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IN THE SUPREME COURT OF THE STATE OF DELAWARE

UNOCAL CORPORATION, a Delaware corporation, Defendant Below-Appellant v. MESA PETROLEUM CO., a Delaware corporation, MESA ASSET CO., a Delaware corporation, MESA EASTERN, INC., a Delaware corporation, and MESA PARTNERS II, a Texas partnership, Plaintiffs Below-Appellees	No. 152, 1985 Appeal from Judgment in the Court of Chancery in and for New Castle County in C.A. No. 7997

Superior Court Courtroom No. 1
Public Building
Wilmington, Delaware

Thursday, May 16, 1985
9:30 a.m.

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ORAL ARGUMENT

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BEFORE: Hon. John J. McNeilly,
Associate Justice

Hon. Andrew G. T. Moore II,
Associate Justice

Hon. Clarence W. Taylor,
Judge of the Superior Court

APPEARANCES:

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P R O C E E D I N G S

MR. SPARKS: Justice McNeilly, before I begin, let me introduce James Martin of the firm of Gibson Dunn & Crutcher who is sitting with me at counsel table this morning.

JUSTICE McNEILLY: Welcome aboard, Mr. Martin.

MR. MARTIN: Thank you, your Honor.

MR. SPARKS: If the Court please, I would like to confine my opening argument to thirty of the forty-five minutes that I understand have been allocated for each side and preserve the last fifteen minutes for rebuttal. Also I would like to thank the court on behalf of my client for hearing this matter on an expedited basis.

In my argument, your Honors, I will focus upon two issues and rely on the voluminous briefs that have been filed by both sides, both in this court and below, with respect to the other issues and perhaps those that are raised on my rebuttal argument to whatever Mr. Richards says. Those issues are Unocal right to make a selective tender offer excluding the raider and what we believe is the lack of irreparable injury in this case notwithstanding the holding in the court below.

I propose to first point to four critical facts which to some extent make this case unique. Second, I will speak generally to the policy question raised by those facts. Third, I will turn to the Vice Chancellor's opinion to summarize what I believe to have been the critical errors of law which lead to the erroneous result which she reached. And finally, and to some extent in the context of discussing that opinion, I will discuss the harm that will flow to Unocal stockholders and to stockholders of Delaware corporations generally from a decision of this court affirming the ruling below.

The four critical facts which I would ask that the court have in mind as we look at this essentially legal question are the following: First, Mesa's partial tender offer of $54 per share for 51 percent of Unocal's stock, which is to be followed by a squeeze-out merger at some uncertain date in the future for the remaining stock, for which Unocal's stockholders will receive highly subordinated debt securities. Not only was it found by Unocal's board, acting in good faith, to be inadequate but also has been objectively established on this record to be so.

Mesa's officers in proposing this transaction to its board of directors utilized an in-house analysis which they characterized as conservative, placing a value of $64 per share on Unocal, and also referred the Mesa board to a Herold's appraisal of Unocal at $73 per share and a Donaldson Lufkin & Jenrette study valuing Unocal at $86 per share. Moreover, this analysis containing these three figures was distributed by Mesa to the persons from whom it secured the financing for its offer.

Under these circumstances Mesa simply cannot deny that upon which its board relied in making its offer. What this means, your Honors, is that Mesa seeks to purchase all of Unocal at $54 a share and, upon achieving 100 percent control, to pocket the difference between that price and Unocal's present intrinsic value for itself at the expense of all the other Unocal stockholders. Even taking Mesa's conservative $64 number as Unocal's intrinsic per-share value, this selective treatment sought by Mesa would result in a gain to it of $1.5 billion at the expense of Unocal's other stockholders. If one accepts the $74 value assigned to Unocal by Herold's, which has been recognized as a qualified authority by Mr. Pickens, the gain to Mesa at the expense of Unocal's shareholders would be $3 billion.

Second, Mesa has also demonstrated by its track record that it is in the business of acquiring interests in oil companies to feather its own nest and not to benefit the shareholders of the companies in which it takes a position. After commencing coercive partial tender offers, it has repeatedly received selective treatment at the expense of other stockholders and has earned the reputation as this country's preeminent greenmailer. As Vice Chancellor Berger found, the public record justifies a reasonable inference that Mesa is seeking to be bought off at premium. As Judge Tashima found, at the beginning of its investment in Unocal and notwithstanding its professed investment intent, Mesa either sought a 100 percent control of Unocal or greenmail. And as Mr. Pickens himself has publicly stated, "I work for only one crowd. That's the Mesa stockholders."

Third, the form of the Mesa offer is coercive, leaving public stockholders with no real choice whether or not to tender. As explained in paragraph 23 of the first affidavit of Unocal's investment banker, Peter Sachs, Appendix 403-404, which testimony, your Honors, is unrebutted, the fact that shareholders are faced with a threat of winding up with a second-step merger consideration of uncertain value and at an uncertain date in the future will force them to tender into Mesa's first-step cash offer, notwithstanding its inadequacy, unless they are offered a viable alternative.

Under these circumstances, your Honors, the stockholders cannot protect themselves. Unocal's directors, as the elected representatives of the stockholders, are the only body capable of acting to protect them from Mesa's greed and coercive tactics.

Fourth, Mesa executives have testified in this action that whether or not the exchange offer goes forward and whether or not Mesa is included or excluded, Mesa intends to continue its efforts to acquire Unocal. That fact is significant when I get to the issue of irreparable injury.

The policy question that we believe is raised by these facts and as framed by Vice Chancellor Berger's rulings that the Unocal board acted with due care and were motivated in authorizing the exchange offer by a good-faith desire to protect stockholders from Mesa's inadequate offer is whether under these circumstances Delaware law will permit directors to make use of a selective tender offer and exclude a raider such as Mesa which, for purely selfish purposes and through use of coercive tactics, seeks to seize for itself valuables which belong to the other stockholders or whether, on the other hand --

JUSTICE MOORE: Excuse me, Mr. Sparks. But ordinarily that applies when there are business policies of the raider or the dissident which are at odds with the corporate purpose and the corporate enterprise. But what business policy of Mesa or Mr. Pickens does the record disclose your clients oppose?

MR. SPARKS: Your Honor, this court and other courts interpreting Delaware law have stated that one of the duties of directors in the exercise of their business judgment is to not only protect the corporation against someone who seeks to impose upon the corporation business policies which are deemed not in good faith but also --

JUSTICE MOORE: I understand that. But excuse me. What business policies of Mesa or Mr. Pickens does the record disclose your clients oppose?

MR. SPARKS: What my clients oppose is Mr. Pickens' effort through coercive tactics to impose upon the stockholders that we have a duty to protect an offer which is inadequate and deprives them of value. Simple as that.

JUSTICE MOORE: All right. Does the record disclose that Unocal is in any way acting to protect itself from a man with a bad reputation?

MR. SPARKS: I think it does, your Honor, in the sense that the directors realized at the time that they considered the steps to take against Mesa that Mesa had a history of in effect being in this game for itself. There was a statement in the briefs --

JUSTICE MOORE: Aside from being a person who wants to take over other companies --

there's nothing illegal about that -- what is the bad reputation, if any? Does the record disclose anything of that sort?

MR. SPARKS: The public record discloses extensively and the Vice Chancellor found based on that public record that Mr. Pickens has repeatedly taken a position in companies, put pressure on them through hostile offers, and then rather than going through and purchasing the company and doing anything creative with the company, he has instead through one way or another ended up being bought off. I think that is a relevant factor.

The second thing that is disclosed in the record is the nature of the financing and the nature of the way that Mr. Pickens intends to finance the second step of this transaction. Both of those result in a large debt being placed upon the company and raise the likelihood that the only way that debt could be paid off is by in effect selling off pieces of the company.

And indeed Mr. Pickens runs on a platform of restructuring. The company obviously --

JUSTICE MOORE: So that your principal objection is that the stockholders are not going to get the true value for their shares. Is that correct?

MR. SPARKS: That is the principal objection, your Honor.

JUSTICE MOORE: Now, if the exchange offer is permitted with the Mesa exclusion, will all shareholders be able to tender 100 percent of their shares for $72 and senior indebtedness without proration?

MR. SPARKS: Absolutely not, your Honor.

JUSTICE MOORE: How can it be said then that the exchange offer is being intended to protect the stockholders' value if all the stockholders' value is not going to be protected?

MR. SPARKS: Because you can't protect all the stockholders' value under these circumstances. You can just do the best you can. And the best you can do under these circumstances is to put out a debt security for 49 percent of the stock. You can't put so much debt on this company that it constitutes -- that it would in effect scorch the earth or render this company unviable. And there's no contention here that we have done that. But there is some limit beyond which you cannot go. And this board has not gone or even approached that limit. It has done what it reasonably can in its business judgment to see that the stockholders get more value.

