 457 U.S. 624, 102 S. Ct. 2629 (1982); Idaho Takeover Statute, Idaho Code §§ 30-1501-13 (Cum. Supp. 1977) discussed in 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).

If the interpolation sought by Household were applied to § 157, not only would a 1929 financing statute be amended to accommodate a purpose solely related to corporate control, but the amendment would engraft on that statute a provision to carry out a purpose specifically disclaimed by the General Assembly as recently as 1976. No authority in the field of statutory construction would authorize such an exercise. Sections of the DGCL should be construed to produce a consistent and harmonious whole. See Nationwide Mutual Insurance Co. v. Kron-
gold, Del. Supr., 318 A.2d 606, 609 (1974); E. I. du Pont de Nemours & Co. v.
Clark, Del. Supr., 88 A.2d 436, 439 (1952); 2A Sutherland, Statutes and Statutory
Construction at 56 (4th ed. 1973). So construing it, § 157 does not authorize a board to adopt the Plan for the admitted sole or primary purpose of deterring unsanctioned changes in corporate control.

4. The Rights are not real rights because
they are not a financing device.

In addition to the anomaly of purporting to allow Household's stockholders to buy a stranger's stock, the Rights created by the Plan are not "rights" as contemplated by § 157. The Household Rights were designed, and are intended, never to be exercised. They serve no financing function.

The Rights are not exercisable unless there is a potential change of control transaction -- a 20 percent acquisition or a 30 percent tender offer. Household concedes in its brief that "the purposes of the Plan would be totally undermined" if 20 percent insurgent groups were permitted. (DTB 57-58) The Plan was designed to prevent the Rights from becoming exercisable by imposing an unacceptable economic penalty on all stockholders if there is a 20 percent acquisition. Similarly, the Plan's primary purpose was to "deter any attempt to acquire [Household] in a manner or on terms not approved by the Board." (PX 211 at 2) It imposes the same unacceptable economic penalty on hostile offers to ensure they will not be made and the Rights will not become exercisable. If the board

approves a tender offer, the Rights will not become exercisable because the board will redeem them. (Clark V 238-39, VI 215; Tower X 73) The Rights are intended never to become exercisable.

If the Plan does not work as intended and the Rights become nonredeemable and exercisable,* the harm to Household stockholders is extraordinary as was conceded by Household's key witnesses at trial. (See Pt. III.A.1 below) This makes Household's Plan a unique "financing" device. If it works, it serves no financing function. If it does not work, the purported "financing" device vests causing severe economic damage to all stockholders.

In "the real world," as Household is fond of saying, Household has not issued, nor has it intended to issue, rights to acquire securities; it has simply defined in a filed document certain potential "rights" which have so disastrous an effect that their activation is intended never to occur. It would come as a shock to a General Assembly, which believed that it had passed a statute to validate an existing financing practice, to find that unwittingly, it had authorized a draconian anti-takeover device utterly unrelated to the function of the statute. A plain and common sense reading of the statute and its legislative history shows that whatever "rights" the General Assembly authorized in § 157, dormant devices denominated rights designed solely to deter takeovers were not intended to be numbered among them.

* The Rights theoretically would be exercisable to buy Household's preferred for a price out of the money by over 300 percent. The preferred was priced to ensure that no one would exercise that right because if the Rights-holders did, the anti-takeover aspect of the Plan would be lost. The Rights are also theoretically exercisable upon a hostile merger to buy the acquirer's stock for half price. Because of the massive dilution inherent in this Right, the Plan virtually guarantees no hostile merger will ever be proposed.

Such a construction of § 157 is required by existing law. In Aldridge v. Franco Wyoming Oil Co., supra, for example, the Supreme Court held that a charter provision was invalid because its purpose was not consistent with the power granted by the portion of the DGCL that, in form, was said to authorize it. The defendant corporation had two classes of stock, common and Class A. The charter provided that no person could be elected a director if 40 percent of Class A stock was cast against his election. The Class A stock was issued pursuant to then § 13 of the DGCL which authorized the creation of a class of stock with voting rights expressed in the charter. Chief Justice Layton found that "the right attached to the Class A stock is not, in reality, a voting right as such right is generally understood" because a voting right is the right to express an affirmative preference or choice, rather than a right to veto. 14 A.2d at 381. Thus, the Chief Justice stated:

If the extraordinary power conferred on the Class A stock is to be upheld, some provision of the law must be found which, either by express words or necessary intendment, authorizes the creation of the power. It is sufficient to say that the right conferred on the special class of stock, in the guise of a voting right, is not within the intendment of the law as it is now written. . . . (emphasis added)

Many other cases hold that statutes are to be construed consistent with their purpose. See, e.g., Application of Penny Hill Corp., Del. Supr., 154 A.2d 888, 891-92 (1959) ("To determine the significance of these clauses as they appear in this statute, we must look into the purpose and intention of the Legislature. . . ."); E.I. du Pont de Nemours & Co. v. Clark, supra, 68 A.2d at 439 ("Whatever the nature of the statute under construction may be, the primary object of construction is to reach a result in conformity with the supposed policy of the statute.").

Section 157 was intended to authorize financing devices and, therefore, cannot be cited as a source of power for a device labelled a financing device but which is solely intended to deter takeovers.

5. The Telvest analysis condemns the Plan.

What Household has devised, then, is not a right but a sham right. Webster's defines a "sham" as "an imitation or counterfeit purporting to be genuine." Webster's Ninth New Collegiate Dictionary, at 1081. Chancellor Brown's decision of Telvest, Inc. v. Olson, Del. Ch., C.A. No. 5798, Brown V.C. (March 8, 1979) (PTB App. A), as he reaffirmed it in National Education Corp. v. Bell & Howell Co., Del. Ch., C.A. No. 7278, Brown, C. (Aug. 25, 1983) (PTB App. B) is on target. The Chancellor there stated that the Telvest preferred

was clearly a sham insofar as it purported to be a preferred stock. It carried no real preferences whatever other than a grant of increased voting power. So viewed, it was nothing more than an attempt by a board of directors, by resolution, to change the existing voting rights of the common shareholders without their consent so as to make a hostile acquisition of the corporation more difficult to achieve. (Slip op. at 9-10)

The sole and expressed purpose and effect of the Plan is the use of the flipover to retain, in the board, control over changes of ownership of the corporation.* As the Franco Wyoming and Telvest cases illustrate, the powers granted in the DGCL have been developed and are interpreted to serve the interests represented by their functions. To paraphrase Telvest, the purported "right" is nothing more than an attempt by a board of directors, by resolution, to change the existing rights of stockholders without their consent so as to make a hostile acquisition of the corporation more difficult to achieve.

* The opinion of Household's Delaware counsel did not reach the validity of the flipover provision. The opinion recites:

[W]e are of the opinion that, when properly and duly issued, the Rights will constitute validly issued and outstanding rights to subscribe to the Preferred Stock of the Company. (PX 238 at 6)

III. THE PLAN IMPERMISSIBLY RESTRICTS
THE RIGHTS OF FREE ALIENATION AND
FAIR CORPORATE SUFFRAGE.

A. The Plan Is An Impermissible
Restraint On Alienation.

Defendants do not dispute that a restraint on alienation may not be lawfully imposed without the consent of each stockholder whose stock has been so restricted. DGCL § 202(b); Joseph E. Seagram & Sons, Inc. v. Conoco Inc., 519 F. Supp. 506 (D. Del. 1981). Defendants do not argue consent has been obtained. Rather, they argue that the Plan does not impose "restrictions on the transfer of title to the securities and the attendant rights that the securities represent" because they do not flatly prohibit the transfer of securities. (DTB 65)

As a court of equity, Chancery has always "look[ed] to the substance of a transaction, not to its form." DMG, Inc. v. Aegis Corp., Del. Ch., C.A. No. 7619, Brown, C., slip op. at 13 (June 29, 1984) (PTB App. D). Consistent with this principle, this Court has not hesitated to void indirect restraints. In Greene v. E.H. Rollins & Sons, Inc., Del. Ch., 2 A.2d 249 (1938), this Court struck down a restraint on alienation by a device which, while not in form a transfer restriction, like the Plan erected practical economic barriers to the free alienation of shares. Pursuant to a charter provision, the board of directors was given the right to repurchase its stock at book value from any stockholders the board determined to be "unsuitable." Because the repurchase price could be far below market and there was no way for a potential purchaser to know if he would be deemed "unsuitable," the number of potential purchasers of the company's shares would be severely limited. Id. at 253. The Court held that the charter provision -- which imposed a potential economic penalty on the purchasers

of shares -- constituted an unlawful restraint on alienation.* In Greene, the restriction was consented to as a part of the company's original charter; the issues there were whether the charter created a restraint on alienation and whether it was reasonable. Here, since there has been no attempt to obtain stockholder consent, reasonableness is not even an issue.

1. The Plan restrains alienation by preventing 20 percent share ownership.

Defendants' argument that the Plan does not constitute a practical restraint on alienation ignores the uncontradicted testimony of their own witnesses that no rational investor would -- by acquiring more than 20 percent of Household stock -- make the Rights non-redeemable. The reason is obvious: if the Rights become non-redeemable, all stockholders, including the 20 percent holder, will be severely harmed.

Clark testified:

- Q. Now, you will agree with me, won't you, that however irrational it is for anyone to acquire 20 percent, that this most important feature of the plan [the power of redemption] utterly disappears once the rights are triggered by a 20-percent acquisition?
- A. I will agree with you that if you have an irrational person who is willing to put \$400 million into a situation that he would deem to be harmful to him and other shareholders -- yes, it could happen. But I would suggest to you that -- I would agree with you it is a possibility, but I would very strongly suggest to you the probability is zero.

(Clark VI 215-16, emphasis added) Whitehead conceded that a 20 percent stock acquisition would be harmful to the interests of all stockholders: "I believe that if the rights were to become non-redeemable today, that would be harmful to

* Section 202(c) validates certain designated voluntary restraints on alienation; all other restraints are to be judged under common law standards. See R. Reed, Section 202 of the Delaware Corporation Law - Per Se Rules for Stock Transfer Restrictions, 9 B.C. Ind. & Com. L. Rev. 405, 410-12 (1968). Thus, the rationale of Greene that alienation may be illegally restricted in the absence of a technical restriction on transfer is not altered by Section 202.

the interests of the stockholders." (Whitehead VI 55) Higgins confirmed the statement in the Board memorandum that non-redeemability would seriously restrict Household's ability to negotiate a White Knight transaction. (PX 183 at 3) Higgins also recognized that "no one is going to come after this company on a hostile basis once those rights become non-redeemable." (Higgins VII 145-46)*

In economic terms, therefore, the Household board's Plan stops anyone from acquiring more than 20 percent of Household's stock as effectively as a board's refusal to recognize the transfer of shares to anyone attempting to acquire more than 20 percent of a company's stock. Chief Judge Latchum's decision in Joseph E. Seagram & Sons, Inc. v. Conoco Inc., supra, is controlling precedent in this regard. Seagram holds that "a Board of Directors [cannot] unilaterally ... impose stock transfer restrictions, which might be of significant economic consequence, on existing shares without the consent of the corporation's shareholders." Id. at 513. Such restraint would be unlawful because it would thereby "severely circumscribe an existing shareholder's market for selling [his] Stock." Id.

Defendants claim that the "Rights Plan has had no effect whatever on the negotiability of Household shares [because] a willing seller can today sell,

* Defendants appear to argue that the 20 percent limitation on stock ownership is not harmful to Household and its stockholders because there was "no evidence . . . that a 20% purchase with no change-of-control intention had ever occurred at any company." (DTB 63-64n) Defendants' argument ignores the testimony of their own witness and exhibits. Director-defendant Upton (a former professor of corporate finance) testified that there are "legitimate reasons" "serious investors" purchase more than 20 percent for "investment purposes." (Upton Dep. 32-33) Higgins' testimony, no matter how defendants may wish to view it, was to the same effect. (Higgins VII 222-23) Notable examples of such 20 percent non-control investments, many of which are referred to in defendants' own exhibits (DX 24, 25), are Seagram's investment in du Pont (Ex. 1), Flick's longstanding investment in W.R. Grace (Ex. 2), Competrol Limited's investment in Donaldson, Lufkin & Jenrette (Ex. 3), the trusts' investments of 27 percent in Carnation Company, and the Meadows Foundation's former 26 percent interest in GAO, among many others.

and a willing buyer can today buy" (DTB 65-66) This argument simply ignores the holding of Seagram that the restraint need not be absolute to be unlawful. Here, as in Seagram, the shares continue to be traded and at prices reflecting the additional attention focused on Household as the result of this lawsuit. Nonetheless, the "economic significance" of the Plan's restraint is far greater than in Seagram because it limits all potential purchasers to less than 20 percent ownership.*

2. The Plan restrains alienation by
detering all hostile tender offers.

The Plan's impact on tender offers more severely circumscribes the "existing shareholder's market" for selling Household stock than in Seagram, where the restraint only impeded alien offerors. There can be no dispute as to the unprecedented limitations which the Plan imposes on tender offers.

Missing from defendants' discussion of how "the Rights Plan does not prevent a hostile tender offer" (DTB 44-56) is any mention of the massive cost the Plan adds to a second-step merger and the in terrorem effect that added cost has on bidders. Defendants give no hint that if, as is not uncommon, 10 percent of the shares and Rights remain outstanding after the first step tender offer (Higgins VII 190-91), an offeror would have to pay an additional \$600 million to acquire 100 percent of Household's stock and that if 20 percent of the Rights

* Defendants' attempt to distinguish San Francisco Real Estate Investors v. Real Estate Investment Trust of America, 701 F.2d 1000 (1st Cir. 1983), on the ground that it is limited to the narrow issue of whether a by-law limiting ownership to 9.8 percent of the stock violated the provisions of a declaration of trust, is unavailing. (DTB 66) The term in the declaration which the court found violated by the limitation on ownership provided that trust certificates were freely negotiable by certificate holders. Section 159 of the DGCL is comparable to the trust provision at issue in San Francisco since it too provides that stock certificates are negotiable personal property. Thus, in both situations, the negotiability of stock certificates -- guaranteed either by agreement or by statute -- has been restricted unlawfully by a board-imposed limitation on stock ownership.

remained outstanding the offeror would have to pay \$1.2 billion more than originally intended. (Trough VIII 55-57; PX 183 at 1)

Defendants say that the plaintiffs have failed to prove "one necessary premise" of their argument by failing to call a witness to validate the "assumption that potential acquirors who see money to be made in acquiring Household will 'pass silently by'." (DTB 44) Household is correct that this premise, or assumption, is important. The Plan's effect of eliminating potential offerors is one of its aspects that harms stockholders the most.