JUSTICE MOORE: If you're not going to protect the value of 100 percent of the shareholders, then isn't the real purpose of this to really just drive Mesa away?

MR. SPARKS: No. You are protecting the value of 100 percent of the shareholders. You can't -- There is not sufficient flexibility to protect 100 percent of the shares.

In other words, if you look at the situation as it exists today, all shareholders other than Mesa, 100 percent of the shareholders other than Mesa will be able to tender into the offer. In the first step for 50 million shares they will get their portion, assuming everybody tenders in, of the added $72. It is in effect a substitute for the back end of the Mesa offer.

JUSTICE MOORE: I understand that. But your exclusion also excludes any bona fide transferees from Mesa, does it not?

MR. SPARKS: That is simply, your Honor, to avoid Mesa putting the stock --

JUSTICE MOORE: Excuse me, Mr. Sparks. Isn't that the fact? Doesn't it -- ?

MR. SPARKS: Oh, that is a fact, your Honor.

JUSTICE MOORE: What is the legitimate purpose behind excluding Mesa's bona fide transferees from the exchange offer if the real purpose is to protect the so-called innocent shareholders?

MR. SPARKS: In the first place, those transferees -- which don't yet exist -- are not presently anyone we have an obligation to protect. As you look at the situation today, if Mesa were to transfer its stock now, it would be transferring to people who were relying in part upon the existence of our offer to achieve, to maintain, if you will, in some part the price of the stock.

What you are doing in permitting Mesa to in effect give its stock to a transferee is indirectly to again give Mesa the benefit of the offer and take its profit from the offer directly to the market.

JUSTICE MOORE: If you have an innocent shareholder, a bona fide transferee, what is the logic behind excluding them just because they did business with Mesa? That sounds punitive.

MR. SPARKS: In the first place, it is not designed to be punitive to anybody. It is designed to make sure that Mesa cannot in effect be an arbitrageur based on this offer and profit from the offer and then use those profits to continue probably at a lower price the effort through these tactics to seize Unocal at a level below its intrinsic value and seize that value from the other stockholders.

Now, the hypothetical bona fide transferee -- and there isn't one yet because Mesa has held on to its stock -- is someone that we at the time we adopted this have no reason, have no obligation to protect. It doesn't exist. There is no relationship and no duty running at the time this was done to that person. And anybody who buys from Mesa knows in advance that we've taken that position. So that anybody who steps into that position is really stepping into -- they're doing it of their own will. We don't have a duty to protect the --

JUSTICE MOORE: I understand that. But Mesa says that the proof that you are really engaging in just a punitive effort to fend them off is that you are even going to reject shares tendered by bona fide purchasers merely because they did business with Mesa. Now, what is the logic behind that?

MR. SPARKS: Well, the bottom-line logic is to prevent people who are in collusion with Mesa from Mesa in effect going out and finding somebody who may be bona fide in the sense that A sells to B and there is an exchange of consideration. But if there is somebody who in effect shares Mesa's predator interest, that Mesa should not be able to in effect part the stock and avoid the impact of what we are trying to do. That is the reason for it.

Now, the other alternative, your Honor, we submit, the one that is suggested by the Vice Chancellor's opinion, is that notwithstanding the selective treatment, the Vice Chancellor would have this court depart from prior precedent and tell Unocal and tell directors of other Delaware corporations that in fashioning a defensive response to a raid they must treat a creditor stockholder in the same manner as those very stockholders which they have a duty to protect under our law even if to do so will facilitate the very harm to those stockholders which the directors seek to prevent.

Your Honors, the role of a director in a Delaware corporation in circumstances such as those faced by Unocal today is not easy. Yet it is an essential role. When faced with a coercive offer such as that made by Mesa, individual stockholders are simply not in a position to respond as a group. Indeed, one reason that partial two-step offers are coercive is because shareholders are unorganized and tender out of a fear that their fellow stockholders will do so, thereby shutting them out in this case from the cash in the first step of the offer.

And, recognizing this reality, the Seventh Circuit in Panter v. Marshall Field, interpreting Delaware law, spoke of the duty of directors to act to protect stockholders. And this court in Pogostin v. Rice relied upon Panter in making it clear that good-faith decisions, decisions not for personal benefit but in the interest of stockholders made by directors in responding to a tender offer fall within the business judgment rule.

Having given to directors the duty to protect stockholders from the depredations of a raider, it is also essential from the point of view of stockholders that directors also be given the freedom to authorize rational responses to meet the ever more sophisticated and coercive offensive techniques being used by modern-day raiders such as Mesa.

I would like to turn directly to the facts of this case. What exactly is it that Unocal's directors determined to do to protect its stockholders from the coercive and inadequate two-step Mesa offer? To prevent Mesa from acquiring Unocal at an inadequate price, it determined to make an exchange offer to its own stockholders for 49 percent of Unocal's outstanding stock, using Unocal's senior debt with terms designed by Unocal's investment bankers so that the debt would trade in the market at $72. One objective of this stratagem was to cause Mesa to abandon its inadequate offer if it were unwilling or unable, given the bootstrap nature of its financing, to pay fair value for half of Unocal's shares.

JUSTICE MOORE: I understand the basic underpinning of your argument is that you actually don't owe any present fiduciary duty to Mesa. Is that correct?

MR. SPARKS: That is incorrect, your Honor. We owe a number of duties to Mesa but we do not owe a duty of fairness to Mesa. We owe a duty of care in fashioning the defensive technique. We owe a duty not to waste assets. We owe a duty of reasonable investigation and good faith. And good faith, we actually not only owe a duty but we have the burden of establishing it, which in the court below we met.

And, in addition, under the business judgment rule, it must be a rational response. In other words, this court or some other court, if the court cannot conclude that the directors reasonably tailored their response to meet the particular selective and coercive threat, instead if it appears that no reasonable man could conclude that it is anything but punitive --

JUSTICE MOORE: That is not essentially

the position you took in the trial court because it is shown that there the Vice Chancellor asked you "Well, then would it be fair to say to parallel the question that I asked Mr. Richards that what you are in effect saying is that when you have a stockholder who becomes a raider and who is determined to be not in the best interests of the company, then the board no longer owes any fiduciary duties to that stockholder?"

Your answer: "It's sort of a springing fiduciary-duty concept. Once that person ceased to become a creditor and became a passive investor, there would be fiduciary duties owed to him."

Now, what is the rule that says that you have to be only a passive investor, otherwise you lose your right to be treated fairly?

MR. SPARKS: Your Honor, just to make sure the record is clear, I believe I did go on immediately after that and in response to the same question and point out that I was speaking of in effect the duty of loyalty, not the duty of care.

JUSTICE MOORE: But is it only to a passive investor? Does someone lose their standing to be treated fairly merely because they want to buy stock and oust management?

MR. SPARKS: In the first place, your Honor, it is not merely buying stock and ousting management. The ability to deal with a predator stockholder in a manner designed to eliminate the threat only arises if the action is taken in good faith. That means only if the action is taken for the purpose not of protecting oneself in office but for the purpose of protecting the stockholders which the directors had the duty under our law to protect, not their personal interest.

JUSTICE MOORE: If a shareholder chooses to exercise the rights of corporate democracy to oust management and to buy shares, does that mean that they're no longer a passive investor and therefore they lose the right to be treated fairly? Just the theoretical concept is what I am interested in.

MR. SPARKS: The theoretical problem that I think the Vice Chancellor faced and did not solve is this idea that people or entities which take on the position as a raider somehow can be viewed as acting in two different capacities: one, as a shareholder and the other, as a raider.

Now, in other areas of our law when we face that kind of problem, as for example in the derivative-suit area which we looked at and pointed to in our briefs, the courts make a determination as to whether the person is acting in his interest as a shareholder consistent with those of other shareholders or in his interest in his personal interest. In other words, if the interests are antagonistic, the court doesn't then say, well, I owe a duty of fairness to the person who is antagonistic to me. The courts say we're not going to let somebody be, for example, a derivative plaintiff if he is pursuing a personal interest antagonistic to the class in that lawsuit.

The same concept has to apply here. You cannot take -- And that's really where the Vice Chancellor went wrong, as we see it, in utilizing the Fisher case as the basis for her fairness determination. She ignored, she shut out the idea that this stockholder had put itself in the position of being antagonistic to all the rest of the company's stockholders and in effect said we can't consider that; you must still be fair to the very person that --

JUSTICE MOORE: No, I understand that. But my question is a little more simple than -- I hope it is simpler than that. What is the dividing line when a stockholder decides to exercise the right of corporate democracy, chooses to wage a proxy contest to oust management, let's say; chooses to buy shares so that they can also achieve value. At what point does the right to be treated fairly end? I mean, to exercise the right of corporate democracy means that you lose the right of fairness?

MR. SPARKS: No. Fairness is sort of a tough -- is a concept that is very hard to grapple with in this context, because being fair to someone whom you have a duty to protect other people against is really the dilemma posed.