Defendants are incorrect, however, in their assertion that the proposition is without decisive record support. Household's own witness, McMahon, in words almost identical to the proposition Household challenges, testified that the very purpose of the Plan:

is to discourage people from trying to come after Household with ... an offer that the board does not feel is in the interest of the shareholders and instead pick another target. (McMahon IX 208, emphasis added)

Higgins testified that the Plan is "going to deter anybody who is thinking about making an offer ..." (Higgins VII 51-52, 124-25) and went on to describe the Plan as a "mine field" and said only those willing to "tolerate ... the pain" would make an offer and then, because of the "tremendous downside risk," only as "one of the last alternatives." (Higgins VII 53, 60, 82, 129-30, 190) For the plaintiffs, Greenberg (IV 72, 75), Abbott (III 77-78, 89, 91-94, 97) and Jensen (IV 179-92) each testified that no rational offeror would be willing to risk the added cost the Rights would impose on second step mergers and, as a result of the added cost, would not make an offer.

Defendants' attempt to minimize the effect of the Plan on two-tier and any-and-all offers ignores or distorts the relevant testimony. They fail to even mention Whitehead's testimony:

Q. This rights plan absolutely stops two-tier tender offers, does it not, if the board doesn't approve?

A. If the board doesn't approve, yes.

(Whitehead VI 67) Higgins also explicitly said no offeror would make a two-tier offer for 100 percent of Household's stock because of the Rights remaining outstanding after the first step:

You know, the two-tier front-end loaded -- that I ... complete in that back-end come hell or high water, and I don't believe any rational chap is likely to do that.

(Higgins VII 157, emphasis added; see also Higgins VII 140-41, 152-53)

Nor does defendants' 95 percent minimum offer scenario provide a viable means of successfully making an any-and-all offer since it ignores the "real world" history demonstrating that a tender offer conditioned on the tender of a very high percentage of the shares has never been made before. (Higgins VII 184-85; Wilcox IX 67, 92) Wilcox's contrary claim that a high minimum offer for Household stock would not be regarded as a "weak" one because the financial community would understand that the condition was imposed because of the Rights, rather than the financial condition of the offeror, is specious. (Wilcox IX 68-69; DTB 49-50) Wilcox conceded that the marketplace will regard an offer as "weak" if it perceives that it has a slim chance of success. (Wilcox IX 91) The vice inherent in a high minimum offer is that an insufficient number of shares will be tendered (Greenberg IV 73-74; Abbott III 79) which makes the offer weak and "self-defeating" regardless of the reason for the minimum. (Higgins VII 185)* Moreover, defendants have left unrebutted, and have therefore conceded,

* Defendants suggest that because "it is not uncommon for a tender offer to attract 90-95% of the shares," an offer conditioned on a very high percentage of the shares could be made for Household. (DTB 50n) This is rebutted by Higgins who testified that by imposing a high minimum the likelihood of receiving a high percentage of tendered shares is adversely affected. (Higgins VII 185) Higgins conceded that tenders of 90 percent were common only
(Footnote continued)

the mathematically provable fact that their control (with their "friends and clients") of more than 10 percent of Household stock makes a hostile 95% minimum offer impossible. (PTB 12-13)

Finally, defendants are left to argue that because the Plan is a new development in "an area that is dynamic," ways to circumvent it inevitably will be devised. (DTB 50) The testimony of their own principal expert refutes their contention. Higgins spent many hours studying this and other rights plans (Higgins VII 181) and yet was unable to testify to any credible means to get around the Plan.* He could only suggest the possibility of partial** or very high minimum offers -- which for sound economic reasons have never done before -- or advising an offeror he could "burn up the rights" in a "gymnasium" and then conceding that it was "an absurd example, as most of mine are." (Higgins VII 219-22) Defendants thus ask this Court to ignore the economic realities of the marketplace in assessing their arguments and instead to rely on indecipherable and illusory schemes that are "never going to happen." (Higgins VII 222)***

(Footnote * continued from previous page)

in "friendly" deals. (Higgins VII 120) Higgins' chart (DX 31), which essentially dealt with "friendly" transactions, also demonstrates that there were a substantial number of cases in which the offeror did not receive 90 percent, much less 95 percent, of the shares it sought.

* While defendants point out in their brief (DTB 48n) that a report of First Boston purported to identify a way around the Plan, they fail to inform the Court that Higgins dismissed the alternative as unworkable. (Higgins VII 181-82)

** While Higgins claimed that there might be an offeror willing to make a partial offer and then wait until 1994 -- when the Rights expire -- to consummate the second-step merger (Higgins VII 149, 163), this testimony ignores the "real world" experience of offers for companies the size of Household. That experience has shown, without contradiction (PTB 9, 17), that no partial offer has ever been done for a company comparable to Household.

*** The combination tender offer and consent solicitation technique is also made impractical by the Plan. (see PTB 14-15) Both Greenberg and Higgins could not have been clearer as to their lack of confidence in the effectiveness of

(Footnote continued)

The Plan's restrictions on stock ownership and tender offers are, under the teachings of Seagram, clearly of "significant economic consequence" and "severely circumscribe" Household's shareholders' market for the sale of their stock. They are therefore in reality and effect an unprecedented and impermissible restraint on alienation.

Defendants make the in terrorem argument that a finding that the Plan unlawfully restrains alienation would require a similar finding with respect to many other takeover defenses. (DTB 66-67) But no other measure imposes such a severe economic penalty on all stockholders -- with its attendant restraint on alienation -- if a stockholder should buy as little as 20 percent of the company's stock. No other measure imposes the same penalty if groups of stockholders seek to join together to protect their investment by consolidating their holdings in an amount over 20 percent and trying to displace the board. No other measure significantly deters, if not absolutely prohibits, a potential takeover bid through the effect of the astronomical added cost of a hostile acquisition. Defendants have not offered any evidence to demonstrate that the more familiar defensive measures have these effects.

Because the Plan restrains alienation of shares without stockholder consent, it is illegal and should be voided.

(Footnote *** continued from previous page)

this technique. (Greenberg IV 77; Higgins VII 224) Moreover, defendants' "real world" examples of consent solicitations do not support their claim about the efficacy of the consent solicitation process. While they say "Jacobs used a consent as part of his strategy to acquire Pabst," they do not mention, as Wilcox's chart demonstrates, that all of Jacobs' consents were later declared invalid and he abandoned his effort. (DX 39, Tab 3, note 49) With respect to Superior Oil, Keck was able to use a consent solicitation only because he and his sister controlled over 20 percent of Superior stock. (Higgins VII 135) Undoubtedly aware of the fact that the stock ownership limitation in Superior of 35 percent was avoided by 20 percent holders (Higgins VII 132-33), the Household board was advised to employ a much lower threshold.

B. The Plan Illegally Restricts
Fair Corporate Suffrage.

Defendants claim that the Plan "does not in any way . . . prevent shareholders from mounting and winning a proxy fight." (DTB 8, emphasis added) Their position ignores the record.

It is a truism that the more stock a dissident owns the greater his chance of winning a proxy fight. (Greenberg IV 77-79; Wilcox IX 72; Troubh VIII 114-15; Higgins VII 171-72) On direct, Wilcox said the Plan would not inhibit a stockholder from being able to wage a successful proxy fight because it was possible to win with less than 20 percent. (Wilcox IX 53) The question is not whether the Plan makes it impossible for an insurgent to win a proxy contest, but whether the Plan would "unfairly hinder" an insurgent's efforts: Lerman v. Diagnostic Data, Inc., Del. Ch., 421 A.2d 906, 912 (1980). Wilcox's own chart shows that dissidents fare substantially better when they own more than 20 percent. (Wilcox IX 90) The Plan's impact on the ability of insurgents to wage a successful proxy fight is thus obvious.

Defendants do not dispute that formation of groups is common as a predicate to a proxy fight (PTB 25-27) and that their holdings are frequently in excess of 20 percent. The 21 dissidents listed on Wilcox's chart, who had more than 20 percent of their companies' stock, would have been prevented by the Plan from accumulating that amount with the result that those stockholders would not have been able to maximize the protection of their investment through a proxy contest. (DX 39)

Defendants admit that the Plan is intended to limit stock ownership to less than 20 percent:

The purposes of the Plan would be totally undermined if holders of 20% or more of the shares could put together a group of shareholders com-

mitted by agreement to concerted action with respect to a block of stock large enough to be deemed effective control of Household. (DTB 57-58)

If defendants are taken at their word, their admission demonstrates that by limiting share ownership to a level below that which defendants say is "effective control of Household," the Plan materially inhibits insurgents from maximizing their chances to win a proxy contest. On the other hand, if defendants' experts are right that an insurgent group needs substantially more than 20% to win (Wilcox IX 99, 101; Troubh VIII 113-14), the effects of the Plan are even more damaging to the insurgents' chances of success.

Household offers no reasoned defense to these unavoidable conclusions. Rather, based on the wholly speculative* testimony of Wilcox, it asserts "that there is no correlation between the number of shares held by a dissident and his chances for success in a proxy contest -- except at ownership levels so high that there is no true contest." (DTB 59) This "sporting theory" of corporate suffrage has no place in Delaware law. Proxy contestants may own as many shares as they wish to buy and may join together with others owning more. Because the Plan bars Household stockholders from reaching previously permitted "high" ownership levels, it restricts their ability to win a proxy fight.

Proxy contests are an essential means for stockholders to preserve and enhance the value of their investments. As Justice Moore stated:

The machinery of corporate democracy ... [is a] potent tool to redress the conduct of a torpid or unfaithful management.

Aronson v. Lewis, Del. Supr., 473 A.2d 805, 811 (1984). In Telvest, Chancellor Brown held that a board may not restrict voting power "on the theory that such

* Wilcox concluded, because insurgents and management both won contests where insurgents owned less than 30%, share ownership must not have been the decisive factor. (Wilcox IX 101-02) Yet he was unable to isolate what the decisive factor was in any particular contest and his testimony was pure speculation. (Wilcox IX 86)

action is needed to curtail a threat to corporate existence presented by a large concentration of stock in one shareholder." Slip op. at 15. This is the precise justification Household offers for its attempt to restrict stockholders' voting power by limiting ownership of shares and thereby the number of shares which a stockholder can vote. (DTB 57-58) Thus, a limitation on the ownership of shares carries with it as an inevitable consequence a "voting rights gloss." (DTB 8)

Defendants claim the Plan is "not remotely comparable to the actions taken by the board" in Schnell v. Chris-Craft Industries, Inc., Del. Supr., 285 A.2d 437 (1971) because "[t]he effect of what the board did there was to preclude a contest altogether" (DTB 61) Defendants misread Schnell. Chancellor Brown more precisely read Schnell in Lerman v. Diagnostic Data, Inc., Del. Ch., 421 A.2d 906, 912 (1980):

In Schnell, the incumbent board amended the by-laws to do away with the established, annually-recurring meeting date in such a manner as to give the board the power to fix the date anywhere within a two-month span. Then the board advanced the date forward one month from the former by-law date so as to allow the insurgent shareholders only some six weeks, as opposed to more than two months, in which to wage a proxy battle.

... [T]he inequitable action taken in Schnell had the effect of hindering the efforts of the challengers by severely curtailing the time in which they had to comply with the Securities and Exchange Commission requirements, to contact shareholders, etc. It did not put the challengers out of business but, the Supreme Court found, it unfairly hindered their ability to present their position to the stockholders within the allotted time, and, because it was intended to do so, this was found to be wrong. (emphasis added)

As has been shown, the Plan "unfairly hinders" dissident efforts to oust the board by prohibiting accumulation of large enough stock positions to maximize chances of success. While it may "not put the shareholder out of business," the Plan certainly advantages management at the expense of stockholders

just as does an unfairly truncated solicitation period. Schnell is controlling authority and requires that the Plan be nullified.*

IV. NEITHER THE POLICY OF THE LAW
NOR THE DECIDED CASES SUPPORTS
DEFENDANTS' CLAIM TO BUSINESS
JUDGMENT PROTECTION.

A. Defendants Cannot Legislate Their
Policy Judgment Under Cover Of
The Business Judgment Rule.

The law, the defendants say, "recognizes that it is the directors, not the stockholders, who have the responsibility -- and the burden -- for the corporation's governance" "in takeover and non-takeover situations alike." (DTB 40) They urge that we seek to reformulate the law based on our policy judgment that "directors have no rightful place in determining when, and at what price, a company should be sold." (DTB 42)

We acknowledge that directors have an important role to play in confronting a "hostile" or "unwanted" tender offer. The issue is whether Household's directors have the power or the right to enlarge the board's role by setting themselves up as "bargaining agent" between the Household stockholders and those who would buy their stock and by preventing dissidents (either singly or in

* By undercutting proxy fights the Plan contributes to its deterrence of tender offers. The defendants argue that if the board rejects a fair offer, stockholders can pressure the board by threatening or launching a proxy fight. (DTB 46-47; Higgins VII 63-67, 166) But that pressure is less effective because of the Plan's unfair restriction of proxy fights. Defendants' witnesses said a board is never forced to accept an attractive proposal. Higgins testified that a board can reject a fair offer (Higgins VII 153-54), is usually "not interested in considering the sale of their business" (Higgins VII 37) and -- like "Horatio at the bridge" -- should have a "veto power" over tender offers for Household (Higgins VII 214-16). If pressure on the board, in Higgins' words, "does not mean in any way that they would capitulate" (Higgins VII 63) when there are no Rights outstanding, a board will surely not feel compelled to accept an attractive offer when the Rights are outstanding and effectively hinders proxy contests.

a "group") from acquiring more than 20 percent of the stock. The defendants fail to address these issues. They fail even to acknowledge that their new role of "bargaining agent" necessarily diminishes the stockholders' rights. It is Household by the use of its radical device which seeks to reorder corporate governance and thereby change existing patterns of law.

Both state and federal law create a role for boards of directors in dealing with takeover bids. In statutory transactions, such as mergers or consolidations, the DGCL requires board approval of the terms and conditions of the transaction before any agreement can be presented to stockholders for a vote. Sections 251 et seq.* The DGCL vests in boards of directors the power to manage the business and affairs of the corporation and thus to exercise the powers of the corporation found in the DGCL or the certificate of incorporation. Section 141(a). These statutory powers may be exercised in the context of control contests, including tender offers that the board reasonably concludes are not in the best interests of stockholders. When they are reasonably exercised by an informed and disinterested board, the directors' action will be entitled to the protection of the business judgment rule. Pogostin v. Rice, Del. Supr., 480 A.2d 619 (1984).***

But nothing in the DGCL or any other law gives the corporation or its board of directors the power to determine whether or not a tender offer should go

* The same is true of sales of all or substantially all the assets of a corporation (§ 271) or of corporate dissolutions (§ 275).