But once the board of directors in good faith -- that means honestly -- has reasonably determined on an informed basis and based on objective facts that a reasonable man could conclude justified the conclusion that the raider was acting contrary to the interests of the stockholders that the board had a duty to protect, then at that point you do not have to be fair to the raider in terms of your dealings with that raider in an effort to protect the stockholders. In some extrinsic area you might have to be fair to him but not in terms of putting into effect your defensive technique.

Now, I have made it clear that of course that does not mean -- We're talking about fairness versus nonfairness. You've still got the duty of care. You've still got the duty to act rationally. You've still got the duty not to waste assets and you can't go around and violate fixed legal rights that he's got.

One of the areas that we've had a dispute on here in this case from the beginning is that the other side keeps talking about constitutional rights, property rights, legal rights, some sort of right to be bought out. That right doesn't exist. If we are into an area -- And that is clear under Section 116 and under Kors and under Cheff. There is no right to have your stock repurchased, no pro rata right to have your stock repurchased.

If we get into an area where there are fixed rights, contract rights, dividend rights, rights arising that our law, either corporation law or the extrinsic law, recognizes as belonging to somebody, well, then you can't do anything about those. That's beyond the scope of what you can do something about.

But here we are not dealing with that. Here we are dealing with the premise, to start off with, that there is no per se right to have your stock repurchased pro rata under our law. And then the question becomes, once a board of directors has made a good-faith determination in the interest of stockholders that a person is pursuing interests contrary to those stockholders and it is dealing in an area where there is no fixed right, what under our law says that it cannot to protect those stockholders take a rational step, carefully tailored, designed to protect the stockholders either by stopping the offer or, if the offer can't be stopped, then to at least give the stockholders more value for the company than they would otherwise get.

JUSTICE MOORE: And the interest you are speaking of here in this case is that the stockholders will not get the true value of their shares. Is that correct?

MR. SPARKS: That is correct. That is correct.

JUSTICE MOORE: And that they will not get it from the front-end part of the tender offer and they will certainly not get it by the coercive two-tier back end?

MR. SPARKS: That's correct.

JUSTICE MOORE: So that's the whole premise upon which you say the fairness issue turns. Is that correct?

MR. SPARKS: That is correct, your Honor.

I believe in discussing as we've gone through here -- Unless the court wants me to go through it, I believe the court understands, now that we have discussed it, what the structure of the exchange offer is and the two purposes for it. I can go back through that portion of the argument if I'm wrong that we haven't gone over it.

Now, as set forth in our briefs, your Honors, we believe that the validity of this defensive response should be determined under the principles set forth in Kors v. Carey and Cheff v. Mathes. These cases, when taken together with

Pogostin, hold that while directors are bound to deal honestly with shareholders as a class, they may in the honest exercise of their business judgment adopt a valid method of eliminating what appears to them a clear threat to the future of their business by any lawful means. Two, those cases also hold that a selective stock repurchase is a valid method and is a lawful means. And, three, they hold that once directors have shown, as they have here, that their primary motivation in authorizing a selective stock repurchase was to protect stockholders --

JUSTICE MOORE: Well, do you write Fisher completely off the books?

MR. SPARKS: Your Honor, Fisher -- In the first place, I thought from the beginning that Fisher spoke, could be read to speak even in the circumstances of Kors v. Carey and Cheff v. Mathes because Fisher says you must have a valid corporate purpose. Now, we've got one here. At least based on the ruling of the court below. And, second, that you must not unduly discriminate. And that really gets back to the question of whether the particular defensive technique is reasonably measured to deal with the particular selective threat faced.

But I think really Fisher has nothing to do with this case because Fisher, one, was a case in which there was no corporate purpose, no valid corporate purpose at all. Anything that went beyond that finding was dicta. And second, Fisher did not come up in the context of this privilege of directors in terms of their representation of stockholder interests to try to fend off a clear threat to control.

So the other side of the balance isn't present in Fisher. And whatever rule Fisher may state for circumstances in which directors do not face a stockholder who has assumed a position hostile to all other stockholders, I think we can leave that for some other day. But it isn't this case. And I think that's the significance. I think this case is a Kors and a Cheff case because it comes up in that context. It comes up in the context of a predator and the duty of directors to do something about that if they have formed a good-faith conclusion that their stockholders are going to be hurt.

JUDGE TAYLOR: Mr. Sparks, do you havefully Delaware case where -- ? And now I'm differentiating between corporate policy and protection of the rights of stockholders generally. Do you have any Delaware case where the restructuring of the corporate setup has been done by the corporation and it's been approved for solely the purpose not of corporate policy but of protecting the rights of the individual stockholder?

MR. SPARKS: Well, I think if you look, for example, at the Panter v. Marshall Field case, that has to be viewed as being such a case. There an acquisition was made in effect to create an antitrust obstacle to the purchase of the corporation by the raider. And, I think, fairly viewed, that is an example of such a transaction.

Now, your Honors, I think -- I would like to go on to Fisher. Excuse me.

JUSTICE MOORE: Are you also basing that response on the fact that Panter was specifically relied upon in Pogostin?

MR. SPARKS: In part, your Honor.

I would like to go on because I believe I've reviewed and we have certainly set forth in our reply brief one, two, three, four, five, six, seven the way we think the case should be decided. And now I would like to go to the Vice Chancellor's opinion and talk about the policy implications it raises and where we think she went wrong.

First at page 18 of her opinion she distinguishes the holdings in Kors and Cheff that the validity of a selective repurchase authorized in good faith in the face of a raider's threat is to be based under the business judgment rule by holding, instead, that such a rule applies only if the dissident is bought off and finds the price paid to him for his stock, in the court's words, "to be acceptable." In other words, in the Vice Chancellor's view, because Mesa does not find its exclusion from the exchange offer to be acceptable, Kors and Cheff are inapplicable and the directors have no right to act in the honest exercise of business judgment to fashion a reasonable selective stock repurchase defense against the Mesa offer.

The Vice Chancellor then goes on at page 19 and directly repudiates Kors and Cheff, holding that, quote, "Good-faith beliefs are not a sufficient justification to discriminate." That's the exact opposite of the holdings of Kors and

Cheff. Instead, she concludes that the defense of a selective repurchase in which the raider is not paid off must be fair to the very raider against which it is directed.

We say that the distinction of Kors and the distinction of Cheff is illogical and it is contrary to our law. First, in both Kors and Cheff the parties discriminated against in the sense that they did not receive the selective payments were all stockholders other than the raider. And in neither case did they accept the discrimination. Indeed, like Mesa here, they sued and, in those cases, unsuccessfully.

Kors and Cheff, therefore, just can't be read out of our law on a consent theory. We also point out in our brief that the consent theory runs counter to cases such as Hall v. Trans-Lux, which was relied upon in Cheff, and Edelman v. Phillips which hold that corporate funds can be used in good faith to protect a corporation from a dissident in a proxy contest or to sue the raider. Obviously, such opposition viewed from the perspective of the raider could not be said to be beneficial or acceptable to it, and fairness just doesn't fit in this context.

Nonetheless, it is protected activity under our case law if pursued in good faith.

Nor can those cases be distinguished on the grounds advanced for the first time by appellants last night that defensive strategies must affect all shares equally. In both Kors and Cheff that wasn't the case. Moreover, such a metaphysical distinction cannot, we submit, form the basis for a rational rule of law. Instead, when faced with questions such as this, as in the derivative-suit area, our courts and indeed, we submit, directors also can look to the realities and determine what that person's primary interest is in pursuing their objective. And if they are pursuing a predator objective against the interests of the stockholders as determined in good faith, then that's the way you deal with them. You don't deal with them with a duty of fairness.

It is just inconsistent to tell directors you have the duty to protect stockholders and on the other hand to say that while you've got one stockholder out there who is taking action contrary to the interests of all other stockholders, you have to have a hand tied behind your back because you owe him a duty of fairness when he doesn't owe one to the stockholders that he is pursuing. It just doesn't work. It tilts the --

JUSTICE MOORE: In other words, if you're being threatened, you don't owe your attacker the duty to hand him a gun to finish you off?

MR. SPARKS: That is precisely correct, your Honor. And that's what we are trying to say.

To tell directors of Delaware corporations that they have a duty to protect their stockholders as we believe this court has in Pogostin and then to turn around and say "Raider, you can come up with any tactic you want because you don't have a fairness obligation to anybody. But in responding to that tactic, Mr. Director, in trying to protect these stockholders, you have to treat him fairly," you've got a hand tied behind your back, your Honor. It just will tilt the playing field in favor of the raider. And that's the word that is going to go out if this opinion by the Vice Chancellor is affirmed.

In fact, what we believe the Vice Chancellor's decision will tell the world if allowed to stand is that Delaware, frankly, in the context that this comes up, endorses greenmail and its concomitant rewards to the raider but denies to directors acting in good faith on behalf of stockholders the right to determine that, rather than rewarding the raider, it would be more appropriate to place value in the hands of the stockholders to protect them against the raider's depredations.

It simply makes no sense as a matter of policy to say that the raider who owes no fiduciary duty of fairness to the stockholders of Unocal may devise whatever coercive technique it desires to achieve a benefit for itself while the directors who are charged with the duty of protecting stockholders as best they can can only do so if the defense chosen is fair to the raider.

Once good faith has been established, there is no sound policy basis for distinguishing a selective stock repurchase from other defensive techniques protected by the business judgment rule such as the issuance of stock to a white knight to reduce the raider's percentage stockholdings. It is simply inconsistent to tell the directors on the one hand that they have a duty to oppose the raider and that on the other hand they have a duty to be fair to him at the same time.

What the Vice Chancellor has done is, in effect, once she distinguishes Kors v. Carey she ignores the whole fact: you don't hear mention until you get to irreparable injury that Mesa is a raider. She just deals with them as a stockholder and deals with cases that are outside of the raider context. And we submit that is unrealistic, closes your eyes to reality, and you can't have this metaphysical distinction.

Let me also touch briefly on one other basis which she utilizes to conclude that we have some sort a fairness obligation to the raider. And that is based on the fact that the directors, like all the other stockholders other than Mesa, tendered into the exchange offer.

The Vice Chancellor does recognize that if Mesa may properly be excluded from the exchange offer, that rationale of imposing a fairness burden fails. The whole purpose for the intrinsic fairness test in self-dealing transactions is because good faith cannot be presumed where the prospect of personal benefit may be the motivating force. Here, however, the Vice Chancellor has expressly found that Unocal's directors are acting in good faith in the interests of stockholders and not for personal reasons. The policy of the self-dealing rule has therefore been satisfied and that finding obviates an intrinsic fairness burden arising as a result of the directors' decision to demonstrate their support for the offer by tendering their shares.

We believe the court should adhere to its decision in Cheff v. Mathes as applied to the facts of this case and should let Unocal's directors know that the Delaware law stands behind them in their good faith and careful efforts to attempt to do the duty assigned to them by our law to protect Unocal's stockholders from a raider such as Mesa. The Vice Chancellor's decision we believe is unsound as a matter of precedent and we believe it is unsound as a matter of policy and should be reversed.

Touching just briefly on the irreparable injury issue, we believe the court should reverse on that ground also. The court's holding -- and this reflects a problem with the whole opinion, because it jumps back and forth from looking at Mesa as a raider to Mesa as a stockholder. It finds probability of success on the merits basically on a theory that Mesa is being deprived of its rights as a stockholder. It then finds irreparable injury on a theory that Mesa is being injured in its capacity as an offeror.

They don't mix. What you ought to do is look at the reality throughout the opinion. The court's holding on irreparable injury is premised on an alleged loss to Mesa of a right to have its stock purchased in the exchange offer. I'm sorry. The court's holding on probability of success is premised on an alleged loss of Mesa of a right to have its stock purchased in the exchange offer. But the unrebutted record below established that Unocal could respond to any claim for money damages arising as a result of the exclusion.

The irreparable injury which the court found had to do with the denial to Mesa of the opportunity to complete its tender offer, not the opportunity to tender. She finds -- it is a finding, we submit, unsupported anywhere on the record -- that the substantial debt which Unocal would incur as a result of the exchange offer will make it, quote, "more difficult," close quote, for Mesa to succeed in its takeover efforts. But, as the Vice Chancellor correctly pointed out, Mesa is not entitled to have Unocal's assets frozen just because of a stockholder attempting to gain control of the company.

Second, Mesa has indicated under oath in this record that it will go forward with its control effort whether or not the exchange offer proceeds.

Third, the conclusion that the acquisition of Unocal may be more difficult for Mesa arises, as I've just noted, not by reason of Mesa's exclusion from the exchange offer, which is the only basis upon which the court found a reasonable probability of success, but because of the debt to be incurred by Unocal as a result of the exchange offer, which debt will be incurred whether or not Mesa is excluded.

Finally, even if Mesa's acquisition were rendered, quote, "more difficult," close quote, we submit that "more difficult" is not equivalent under our law to irreparable injury. Your Honors, we believe there is no logic whatsoever to the lower court's irreparable injury holding. We agree in that respect with Judge Tashima who faced a similar argument and rejected it, and for that reason also we believe the decision should be reversed.

Are there any other questions or should I -- ?

JUSTICE MOORE: Thank you.

JUSTICE McNEILLY: Mr. Richards.

MR. RICHARDS: Your Honors, defendants-appellants here have attempted to do something that no one has ever attempted before. And for good reason. In making such a discriminatory tender, they run counter to the main tenet of our corporation law: that shareholders must be treated equally and fairly.

There is little wonder that they are recommending the tender offer and that they are tendering themselves for securities with a face value of $72, a probable value of $75, when the inflated market -- and the market is inflated by the existence of both tender offers -- is at 46. And yet they say that it is perfectly fair to exclude their largest shareholder. They say in their affidavits that the stock is worth at least $60 and might be, or could be, worth $70 to $75.

JUSTICE MOORE: Didn't Mr. Pickens himself say that he took the Herold valuation and he could live by that?

MR. RICHARDS: No, sir, he didn't.

JUSTICE MOORE: What did he say?

MR. RICHARDS: Well, Mr. Pickens talks to the press quite a few times and so we have to talk about what time we're talking about. But the first time they charge us with that was with the Knight affidavit on the temporary restraining order. And if you read the transcript, the first question that Mr. Pickens was asked was what did he think Unocal was worth and he said he thought it might be worth $64. And then later, on a few pages later, somebody said, "Well, how about the Herold value of $73.90?" And he said "Well, that's a" -- I don't know his exact words -- "that's a recognized value that compares oil companies and it's out there."

You know, the Herold value, we went into the Herold value, as your Honor will appreciate, in great depth in the Rosenblatt case recently completed. And Herold is sort of a small shop that tries to evaluate all of the oil companies on a comparable basis based on publicly disclosed data.

JUSTICE MOORE: But didn't Mr. Pickens say on May the 3rd, he was asked "What do you think Unocal is worth per share?" and he said, "Oh, I just go from the John S. Herold number on it and I believe it is something just under $80 a share." Now, your client said that, didn't he?

MR. RICHARDS: If your Honor is reading from someplace in the record, I assume he did say that. But I don't have the citation in front of me.

JUSTICE MOORE: Then he gave a similar response at a Unocal stockholders' meeting, said "Isn't the company valued at higher than $72, as far as you know?" And Mr. Pickens said, "John S. Herold's figure is $73 per share, recognized authority."

MR. RICHARDS: Yes, that is the meeting in Los Angeles to which I was referring and which is referred to in the Knight affidavit. That's the one in which the first question that he was asked, he expressed the opinion that it might be worth $64 a share. But, you know, these are statements at public meetings. One of these meetings was at a --

JUSTICE MOORE: Well, isn't he bound by his own conceptions?

MR. RICHARDS: Bound by his own -- ?

JUSTICE MOORE: His own views. Isn't he bound by what he can perceive? He is a recognized expert in the oil field, in the oil industry, isn't he?

MR. RICHARDS: Well, yes, I think he is bound by his views. But I think that the defendants have misrepresented those views. I don't think that your Honor will find any place in the record where Mr. Pickens has expressed an opinion that the value is $73.90 a share or $80 a share or indeed any specific number.

JUSTICE MOORE: Well, he said "Oh, I just go from the John S. Herold number on it and I believe it's something just under $80 a share."

MR. RICHARDS: Well, I don't know what your Honor is reading from. But reading from page --

JUSTICE MOORE: Well, how about taking a looking at page 53 -- or page A-62 of the appellant's appendix.

MR. RICHARDS: All right. I will look at that as soon as I get it before me.

Reading from page 916 of their appendix, when he was asked on testimony, a little more formal proceeding, he was asked a question -- well, it doesn't have the preceding page with the question on it. The answer is, "When I'm asked questions, I'll give John S. Herold appraised figures because they are well known and he appraises all the oil companies and they are good for comparative purposes."

I think his testimony fairly taken and even his public utterances, which is what we're talking about now, is not that he endorses the John S. Herold as an appraised value as the basis on which you would buy an oil company as a going concern.

But I don't think we need to get too bogged down in what the appraised value might be or what the liquidation value might be. Because, whatever it is, Unocal of course doesn't explain that Mesa has no way of realizing on those hypothetical values unless, of course, it obtains 100 percent control and unless it could do away with the restrictions and covenants designed to prevent it from taking control or, once control is gained, designed to prevent it from selling any assets. And, of course, it would depend upon their selling all of the assets at the high end of the range and overlooking the discounted value of money in the future versus the present and the difficulties of liquidating an enormous company such as Unocal, which has never been done.