*** Defendants contend that we argue that no defensive transaction can be validated under the business judgment rule where there is no existing takeover attempt. In fact, we do not dispute that actions within the board's powers, rationally undertaken, can be properly accomplished in such circumstances. For example, boards exercise their power under § 242 to propose charter amendments for a stockholder vote. Boards may also take steps to strengthen the company's performance or asset mix and, thus, improve the relative trading price of its stock. Panther v. Marshall Field & Co., 486 F. Supp. 1168 (N.D. Ill. 1980), aff'd, 646 F.2d 271 (7th Cir.), cert. denied, 454 U.S. 1092, 102 S. Ct. 658 (1981).

forward or the terms on which it can be presented to stockholders. That decision is reserved to the person making the offer, and the decision to accept or reject the offer is reserved to the stockholders. As Judge Weinfeld said in Conoco Inc. v. Seagrams Co., Ltd., 517 F. Supp. 1299, 1303 (S.D.N.Y. 1981):

To be sure, the Board of Directors are under a duty to exercise their best business judgment with respect to any proposal pertaining to corporate affairs, including tender offers. They 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 (emphasis added)

The right of stockholders to make their own decisions in tender offers was reaffirmed by the Second Circuit in its landmark decision in Norlin Corp. v. Rooney, Pace Inc., [Current] Fed. Sec. L. Rep. (CCH) ¶91,564 (2d Cir. 1984):

While the day-to-day affairs of a company are to be managed by its officers under the supervision of directors, decisions affecting a corporation's ultimate destiny are for the shareholders to make in accordance with democratic procedures.

Id. at 98,862. As we point out at Pt. II.B.3 above, § 203 of the DGCL supports this basic ordering of power.

We do not seek to vindicate a "policy" other than the existing legally ordained allocation of power among Household, its stockholders and directors. It is the defendants who seek to "reformulate" the law to reflect their view that they -- better than the stockholders -- can decide whether an offer to acquire a controlling amount of shares is fair or unfair to the stockholders. (See Whitehead VI 63) The defendants admit as much when they claim "this Court's role is to decide whether the Household directors formulated their policy view with the requisite care, and in reliance on qualified experts." (DTB 9, emphasis added)

A decision to change the structure of corporate governance to adopt the defendants' view of a better world is not for this Court and is certainly not for Household's board. That decision can only be made by a legislature, as Trough

acknowledged. (Trough VIII 61) Jewel Companies, Inc. v. Pay Less Drug Stores Northwest, Inc., 741 F.2d 1555 (9th Cir. 1984), is on point. In Pay Less, the Ninth Circuit flatly rejected a plea by a board of directors that the "policy" of securing the highest available price for stockholders justified the board's repudiation of its obligations under a merger agreement. In language quoted by the defendants, the court said:

No authority has previously suggested that the market for corporate acquisitions is unbounded by traditional principles of contract and corporate law. It is not the function of the courts to fashion so novel a rule or to resolve the policy disputes that have divided the economic experts. That task, if it is to be performed at all, is best left to the California legislature.

741 F.2d at 1568. Defendants' "policy" concerns, like those in Pay Less, must be addressed to Congress or the General Assembly.*

Not even the General Assembly has constitutional power to accomplish by legislation the fundamental reordering of power relationships which is the object of the Household Plan. In Edgar v. MITE Corp., 457 U.S. 624, 102 S. Ct. 2629 (1982), the Court struck down an Illinois statute which empowered a state official to prevent the making of a tender offer (unless approved by the board of directors) if he found that the offer was "inequitable." Justice White wrote:

The Court of Appeals understood the Williams Act and its legislative history to indicate that Congress intended for investors to be free to make their own decisions. We agree.

* * *

Thus, as the Court of Appeals said, "[t]he state thus offers investors protection at the expense of investor autonomy -- an approach quite in conflict with that adopted by Congress."

* Household's Special Counsel, Martin Lipton, submitted proposed legislation on this subject to Senator Alfonse M. D'Amato and Representative Timothy E. Wirth on November 20, 1984. According to Mr. Lipton, his proposed legislation is designed, in part, to eliminate "abusive front-end loaded two-tier tender offers . . . and thereby eliminates the need for takeover targets to resort to shark repellents, crown jewel options, pac-man defenses, issuance of blocking preferreds, poison pills, greenmail and other pejoratively named defenses. . . ." (Ex. 4)

457 U.S. at 639-40, 102 S.Ct. at 2639-40 (citations omitted). See also Kennecott Corp. v. Smith, 637 F.2d 181, 187-88 (3d Cir. 1981); Great Western United Corp. v. Kidwell, 577 F.2d 1256, 1279 (5th Cir. 1978), rev'd on venue grounds sub nom. Leroy v. Great Western United Corp., 443 U.S. 172, 99 S. Ct. 2710 (1979).

The Household Board not only lacked authority under the DGCL to effect the Plan, it also lacks authority to accomplish its apparent goal -- the alteration of the structure of corporate governance to give the board the power to determine the fate of takeovers. The business judgment rule does not protect unauthorized acts.

B. The Defendants' "Interest" Precludes
The Application Of The Business
Judgment Rule.

1. The Plan created an "interest"
on the part of the defendants.

Where board action, unlike the Plan, falls short of altering the structure of corporate governance, the business judgment rule still does not insulate it where that action is taken for the sole or primary purpose of strengthening the board's control or has the effect of interfering with fundamental stockholder rights. In such cases, the board must demonstrate the fairness of its action. See Good v. Texaco, Inc., Del. Ch., C.A. No. 7501, Brown, C. (May 14, 1984) (PTB App. F); Norlin Corp. v. Rooney, Pace Inc., [Current] Fed. Sec. L. Rep. (CCH) ¶ 91,564 (2d Cir. 1984);* Thompson v. Enstar Corp., Del. Ch., C.A. Nos. 7641, 7643, Hartnett, V.C. (July 5, 1984, revised August 16, 1984) (PTB App. E).

* Johnson v. Trueblood, 629 F.2d 287 (3d Cir. 1980), cert. denied, 450 U.S. 999, 101 S. Ct. 1704 (1981) is not to the contrary. All the court did there was to uphold a jury instruction that a finding that the defendants acted "solely or primarily because of a desire to retain control" would suffice to rebut the presumption of the business judgment rule. 629 F.2d at 292. The court of appeals did not review that jury's application of the instruction to the facts. Id. at 293.

In Good, the Texaco board approved a "stand still" agreement by which it acquired voting control over 5 percent of Texaco's voting stock. Moreover, if certain proposed charter amendments were adopted, Texaco's board would "have acquired the right to control 25% of the vote which will be needed [t]hereafter to veto or vote down any attempt by Texaco's shareholders to approve a business combination not favored by them which might result in their removal from office." Slip op. at 10. On these facts, the Chancellor found the directors "necessarily interested in the transaction." Slip op. at 11.

Household's directors, by adopting the Plan, have given themselves far greater powers to control the destiny of the company than it was alleged Texaco's board did. No business combination not approved by the board will be presented to the Household stockholders. No stockholder or group of stockholders owning 20 percent or more of Household's stock will confront the board in a proxy contest. Good applies a fortiori. Defendants respond to Good in a footnote and argue only that Good is a case concerning the demand requirement of Rule 23.1. (DTB 55n) That is not a reasoned distinction. The Chancellor excused demand because he concluded that the directors were "interested" and therefore not entitled to the protection of the business judgment rule. See also Norlin, supra (directors, who vested in themselves voting power over stock issued to an ESOP and a subsidiary, were "interested" and therefore not protected by the business judgment rule.)*

* Defendants make a similarly facile effort to avoid the clear language of Vice Chancellor Hartnett's opinion in Enstar, supra. They say the Court applied the business judgment rule to the lock-up in Enstar. They ignore the Court's plain distinction between its "careful scrutiny" of the lock-up -- which it found "often prevented open bidding for assets, which [is] in the best interests of the shareholders," slip op. at 11 -- and its business judgment analysis of the agreement to merge.

2. The defendants cannot demonstrate the fairness of the Plan.

The evidence is clear that the Plan radically weakens the stockholders' role in each of the recognized corporate change of control mechanisms. The Plan effectively bars ownership of 20 percent of Household's stock by an individual or group, as defendants concede. (DTB 57-58; see also Pt. III.A. above) The Plan significantly inhibits and restricts the right of potential insurgents to wage an effective proxy contest to remove management. (See Pt. III.B. above) The Plan makes hostile tender offers impractical. (See Pt. III.A.2 above) The defendants' own letter to stockholders seeking to justify the Plan admits that it "should deter any attempt to acquire your company in a manner or on terms not approved by the Board." (PX 211 at 2) No authority defendants can cite justifies these effects on the rights of stockholders.

On page 62 of their brief, defendants advance four reasons why they claim stockholders benefit from the Plan. None of these "benefits" is substantial. First, they say that the ability of the board to act as "bargaining agent" "gives the shareholders a realistic opportunity to get the best price in a takeover." (DTB 62) Defendants cite no evidence that boards of other companies without Plans cannot act effectively to secure a fair price for stockholders in a takeover. Defendants must acknowledge that this new power of the board comes at the expense of the stockholders' rights, including the right to sell shares to persons of whom the board does not approve. That right is itself a means of producing optimum value by fostering a free market for corporate control. (Jensen IV 175-76) The existence of that market is of significant value to stockholders (Jensen IV 135, 174-75) and is an integral part of the legal structure erected by Congress and the General Assembly.

Second, defendants claim that by deterring two-tier front-end loaded tender offers, the Plan protects stockholders from having to surrender their

shares at an inadequate price. The evidence at trial showed no instance in which a two-tier front-end loaded offer succeeded at an unfair price.* The record at trial did show that two-tier offers are frequently used methods of acquisition (Higgins VII 138-40) that often prove to be of significant economic value to stockholders. (PTB 7-8) Any "benefit" to stockholders in prohibiting two-tier front-end loaded offers is achieved by preventing all two-tier offers, which Whitehead admitted the Plan "absolutely stops," (Whitehead VI 67) and deterring all hostile acquisitions of the company. Defendants make no effort to justify these effects of the Plan as beneficial to the stockholders.

The defendants' last two claimed "benefits" of the Plan are even less substantial. They say the Plan assures stockholders a continuing equity interest in Household's business "should an acquiror of Household determine to merge out the remaining shares." (DTB 62) All of the evidence shows that this will never happen and that, in fact, the in terrorem effect of the 2-for-1 flipover is intended to prevent its occurrence. (See Pt. II.B.4 above) Finally, they say the Plan creates the "possibility" that stockholders may profit, at some time in the future, by purchasing the preferred stock (or selling the Right to do so.) (But see PTB 33-34) This after-the-fact rationalization ignores the uncontradicted testimony of defendants' own witnesses about the disastrous consequences to all stockholders if the Rights become non-redeemable. (See Pt. III.A.1 above) By

* Defendants expend enormous rhetorical energy denigrating two-tier offers, but concede that the two-tier offers for Conoco, Marathon Oil and Enstar were "good." (DTB 53) Defendants qualify this concession by stating the only "good" two-tier offers are ones which a board of directors can negotiate. Id. They ignore the fact that even "bad" two-tier offers start the competitive bidding process which leads to the payment of substantial premiums to stockholders in tender offers. The SEC did not distinguish between negotiated and non-negotiated transactions in finding that two-tier offers significantly benefit stockholders by providing them with 55 percent blended premiums, or in refusing to prohibit such offers on the ground that they are coercive. (PX 333 at 3, 9)

its very terms, the Plan permits the Rights to vest and become non-redeemable without the knowledge or consent of the board. No device which poses such severe consequences to the economic interests of stockholders can be regarded as "fair" or even rational.

Since the interested nature of the transaction places the burden of proof on the defendants and an objective review of the evidence demonstrates that the burden has not been satisfied, the Plan must be struck down.

C. Defendants Have Failed To Cite A
Single Case To Justify Validating The
Plan Under The Business Judgment Rule.

As the foregoing makes clear, we do not seek to "shrink," "whittle away at," "turn upside down," or otherwise impose any new limitation or stricture on the business judgment rule. Distilled to its essence, defendants' business judgment argument is that because board defensive actions that have had far more detrimental effects on companies than the Plan has on Household have been upheld under the business judgment rule, the Plan must be upheld.

Remarkably, and despite this Court's specific invitation, Household has failed to analyze -- indeed it appears to ignore -- the opinions of the courts validating those anti-takeover actions. Instead, it relies on assertions by counsel and hearsay testimony from Higgins (based not on personal knowledge but on newspaper accounts) as "evidence" of the allegedly sweeping effects of the defensive transactions there at issue. The reality of those cases is much different. A reading of the opinions shows that, in fact, where such transactions have approached the Plan in detrimental effect or, like the Plan, have been wholly lacking in independent economic or other significance apart from their anti-takeover effect, the courts have not hesitated to strike them down. Those transactions which are beneficial to the corporation, on the other hand, have been approved.

1. The detrimental effects of the Plan far exceed those of any defensive transaction cited by defendants.

Defendants refer to Higgins' testimony that the defensive actions undertaken by Carter Hawley Hale had "ripped the guts out of the company." (DTB 14) To begin with, his testimony is plainly incompetent; Higgins conceded that his knowledge of the Carter Hawley-Limited struggle was based solely on newspaper reports. (Higgins VII 39-40) In fact: (i) the Limited -- which raised its bid \$5.00 after Carter Hawley took its defensive actions, S.E.C. v. Carter Hawley Hale Stores, Inc., 587 F. Supp. 1248, 1251 (C.D. Cal. 1984) -- obviously didn't think Carter Hawley had committed hari-kari; (ii) Waldenbooks, the supposed prize asset, or "guts," of Carter Hawley, was apparently not deemed especially attractive by General Cinema, which declined to exercise an option to purchase it for \$15 million less than the price at which the subsidiary was ultimately sold to K-Mart; (N.Y. Times, July 24, 1984, § D, at 3, col. 2) (Ex. 5); (iii) contrary to defendants' claim, Carter Hawley stockholders were asked to vote on the sale of preferred stock to General Cinema -- and approved it by a resounding 83% vote (N.Y. Times, July 27, 1984, § D, at 5, col. 5) (Ex. 6); and (iv) the damage cannot have been too crippling since Carter Hawley recently reported a 58% earnings increase in the third quarter of 1984 over the comparable 1983 period (N.Y. Times, Nov. 13, 1984, § D, at 27, col. 3) (Ex. 7).*

* In addition, Carter Hawley's action did not stop the Limited, which failed to get control of Carter Hawley only because it did not receive sufficient tenders. (The Washington Post, May 22, 1984, § C. at 4) (Ex. 8)

Defendants mistakenly suggest that by pointing out that most of the defensive transactions did not stop the takeover to which they were directed, we "seem to be saying that an anti-takeover device is within the business judgment rule only if it ultimately proves to be unsuccessful." (DTB 39) In fact, we pointed out that fact only to show that the effect of those devices -- which did not even stop the takeover they were aimed at -- fell far short of the effect of the Plan, which effectively stops all offers for Household.

(Footnote continued)

Defendants refer to Higgins' testimony, again based entirely on newspaper reports and other hearsay (Higgins VII 40-41), that Pogo's issuance of new preferred stock and commencement of a self-tender offer created "a much more highly leveraged company . . . [with] different investment characteristics."