Now, one of the things that the defendants give very quick treatment to in describing their conduct is the burden of proof that is on them for their interest. The defendant directors who adopted this plan have an interest in this tender offer of something over $70 million would be the proceeds that they could receive if all of their stock were accepted. Now, we know that all their stock is not going to be accepted because the tender offer is going to be oversubscribed. But their interest in the exclusion of Mesa alone runs from $1.46 million if there is a tender of 85 percent of the shares to a high of $7.28 million if 50 percent tender.

And their chart, I think, in their

briefs below is rather misleading because they selected six directors carefully, so carefully that they excluded 1,337,000 shares held by other directors or 98.7 percent of the stock held by the board.

JUSTICE MOORE: There are eight outside directors. The majority of this board consists of outside directors, does it not?

MR. RICHARDS: That's correct, your Honor.

JUSTICE MOORE: And the only one they excluded was Mr. Doheny, wasn't it, who is a large outside shareholder?

MR. RICHARDS: The only outside director. I think they had six on their list so they must have excluded one more, your Honor.

JUSTICE MOORE: But as to the others it shows that these outside directors, if they benefit, they benefit to the same extent as the other shareholders except for Mesa. Isn't that right?

MR. RICHARDS: Yes, that's right.

So I think that we have seen that their self-interest, which of course is distinguished in Cheff and distinguished in some of the other cases, places a special burden upon them to show the intrinsic fairness of this transaction.

JUSTICE MOORE: If the proposition that is being advanced today by the appellants is correct that they have a right to treat Mesa differently and Mesa thereby is to be treated differently as a matter of law, then aren't the directors sharing equally with all other shareholders?

MR. RICHARDS: Yes, if you read -- If Mesa is a nonshareholder for purposes of Delaware law, yes. They are still interested, of course. I mean, they are still getting an enormous profit that --

JUSTICE MOORE: Well, they are getting the same essential benefit that every other shareholder except Mesa gets. Is that correct?

MR. RICHARDS: Yes, if you read Mesa out.

Now, I think in addition the Vice Chancellor found and I think this court should fairly find under the circumstances that under Fisher v. Moltz the burden would be on the defendants as well to show not only a valid corporate purpose but also that their discrimination does not unduly favor one group over another and that it is fair to all shareholders.

JUSTICE MOORE: Well, on Fisher, it says a burden is imposed upon the corporation to show that there is a valid corporate purpose for limiting the offer and that in doing so it has not unduly favored one group over another and then cites Singer v. Magnavox and Tanzer. Weren't those two cases overruled in terms of their espousal of the so-called business purpose requirement of transactions?

MR. RICHARDS: Yes, your Honor, they were.

JUSTICE MOORE: And then in Pogostin, which was decided by the Supreme Court in 1984, we said "In Aronson we discussed the availability, function and operation of the business judgment rule including the standards by which director conduct is judged. What we said there is equally applicable here in the context of a takeover," citing Panter v. Marshall Field at page 295.

And at page 295 it says in Panter: "Rather than proceeding under the business judgment rule, the plaintiffs here seek to apply a different test in the takeover context and propose that the burden be placed upon the directors to establish the compelling business purpose of any transaction which would have the effect of consolidating or retaining the directors' control. In light of the overwhelming weight of authority to the contrary, we refuse to apply such a novel rule to this case."

So really is Fisher still viable?

MR. RICHARDS: Yes, sir. I don't see that the cases that your Honor has referred to have touched on Fisher. Fisher dealt with a discriminatory self-tender, if you will.

JUSTICE MOORE: Well, I --

MR. RICHARDS: Let me finish my explanation, if I may.

Fisher dealt with a discriminatory self-tender. Panter v. Marshall Field did not. The distinction is, you have the business judgment rule if you're doing a defensive maneuver against a takeover if you're not discriminating against one of your shareholders and treating his shares differently.

Now, the antitrust acquisition in Panter v. Marshall Field had the same effect on all of the shareholders. Plus the board of Panter v. Marshall Field was not interested in the situation. They weren't buying something from themselves. So it's those distinctions that apply in Fisher and apply here to deprive the board of directors of the benefit of the business judgment rule.

JUSTICE MOORE: But in Fisher you had a situation where the corporation was refusing to buy back stock of certain ex-employees whom they apparently were angry at because they were now in legitimate competition. Now, that isn't what the issue is here, is it?

MR. RICHARDS: No, certainly not.

The appellants here contend that they need only show that they acted in good faith and, having shown that, their conduct is beyond the power of this court to review. The appellants find support for this argument in the Cheff line of cases and in the line of cases upholding various other defensive maneuvers.

However, as Vice Chancellor Berger said concerning these anti-takeover maneuver cases in holding that this appeal presented a case of first impression, quote, "The Supreme Court appears to be recognizing that the line of authorities permitting other defensive maneuvers under the business judgment rule did not involve corporate action where the raider was treated unfairly vis-a-vis the shareholders."

JUSTICE MOORE: Mr. Richards, the argument, as Mr. Sparks boiled it down, was that your client is treating the shareholders unfairly by attempting to obtain stock at $52 which is essentially worth a great deal more and engaging in a coercive two-tier tender offer the back end of which will result in the non-tendering shareholders receiving what they call junk bonds. Now, why isn't that response to such a takeover a legitimate one?

MR. RICHARDS: Well, it is not -- First of all, as your Honor has I think observed in a question to the other side, our right to buy stock in Unocal is a perfectly lawful act. And our right to make a tender offer for control of Unocal is a perfectly lawful act. So that we're not doing anything improper.

Now, secondly, we know from the cases that defendant management has a right to try to protect its shareholders. But it can only use lawful means. We contend -- and I think there's no support in the law, as we've seen. We contend that they have a duty to respect our rights as a shareholder and that whatever they do, they must treat all of the shares the same. And none of these defenses --

JUSTICE MOORE: Well, excuse me. Excuse me. Did all the shareholders get treated the same in Kors and in Cheff?

MR. RICHARDS: But in Cheff -- No. In Cheff there wasn't an issue of discriminating against the person who was not wanted in the corporation. That person had agreed to the discriminatory treatment.

JUSTICE MOORE: I understand. It was a derivative suit in which the other shareholders felt aggrieved because money had been used from the corporate treasury to pay someone else more for their shares than the other stockholders were going to get.

MR. RICHARDS: I think that's right, your Honor.

JUSTICE MOORE: So the shareholders who were not so paid felt aggrieved.

MR. RICHARDS: I think that's right, your Honor. And I think that's where the Fisher test is worth considering. I think if you take Martin v. American Potash or Fisher or whatever you want to take, there needs to be still an examination of the fairness of the underlying transaction. And among the ingredients referred to by the Cheff court and also referred to by the lower court is that the other shareholders, according to the board of directors in that instance, got a benefit from the removal of the dissident. The dissident there did consent and was paid fair value.

Also, in Cheff the court was at pains to point out that there was a different burden of proof in Cheff, quote, "when a director sells property to the corporation." And that was at 199 A. 2d 554-555. There the directors were not self-interested; they were not selling to the company. Here they are.

Plus, I would submit that there is a dramatically different equitable effect if you examine the underlying transaction in Cheff than here. The difference is between purchasing from one shareholder at slightly over market versus purchasing from 86 percent of the shareholders at 56 percent over the inflated market value. I mean, the swing, the equitable effect of just buying out one shareholder -- and typically we've seen in our cases the one dissident shareholder has 5 or 6 percent and the effect of that in diluting market value and the underlying values of the stockholders is thought by the board of directors in those situations to be balanced by the removal of the dissident.

JUSTICE MOORE: Is there actual dilution here? If this exchange offer is permitted, your client's percentage interest in the company goes from 13 percent to 19 percent. So there's no dilution to your client, is there?

MR. RICHARDS: Yes, there is.

JUSTICE MOORE: How?

MR. RICHARDS: From the unrebutted testimony, both sides are agreed that there will be a dilution in market value. Mr. Sorte's affidavit on that fact is not challenged. And indeed that result is suggested in the very offer to purchase put out by Unocal in which they say to their favored shareholders "You boys better tender because the market value of this stock is likely to be adversely affected by the completion of this tender." That means going down.

Now, under our analysis of the intrinsic value, our intrinsic value per share is going to go down. And, as I've pointed out, there is no way that we can even realize this hypothetical intrinsic value unless we were to be successful and acquire 100 percent and then if we were to jump over all of those other hurdles that I mentioned. So there is not much doubt in the board of directors' minds. They are not going to wait on the back end for their predictions of what the intrinsic value will come to be. They want to be right there in the front end to get their share at $72.

And I think that speaks volumes for where they think the balance lies. I think that is why you don't have to get into a resolution of the disputes between the investment bankers as to what the true or intrinsic value of Unocal is. It is the very fact that now you have an opportunity to realize $72 or $75 a share -- everybody agrees it's more than 72 -- versus the only other alternative of getting 46, and with the facts agreed by both sides that after the tender offer the market value is going to go down.

So I think that's the unfairness. Whatever the hypothetical intrinsic value of Unocal may be I really don't think is the issue.

I think perhaps we shouldn't move on from this point without observing that motivation is also mentioned in these cases. And here I think there are serious concerns about the board's motivation on two levels. First, let's not overlook the evidence existing of the Unocal board's entrenchment motive. They adopted an immediate siege mentality. The record is undisputed that they never gave any thought to negotiating a better deal for the shareholders with Mesa or anybody else and that they set up -- indeed it was designed by an executive vice president and inside director Mr. Brinegar -- a disincentive to their investment bankers to bring them any advice to the contrary: i.e., -- uniquely, in my experience -- the investment bankers get paid more in this case if Unocal stays independent than if there is a sale.

In the range of values we're all now used to seeing, investment bankers get a percentage of what the company may be sold for. Uniquely in this case they put a cap if the company is sold for $60. There is no incentive to the investment bankers to sell for more than $60. Now, I think that speaks --

JUSTICE MOORE: Can it be said of a two-stage squeeze-out merger that the minority has received, as we said in Rosenblatt last week, quote, "the substantial equivalent in value of what it had before," unquote?

MR. RICHARDS: Well, I think they are entitled to that. And --

JUSTICE MOORE: Is that what they are going to in fact get in light of what your client has advised the stockholders will be the effect and nature of the securities that they'll get upon the back-end tender?

MR. RICHARDS: Yes, your Honor, we think it will. They are going to get the going-concern value which is what this court held in Rosenblatt they were entitled to. And if there's any doubt about that, let's look at the protections that are not only built into our law but built into Unocal's charter.

First of all, they have a fair-price and a supermajority provision so that 75 percent of the shareholders are going to have to approve whatever the back end is. That is at a time when we don't control more than 50 percent. And secondly, of course, they have appraisal rights. The court has recently expanded and modernized and improved appraisal rights so as to make sure that shareholders get fair value.

So if it can be demonstrated -- and it certainly hasn't been demonstrated on this record -- if it can be demonstrated that the securities that we offer on the back end with a value of $54 a share, that that's inadequate, first of all the Unocal shareholders will have the power to defeat it. And, secondly, they'll have the power to seek an appraisal right. And that would seem to be the answer.

JUSTICE MOORE: Those will be highly subordinated securities, will they not?

MR. RICHARDS: Yes, they will.

I think the record is really indisputable, picking another theme of motive out of the Cheff line of cases, that policy differences with Mr. Pickens were not the reason for the board's action. There is nothing in the depositions, in the pre-May 2 affidavits, nor in the very extensive 22-page single-spaced minutes carefully drafted by trial counsel for Unocal --

JUSTICE MOORE: Excuse me. Let me go back for just a moment to the previous point we were discussing, Mr. Richards.

In your client's supplement to the proxy statement of Mesa Partners II, dated May 3, 1985, at page 6, it says "The indebtedness incurred in the offer" -- meaning the second stage -- "and the merger would result in Unocal being much more highly leveraged and the capitalization of the corporation surviving the merger would differ significantly from that of Unocal at present. And in their analyses of cash flows provided by operations of Unocal which would be available to service and repay securities and other obligations of the corporation surviving the merger, the purchasers assumed that the capital expenditures and expenditures for exploration of such corporation would be significantly reduced."

Now, why can't a corporation mount a

legitimate defensive tactic to provide the shareholders the true value and to prevent them from getting this rather illusory value that your own document seems to indicate they will get?

MR. RICHARDS: Well, it can. And the whole question is, what's legitimate? I started out -- My friends in the lower court thought it wasn't a suitable example but I think it still works and I'll bring it back here. The trouble with their reasoning is, they say "All we have to show is good faith" and then, as they said in the lower court, "You shouldn't intrude yourself into the board room. This is the defensive method that we have chosen and that's it."

And I said, well, suppose they had decided to assassinate Mr. Pickens as the most effective way to deter the takeover. I mean, there's no question that that would throw the Mesa camp into disarray. But, you know, it is so absurd, nobody would even discuss it. Obviously, they can't do that.

So what we're talking about is: Is this in the area of something that is prohibited? It is something that has never been done before.

That is, in all of these defensive maneuvers the rights of the raider as a shareholder have always been respected. There has never been a distribution of assets to all of your shareholders except one. And that's the difference.

JUSTICE MOORE: Well, because it's never happened before doesn't mean that Delaware law is static. Does it?

MR. RICHARDS: Absolutely not, your Honor. I quite agree with that. But the absence of any supporting authority and precedent in support of my friend's case is not one of the strengths of it. I mean, boards have been attempting to deal and fend off tender offers for some time and I would suggest that none of them ever had the temerity to think before that they could get away with this. Indeed, if you look at their minutes, as I know the court has done, they did it with a certain sort of cynical calculation.

I mean, their counsel told them "We don't have any precedent for this and we're sure Mesa is going to challenge it but let's give it a try." Indeed, Mr. Sachs said below at paragraph 42 of his affidavit that the defense was designed so it didn't matter whether Mesa tendered; that as far as they were concerned, the tender for 50 million shares would be an effective defense even if Mesa tendered. So the arguments tend to change from day to day in these courts, but at that time they were arguing that it was absolutely a necessary ingredient. And Mr. Sachs's testimony refutes that.

But the answer to all of this when they say "Well, it won't work if we include Mesa" is, then they should try something else. I mean, there are lots of other defensive maneuvers. But they can't say it is necessary for us to do something in violation of our fiduciary duties to Mesa, to do something without precedent in our law because that's the only way this discriminatory self-tender will work. I mean, that's too bad. They can try something else. It's not -- The whole realm doesn't stand or fall on this particular maneuver.

Now, I think I was about to say and maybe it's not a matter of great interest to the court any longer in light of the dialogue we have had, but I wanted to establish the point that this was not a Goldsamt case. There just simply isn't anything in the record to establish business policies or bad reputation. And indeed the lower court found that in her opinion at page 12 where she said the second question -- that's your Honor's question B -- dealing with can't you draw a reasonable inference that they are seeking selective treatment, is factual and was not addressed in connection with the application for a temporary restraining order.

I think this is a case, to the extent they are arguing it -- and I couldn't really tell from Mr. Sparks' response to the court's questions whether they still were arguing it. But in the event that they are arguing it, I think that it's governed by Bennett v. Propp where here these are afterthoughts, and I think there is an important distinction which makes this even a worse situation than Bennett v. Propp. These are not just afterthoughts thought up after the board events and before the lawsuit for purposes of parading in court. These are afterthoughts after all of the depositions have been taken, after formal, considered positions have been taken in the lower court by everyone in this litigation.

JUSTICE MOORE: But Vice Chancellor Berger made several rather critical findings in Unocal's favor. One, she found that the exchange offer was based on the board's good-faith belief that Mesa's offer was inadequate. And that is found at page 16 of her opinion. And, two, she found that the board's action was informed and taken with due care; and, three, that Mesa's prior activities justify a reasonable inference that the principal objective is to be bought out at a substantial premium.

Now, with those findings, why isn't this action thereby legitimate and the business judgment rule apply?

MR. RICHARDS: Well, there's a lot of territory covered by those findings. Let me deal with the one that we are sort of on now and, if the court will pardon me, deal with the others in a moment. The one we're on now is the reasonable inference. And I would respectfully disagree with the Vice Chancellor on that.

She found the reasonable inference from the collection of newspaper articles attached and magazine articles attached to the Nachbar affidavit. Now, first of all, there was no evidence that that collection of newspaper articles had been distributed to the board of directors, had been considered by them or was any basis for their acting or indeed that those policies had even been discussed by the board of directors. But even if there had been, I think this court requires a higher standard.

In what lawyers sometimes call the bad-man cases, the courts have said that there is a duty of reasonable investigation. And here the board of directors of Unocal did not conduct any investigation into the documented transactions in which Mesa has participated. And if they had, they would have found, contrary to the selective reading of those newspaper articles -- because if you read them all, there's sort of good things for Mesa on one paragraph and on the other hand bad things in the next paragraph. But if you deal with the facts, the facts are set forth in the fourth Tassin affidavit and are inconsistent with the charges that are aired again here that Mr. Pickens is a greenmailer.

But I would say suppose he was a

greenmailer. You know, the simplest defense in the world to greenmail for a board of directors is to say, "Well, we're not going to pay it." I mean, that is the end of greenmail. You don't need to have a wholesale distribution of assets. You don't need to laden your corporation with $6.7 billion of debt. You just say you don't have to pay it.

But let's suppose they didn't say that. There is an irony in their position in attacking somebody as an evil greenmailer when their whole position here is bolstered by a selection of cases which they say justify a board of directors in paying greenmail. I mean, the Cheff case and all those they say justify that. Well, if that is perfectly valid under Delaware law for them to do that, then I submit that greenmail is a misnomer because it would then be perfectly valid as an objective under Delaware law for a shareholder to seek as an alternative.