(DTB 14) The Pogo opinion itself belies any notion that the "difference" in the company was necessarily harmful to Pogo's business. The court held there that Pogo's reasons for the self-tender -- to deter a takeover by persons not competent to run the business, and to give a greater number of Pogo stockholders an opportunity to sell their shares at a premium -- were reasonable. Pogo Producing Co. v. Northwest Industries, Inc., C.A. No. H-83-2667, slip op. at 9, 11 (S.D. Tex. May 24, 1983) (PTB App. I).*

Citing the Carter Hawley and Pogo situations, defendants argue that a board's decision to issue new securities "is deferred to, and expressly upheld by, the courts." (DTB 14-15) But in Podesta v. Calumet Industries, Inc., [1978

(Footnote * continued from previous page)
(PTB 34-36)

In Whittaker, where the offeror withdrew, the court expressly held that the sale did not preclude that or any other offers for the company. Whittaker Corp. v. Edgar, 535 F. Supp. 933, 949 (N.D. Ill. 1982), aff'd, Nos. 82-1305, 82-1307 (7th Cir. Mar. 5, 1982).

* Defendants refer to Higgins' testimony that Martin Marietta's counter-tender offer for Bendix produced a company with a debt-equity ratio that would "change the very operating philosophy [of the business]." (DTB 14; Higgins VII 163) The court in Martin Marietta noted that Marietta might be required to sell certain non-core assets but also suggested that "[l]eaner is not necessarily weaker; in light of the apparent agreement among the parties that Marietta has had a good track record in running its aerospace businesses, a streamlined Marietta could emerge as a very powerful company." 549 F. Supp. at 631. While Higgins undoubtedly was personally familiar with the Bendix-Martin Marietta fight at its outset, the record is undisputed that he and his firm were supplanted in midstream as Bendix's investment banker by First Boston. His attitude is also doubtless colored by his position as a representative of Bendix, the target of Marietta's offer. (See Higgins VII 126, 161-62) In any event, his testimony is contrary to the findings of the court -- which in the last analysis are controlling.

Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,433 (N.D. Ill. May 9, 1978), Condec Corp. v. Lunkenheimer Co., Del. Ch., 230 A.2d 769 (1967), and Norlin, stock issues were struck down, in each case because they lacked independent economic significance or other purpose apart from takeover defense.*

Defendants refer, without citation except to their own pre-trial brief, to the alleged fact that the sale of "crown jewel" subsidiaries upheld in GM Sub Corp. v. Liggett Group, Inc., Del. Ch., C.A. No. 6155, Brown, V.C. (April 25, 1980) (PTB App. J) and Whittaker Corp. v. Edgar, supra, "materially changed the nature of their businesses." (DTB 14) The sale of an operating subsidiary always changes the nature of a company's business; defendants cannot contend that mere validation of the sale of a business by a Delaware corporation somehow justifies the Household board's adoption of the Plan. The fact is that Liggett sold its Austin Nichols subsidiary for twenty-two times earnings compared with a tender offer price of eight times earnings, slip op. at 4, and Brunswick obtained 20 percent more for its subsidiary than the value attributed to it by hostile offeror Whittaker. 535 F. Supp. at 938, 941-42.*** By contrast, in Gimbel v. Signal Companies, Inc., Del. Ch., 316 A.2d 599, aff'd, Del. Supr., 316 A.2d 619

* Other stock issuance cases cited in defendants' pre-trial brief (DPTB 65-69) and distinguished in our opening brief (PTB 54-56) are conspicuously absent from defendants' post-trial brief. Suffice it to say that the issuance of stock in Crouse-Hinds Co. v. InterNorth, Inc., 634 F.2d 690 (2d Cir. 1980), was effected to facilitate consummation of a merger agreement negotiated before InterNorth's offer; the issuance in Treadway Companies, Inc. v. Care Corp., 638 F.2d 357 (2d Cir. 1980), was to facilitate a bona fide merger with a third party; the Court found that the issuance in Heit v. Baird, 567 F.2d 1157, 1161 (1st Cir. 1977), could have "served any number of entirely proper corporate purposes"; and the issuance in Buffalo Forge Co. v. Ogden Corp., 555 F. Supp. 892 (W.D.N.Y.), aff'd, 717 F.2d 757 (2d Cir.), cert. denied, 104 S. Ct. 550 (1983), was not intended to, and did not, foreclose competitive bidding -- to the contrary, the court found that in fact it stimulated an auction for Buffalo Forge.

*** Defendants also refer to certain alleged "greenmail" payments but candidly concede that these payments have not been validated by any court. (DTB 15n)

(1974), this Court enjoined such a sale where the compensation to be received was alleged to be "wholly inadequate." Id. at 608.

Defendants refer to their own "rescue" mission for the Jewel Companies in the summer of this year (DTB 17), without mentioning that neither Jewel's board nor its investment bankers ever found American Stores' offer to be inadequate, and that Jewel and American Stores ultimately negotiated a transaction which yielded a large premium for Jewel's stockholders -- again without benefit of any device such as the Plan. (N.Y. Times, June 15, 1984, § D, at 1, col. 3) (Ex. 9) Defendants refer repeatedly to Avco and Leucadia (see DTB 15, 16n, 18, 30), without reference to the "real world" facts that Avco's so-called "green mail" payment to Leucadia was at \$35 per share and that Avco's stock continued to climb after the repurchase, closing on November 29 at \$41-3/8. (N.Y. Times, Nov. 30, 1984, § D, at 7, col. 1) (Ex. 10) In fact, on December 3, a negotiated takeover of Avco by Textron was announced at \$50 per share, all without the operation of a device like the Plan. (The Wall Street Journal, Dec. 4, 1984, at 5, col. 1) (Ex. 11)

In short, there is no dispute that the defensive transactions in the cases cited by defendants effected certain reallocations of corporate resources. But there is no record evidence -- other than counsel's ipse dixit assertions and Higgins' hearsay-based conjectures -- that such reallocations had a material detrimental effect on the companies' businesses, let alone the welfare of their stockholders. Moreover, unlike any anti-takeover transaction cited by defendants, the Plan precludes the effective operation of the only mechanisms by which stockholders can effect changes in corporate control without management's consent -- large share accumulations by tender offer or otherwise and proxy contests.

That impact vastly exceeds the impact of any other defensive transaction,* and no business judgment precedent founded on any other such transaction can validate the Plan.

2. The caselaw requires that defensive actions be justified by some proper corporate purpose other than resisting an unwanted takeover.

In support of their argument that "repeatedly and explicitly the cases recognize that preventing harmful takeover activity is itself of great 'economic substance'" defendants cite a single case -- the Pogo decision. We are unable to find any support for their argument in that opinion. By contrast, the argument that takeover defense can constitute per se economic significance (or, more broadly, a proper corporate justification of any kind) was squarely rejected in Norlin and Telvest. Norlin argued that its issuance of shares without real consideration to an ESOP was justified because the board needed to "buy" time to explore alternatives to a Piezo takeover:

The company asserts that the shareholders will benefit if the directors are insulated from challenges to their control, for an interim period of unspecified duration, so that all of Norlin's future options can be considered with professional guidance.

Id. at 98,869. The court gave the argument little heed:

We have never given the slightest indication that we would sanction a board decision to lock up voting power by any means, for as long as the directors deem necessary, prior to making the decisions that will determine a corporation's destiny. Were we to countenance that, we would in effect be approving a wholesale wresting of corporate power from the hands of the shareholders, to whom it is entrusted by statute, and into the hands of the officers and directors.

* Defendants' reference to other "poison pills" and their consequences does not support their contention that the Rights Plan is not a deterrent to a hostile offer. (DTB 47) Unlike the Lenox and Superior preferreds, the Rights have a 2-for-1 flipover -- the dilutive feature that makes this poison pill unique and lethal. (Trough VIII 54-57; Higgins VII 133, 137) Defendants' reliance on Huffington v. Enstar Corp., Del. Ch., C.A. No. 7543, Longobardi, V.C. (April 25, 1984) (Ex. 12) at 7 is puzzling. The legitimacy of the Enstar "suicide" poison pill was not at issue in that case.