JUSTICE MOORE: If greenmail is valid, then why isn't the reverse of it also valid? I mean, that is essentially what we've got here.

MR. RICHARDS: But greenmail isn't valid, notwithstanding the circumstances. And that's why you have to look at unduly favored one group or another. And I think, to me, the perfect example of that would be: Suppose you had a corporation with a crusty old owner who owned 86 percent of it and 14 percent was held by the public and the crusty old owner wasn't getting along with the outside independent directors and they all said, "Well, it's time for you to go" and he said "Great. Just buy out my 86 percent at 56 percent over the market and I'll go."

Well, of course I can't see any board of directors doing that. They would say, "Well, you're asking us to pay out the net equity of the company and to strap the company with debt and leave the public shareholders holding the bag, and just because we're not getting along with you."

There's no equitable inquiry into those circumstances? Of course there is. In each one of the Cheff cases there is an examination of the price at which the stock is being bought. There is an examination of the other equitable effects. There is recitation in a number of the cases, as the court is aware, that it is approved by all the other shareholders. In some cases it wasn't submitted to shareholder approval.

I think the best answer or the best one-sentence answer to dealing with the Cheff line of cases is that, fairly read, those cases treat the person being discriminated against as the person being bought out. They are not really dealing with the idea -- They're not really Fisher cases where they are dealing with the people that have been excluded from the tender offer. Because those really aren't tender offers. When you're buying one person's stock, it is a sort of unique situation.

JUSTICE MOORE: And there are shareholders who sued in Kors and Cheff who said, of course, they were dissatisfied with being treated unequally. That's how the case got started.

MR. RICHARDS: That's how the case got started. But what I am referring to is the analysis by the Supreme Court in which they appeared to feel as if it was the dissident who was being discriminated against and bought out and the benefit to the other shareholders is that they have gotten rid of the dissident. And they look at the equitable circumstances and they say, "Well, what the heck. We only bought 6 percent of the stock and it was only at market or a few dollars above market."

I mean, nobody has -- There is no case anywhere where a greenmailer, even for 5 percent of the stock, was bought out at any premium like 56 percent over the market. You know, you'd have an insurrection. Let alone the fact that I don't think there's any court in this state that would approve that. And I think that is a vastly different equitable circumstance.

Well, I do want to go on and talk a little bit about the Van Gorkom aspects of this case. But before we leave this point I think I'm constrained to add that in all of these defensive maneuver cases, all of the shares are treated the same or are affected the same by the maneuver, including the raider's shares. I mean, that's true where you sell a crown jewel: the proceeds are equally available to all the shareholders. It is true where you purchase assets. It is true where you issue stock: everybody is diluted and treated the same. It is true in the Pogo Producing case cited by my friends in which there was a self-tender but not a discriminatory self-tender. It is true in

Carter Hawley Hale where they bought on the market and anybody could have sold on the market.

JUSTICE MOORE: Was it true in Trans-Lux where funds were used to fight off the dissident and was it true in Hibbert v. Hollywood?

MR. RICHARDS: Yes, of course it was. I don't know what the sum was but let's say you spent, for purposes of discussion, a hundred thousand dollars in the lawsuit. Well, that diminished the net assets of the corporation by $100,000 and everybody shared equally.

JUSTICE MOORE: But did that benefit the dissident?

MR. RICHARDS: No. But I don't subscribe to their theory that you have to benefit the dissident. All I'm saying is that you can't treat the shares of the risk dissident or the raider differently. You can't affect them differently than any other person's shares.

JUSTICE MOORE: But they were treated differently, you would have to concede, in Kors and Cheff, were they not?

MR. RICHARDS: Yes. And there isn't any question -- We have never argued that you don't have the power to buy shares selectively under 160. I mean, I thought that was assumed. Now it seems to me that what we're talking about is, you know, do you examine the equitable circumstances. And what I'm saying is, all of those cases are consistent with examining the equitable circumstances, whether you adopt Vice Chancellor Hartnett's formulation of it or not, of looking and seeing whether one group is unduly favored over another. (Pause)

I'm trying to skip over much of the material we covered in questions, your Honor.

JUSTICE MOORE: You said you were going to answer the other questions I posed with respect to the Vice Chancellor's finding that the board's action was informed and taken with due care and that the exchange offer was based on a good-faith belief that Mesa's offer was inadequate.

MR. RICHARDS: Right. And I would like to develop that answer in connection with presenting, if you will, the Van Gorkom elements of it and I will turn to that now, if the Court pleases. We submit that the director defendants did not exercise due care and that the court's issuance of a preliminary injunction can be sustained on these grounds as well.

First of all -- and we see this as having two elements. One is the value determination and the second is the debt restrictions and the restrictive covenant. We think that with respect to those two the Vice Chancellor held that we hadn't sustained our burden of proof on both. But we sensed in her treatment of the debt restrictions that she was troubled by that. And so I would like to devote more attention to the debt restrictions, which I think present a more easily understood and compelling case than the value, but I would like to deal with the value as well.

First of all, we submit there was no clear understandable evidence or no clear opinions, no written materials submitted to the board of directors in connection with their valuation evidence. The evidence that they put forward I think is somewhat suspect. I mean, the Eamer affidavit -- and we went through all this in the briefs below -- but Mr. Eamer was in London; it was 3:00 a.m. to 6:00 a.m.; he couldn't take any notes, he couldn't hear very well. And yet he is the scribe who gave us the account of the meeting below.

And we have other difficulties. I guess the April 22 meeting when the critical vote was taken, there were seven on the phone who weren't able to hear any of the transparencies. We have the description of the transparencies provided by Vice Chancellor Berger that they really don't go to showing specific values but instead deal with methodology. They were designed to convince the board that the investment bankers had examined a lot of methodologies.

I think there needs to be consideration in terms of value that the board did not adequately consider that, with the interest rates and the other provisions of these debt securities, they were actually going to be worth more like $75 a share. There doesn't seem to be much consideration of the relationship of the intrinsic value to the underlying market values and to the current market values.

JUSTICE MOORE: As I understand, one of your arguments is that the board improperly delegated some of its functions. Specifically, quickly delineate those as you perceive them to be.

MR. RICHARDS: All right, your Honor. I think the restrictive covenants that were imposed -- and I believe a list of them appears, nine or ten, in our opening brief in the court below -- are set forth at pages 23 through 27. The net effect of these restrictions is to completely change the way that Unocal Corporation will be able to operate in the future no matter who is in control of it. These restrictions are so far-reaching that they represent a sea change, if you will, or a complete change in the power of a board of directors to deal or manage the corporation thereafter.

Yet these restrictions, I think really the undisputed evidence is that they were never discussed or considered by the board of directors; that there were never any term sheets present; that there was never any going-through with the board of directors item by item. They've never seen the restrictions at any one of the three meetings, before, after or during, and to this day, as far as we know.

JUSTICE MOORE: Does that square with what happened in the recent case that you were involved in and we announced decision last week in, Rosenblatt v. Getty, where we specifically held that the DeGolyer & MacNaughton valuation was entirely proper as a delegation by the board?

MR. RICHARDS: No, it doesn't square with it. And here's why, your Honor. In that case, of course, as the court held, there was arm's length negotiation for a period of months and the parties couldn't agree and finally they said, "All right, we will delegate this element of our decision to DeGolyer & MacNaughton and then that will come back to us," in the lingo of that case, "in the subsurface asset value and we'll use that value and then we have our negotiated above-ground asset value and then we're going to negotiate on the weightings to be applied to asset values and so forth and we're going to negotiate with respect to earnings and market value and then we're going to put that all together and see if we can negotiate a merger ratio." And they did that.

So that the final decision for effective corporate action was taken by the boards of directors of Getty and Skelly. It is true they delegated an evaluation element as information which they used and relied upon. But they did not --

They didn't delegate, for example, to a bunch of lawyers "You negotiate all the terms and you write up the merger agreement. We just want to merge with Skelly and do it on the customary terms."

That latter explanation is much closer to what they did here. What they did here was, they delegated the future circumstances under which this company can operate to its officers and those officers, advised by whoever advised them, have imposed this fantastic list of restrictive covenants. And I think that is a critical difference here.

JUSTICE MOORE: I notice that nobody seems to address the Graham v. Allis-Chalmers case where Chief Justice Wolcott talks about the question of whether or not a board recklessly reposes confidence in an untrustworthy employee. Now, there is no such a suggestion here, is there, that that occurred?

MR. RICHARDS: No. No, your Honor, there isn't. But I would suggest that in a climate -- We were talking about valuation items and one of the things I was going to mention was of course the completely inadequate, in fact nonexistent consideration or discussion of the budgetary impact that went along with this debt offer, that is, a reduction of half a billion to 900 million dollars a year in capital expenditures.