Id. To the same effect is Telvest, supra, slip op. at 15:

[T]o the extent that OSI relies on the decisions in Kors v. Carey, Del. Ch., 158 A.2d 136 (1960); Cheff v. Mathes, Del. Supr., 199 A.2d 548 (1964); and Kaplan v. Goldsamt, Del. Ch., 380 A.2d 556 (1977), I agree with Telvest that such reliance is misplaced Those cases do not purport to authorize management, without putting the matter to the shareholders, to superimpose new strictures on existing shareholder voting power on the theory that such action is needed to curtail a threat to corporate existence presented by a large concentration of stock in one shareholder.

Norlin and Telvest are logically indistinguishable from this action.

Defendants have conceded that their sole purpose in adopting the Plan was to ensure a greater role for themselves in determining the fate of tender offers. They protest, of course, that they seek to accomplish that goal for the greater good of the stockholders* -- but so did the board in Norlin and the OSI board in Telvest.

Defendants' argument that there is no requirement that transactions have independent economic or other significance apart from any anti-takeover effect in order to be entitled to business judgment protection is equally unavailing. Where a Delaware corporation effects a business transaction that lacks independent economic substance it will be struck down as a waste of assets; where it effects a non-economic transaction (e.g., a bylaw change) which has no corporate purpose apart from its anti-takeover effect, the courts will also strike it down.

* Defendants' protestations of good faith in that regard is undercut by a number of record facts: Clark's refusal even to meet with Bachheimer regarding a possible acquisition of Household (Clark V 189); Clark's fear of putting his company "on the block" (Fahey Dep. 143; PX 191 at H00393-400); the board's adoption on August 14 of a corporate "independence" resolution (PX 203); the Board's hasty adoption of the Plan because of their unfounded fear of a Moran takeover (see PPTB. 23-24); and the advice of Goldman, Sachs to management that it not discuss unsolicited takeover proposals with anyone. (Fahey Dep. 143-49; Whitehead VI 43-44)

For example, in invalidating a stock transaction in Condec Corp. v. Lunkenheimer Co., supra, this Court laid heavy emphasis on the fact that the exchange of shares with a third party "brought no money into the corporate treasury [and] was not connected with a stock option plan or other corporate purpose." Based on the absence of any economic substance to the transaction, the court concluded that it must have been designed for the primary purpose of entrenchment. Id. at 777. Similarly in Norlin, the court placed great weight on the fact that "no real consideration was received from the ESOP for the shares [issued to it by the company]" in striking down the stock issuance. See also Royal Industries, Inc. v. Monogram Industries, Inc., [1976-77 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,863 at 91,137 (C.D. Cal. 1976); Holly Sugar Corp. v. Buchsbaum, [1981-82 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶98,366 at 92,233 (D. Colo. 1981) (by-law amendment); Schnell v. Chris-Craft Industries, Inc., supra; Telvest, supra.

Absent some independent economic substance or other valid and credible corporate purpose apart from its anti-takeover effect, no defensive device -- including the Plan -- can be upheld under the business judgment rule.

V. THE BOARD'S ADOPTION OF THE
PLAN WAS NOT THE PRODUCT OF
AN INFORMED BUSINESS JUDGMENT.

As described in the Plaintiffs' Pre-Trial and Post-Trial memoranda, the Household board's decision to adopt the Rights Plan was so hopelessly misinformed as to crucial aspects of the Plan's operation that it cannot be said that the directors were "informed of all material information reasonably available to them." Aronson v. Lewis, supra, 473 A.2d at 812. Defendants assert that it would open a "Pandora's box" to hold that directors were expected to "appreciate or remember all the complexities of a given legal document." (DTB 28) But the issue is not whether the board understood or remembered "complexities." The is-

sue is whether directors, who did not appreciate the fundamental purpose or effect of the Plan -- including the now conceded fact that the Plan was designed to prevent (i) the acquisition of 20 percent or more of Household's stock and (ii) the formation of groups of Household stockholders holding 20 percent or more of the stock -- can be held to have satisfied the legal requirement that they be informed of all material information relevant to their decision to adopt that Plan. Since the evidence establishes that the board was misinformed as to the basic nature of the Plan, the Plan was never validly adopted and must be struck down.

VI. JUDGMENT SHOULD BE ENTERED IN FAVOR OF
THE APPEARING COUNTERCLAIM DEFENDANTS
ON HOUSEHOLD'S COUNTERCLAIM.

Household's counterclaim -- frivolous from its inception -- was an effort to gain a tactical advantage in the litigation by attempting to tarnish the "first class reputation" Moran and DKM* enjoy in the financial community. (Whitehead VI 53)

Household asserted in its counterclaim that purchases of its stock by DKM and Moran in April-May 1984 violated fiduciary duties owed to Household. However, it is well settled that directors possess the same rights as other stockholders to buy and sell shares of their corporation's stock so long as they do not possess material inside information. See, e.g., Field v. Allyn; Del. Ch., 457 A.2d 1089, 1099, aff'd per curiam, Del. Supr., 467 A.2d 1274 (1983). Household offered no proof that Moran or DKM traded on the basis of any non-public information, material or otherwise. The undisputed testimony established that

* While Charles H. Dyson was also named as a counterclaim defendant, he has not been served, this Court does not have jurisdiction over him, and, in any event, no evidence was presented against him.

DKM bought approximately 500,000 shares of Household stock in April-May 1983 because the price per share had dropped to a level below the publicly disclosed book value. (Moran I 81-82) As Clark conceded, Moran advised him of DKM's purchases prior to their conclusion and neither Clark nor any other Household director objected. (Clark V 180-81; Moran I 82-84)

Household next claims that Moran's exploration of a leveraged buy-out of Household was somehow improper. A director may engage in discussions concerning a leveraged buy-out of his corporation even if he is to be a participant in the buy-out group and the remainder of the corporation's stockholders will not retain their equity participation. See Field v. Allyn, supra, 457 A.2d at 1099. Here again, the evidence is clear. At meetings Clark held with Moran on May 29 and July 16, 1984, various DKM officers and employees were active participants. Clark neither discouraged Moran from proceeding with his analyses of Household or stated any objection to the DKM employees' involvement in those analyses or the discussions. (Moran I 103-105; Clark V 189-92; Clark Dep. 135-40)

Household presented no evidence at trial to support its claims that Moran transmitted material, non-public information to individuals not entitled to it. Clark, himself, conceded that the valuation used by Moran for National Car Rental, the only "confidential" document ever identified, could have been computed by anyone sophisticated in the field and aware of recent prices for comparable companies. (Clark VI 102-03) Clark also testified that he had no evidence that Moran ever discussed confidential information with any third party. (Clark Dep. 138; Clark VI 98, 103) Moran testified that he had not. (Moran III 38; I 98, 108, 122-23)

The record establishes that Moran has acted at all times in furtherance of his fiduciary duties to Household and all of its stockholders. Judgment should be entered in favor of Moran and DKM on Household's counterclaim.

CONCLUSION

For all of the reasons stated herein and in Plaintiffs' Pre-Trial and Post-Trial Memoranda of Points and Authorities, plaintiffs and appearing counterclaim-defendants respectfully request that the Court enter judgment against defendants and counterclaim plaintiff declaring the Rights Plan invalid and unlawful and dismissing the counterclaim and granting such other and further relief as is just and proper under the circumstances.

DATED: December 5, 1984

Respectfully submitted,

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