Now, this is the climate in the board meeting. Mr. Doheny, who is one of the officers to whom this was delegated, here's what he had to say about it. He had to say, quote, "There is no question that the company can get through 1985." I mean, that's a sort of reassuring assumption on which a board of directors can operate: we can get through the next seven months. And, quote, "would not have an immediate severe effect on revenues." Well, now, that's what they put in their minutes, carefully prepared by counsel. So that is the best they can make of his presentation.

I submit that in a climate like this where you're proposing the biggest debt offering ever and you have to reclassify your equity in order to have enough equity to be able to even do this, you have to raise the value of your -- revalue your equity up 3 billion, the question is: can you possibly cover the interest. You have all these sorts of questions. And then to say, "Well, whatever the restrictive covenants are, boys, you go ahead and put 'em in place," et cetera, et cetera, as Mr. Hartley said, I submit under the circumstances of this case that that is simply not due care. And if it is permitted, it sets a hew low which anybody would be able to meet and the salutary effect of this court's recent decisions will be eradicated.

Now, the evidence on that is quite compelling in terms of the lack of discussion. Rather than go over it, unless the court would like me to, I would beseech the court to reread pages 81 to the top of page 84 of our brief below in which we go through and describe and cite a multitude of the individual defendants' testimony for the complete failure of board supervision, inquiry, or due care with respect to the restrictive debt covenant.

Now, like my friend Mr. Sparks, we will have to rely on our briefs and particularly our brief below for many of our arguments. But I would simply like to mention one in addition because it also bears upon the burden-of-proof question. I think we have demonstrated the elements of tortious interference with our prospective advantageous contractual relations. I don't think that is disputed. The cases are clear, particularly the Bowl-Mor case cited in our brief below at page 103, that once you set up that situation, then it is up to the defendants to come forward and say that they have a privilege, that they are protected in the conduct that they took.

Now, the Vice Chancellor sort of said that she wasn't sure whether the same standard that would apply intracorporate should apply to a claimant who is claiming the tort of tortious interference. But I don't know why not. Because in order to establish that their defense is privileged, they have to establish that they had a right to do what they were doing under corporate law. And so we would submit that in addition to the other burdens on the defendants here, the Bowl-Mor case places the burden on them to establish that what they've done is proper.

To return then briefly before dealing with irreparable harm to the discrimination point, we submit that if they can discriminate against us in the manner which they are attempting here, that really a new principle will be born. And that will be that a takeover bidder, someone trying to acquire control of a company, is not entitled to equal protection of the law. His rights will be able to be treated differently from all other shareholders. If that is so, there will be no more takeovers initiated by a shareholder because no one will be able to take the risk of discrimination and punitive treatment. And, of course, as my friends often point out, while Mesa has attempted to take over many corporations, in terms of the recent giants that they have attempted to take over they haven't succeeded as yet.

It is evident that in all of these acquisition attempts, someone attempting to do that has to buy a stake in the corporation in order to give themselves leverage, in order to give themselves standing. And in the event that somebody comes along like Chevron did and offers $80 a share for Gulf, they have to have some way to recover their expenses and to make a profit if they're outbid. Because these things are enormously expensive. I think somebody mentioned in the papers below that just the commitment fees on the contingent financing to make our tender offer cost

$45 million. So there are vast sums of money that are being staked, if you will, on these investments. If this court establishes a rule which prevents anybody who is a shareholder from making such a bid, then I submit that the number of such bids will be vastly reduced, to the harm of all shareholders and to the harm of our economy.

Then I think we close on really a startling proposition advanced for the first time below and that is some notion of springing fiduciary duties or that when we become an active shareholder seeking to replace management or seeking to acquire more, they don't owe us fiduciary duties but if we'll be good boys and be passive, they owe us fiduciary duties. I think even to state such a proposition should be embarrassing to Unocal and it certainly finds no support anywhere in our law, either in corporation law, in trust law, or anywhere in our jurisprudence.

Finally, I think the Vice Chancellor was on sound ground when she found that we would be irreparably harmed unless this offer was enjoined. It really was undisputed by Unocal and it is still undisputed that the eggs here cannot be unscrambled.

With a tender offer to some 70,000 shareholders, with the vast change in the equity and the legal restrictions under which Unocal operates, and with all of the third persons who are buying and selling and changing their position based on this transaction, there's just no way of restoring the situation to the way it was before unless an injunction is granted.

Indeed, the tender offer will have an irreversible effect on Unocal, on its shareholders. We had submitted below that this improper tender offer may have -- and we'll soon know -- improperly affected the outcome of the proxy contest because it was perfectly plain that they solicited proxies on the basis of "Vote for us, we're going to give you more value because we're excluding Mesa." Obviously, in this situation it would be impossible to calculate the damages. You would not be able to get the money back by rescission from the shareholders. Certainly the directors would not be able to respond in the potentially billions of dollars worth of damages, nor could we get the money from Unocal even if it had that amount of net equity left.

Under their scenario the only way we could protect ourselves is to go ahead and acquire 100 percent of Unocal. So that would require us to pay the damages to us, to ourselves, from a company that we owned 100 percent of. Obviously, that wouldn't be much of a remedy.

And, finally, I think that the Vice Chancellor's holding is well within the settled precedents of not only this court in Plaza Securities and Applied Digital but also in the recent ASARCO case where a federal judge in New Jersey on May 1, in enjoining an anti-takeover device, a special preferred, said as follows, quote: "Weeks' opportunity" -- And they also found that the board of directors in that case had a reasonable basis for assuming that Weeks was a bad man, that he had an unsavory reputation, that he was a liquidator and would adopt all these bad policies.

But notwithstanding that, notwithstanding that the board was acting in good faith in its business judgment in trying to ward off a raider, they found that the device that that board had selected was illegal. And they found irreparable harm here. They say "Weeks' opportunity to make a tender offer will be limited by an unlawful device and, correspondingly, the opportunity of other shareholders to receive a tender offer will be impaired. All this constitutes irreparable injury." And so we submit here.

Thank you for your attention.

JUSTICE McNEILLY: Thank you, Mr. Richards.

MR. SPARKS: Your Honors, in my reply I will be very brief.

First, after hearing and even seeing in the briefs before this court over and over legal rights, property rights, finally -- finally -- Mr. Richards has conceded that he doesn't have such a legal right or such a property right. Nonetheless, he did try to come back to that sort of towards the end of his argument by saying there is an equal-protection-of-the-law issue raised here. But that also assumes that there is some legal right being infringed. It also assumes state action, which doesn't have anything to do with what we are talking about here.

He suggests that maybe the standard should be an equitable one. Well, we submit that our courts have already sorted that out in the context of the business judgment rule. But even assuming there were some equitable standard, that would be very different from the fairness standard that the court imposed upon us with the burden upon the defendant. Plaintiff would have the burden in an equitable argument, and the concept of he who seeks equity must also be doing equity would come into play. Mesa, which is seeking to take value by coercive methods, simply can't invoke the aid of a court of equity to help it in that context.

Mr. Richards talked about that there is a dilution in market value. That's putting back on the sort of market-player hat instead of the hat of the person seeking control. We are talking about someone here, Mesa, who is seeking 100 percent control of Unocal. Mesa is not looking to sell into the market. It is a buyer. Market value is irrelevant to Mesa. And everybody knows that. That's why both sides have done their valuation studies and the investment bankers have looked at this in terms of the intrinsic fairness of this company.

If market value were a determinant, we

would be up for remand, for example, in Smith v. Van Gorkom. We know that is not the law.

There is some talk about appraisal rights. Well, appraisal rights don't really come into realistic play here. First, we don't know if there will be appraisal rights because they haven't told us how they are structuring this second-step transaction. But even if there were, that doesn't deal with the problems faced here in an appraisal right circumstance where one waits two or three years. If somebody is in this company as a stockholder in effect betting on where oil prices will move, he can't do that any more through the appraisal context because the appraisal proceeding would be frozen at the time that the merger was reasonably expected, whenever that is. It may already be frozen in terms of the valuation concepts for appraisal purposes. We don't even know when this merger is going to happen. So there is a whole period of time in the interim where things happen that appraisal rights don't protect.

Moreover, in this context one's investment is frozen in the appraisal context. And if they take these securities, as the court noted, what they've got is a very, very high-risk security even if it turns out that it might be worth 54 as Mr. Pickens and Mesa say they're going to be worth.

Let me also touch for just a moment on the suggestion which has been made right at the end that somehow what's going to happen here will defeat all tender offers, doomsday device. Not true, your Honor. This particular strategy will only defeat grossly inadequate two-tier partial tender offers. And it may not even do that. As they've said, they're going to go forward. It won't defeat them if somebody is willing to pay fair value.

And there are several reasons why this is necessarily true. First, the exchange offer will only deter two-tier offers at an inadequate price. The market will prefer any and all offers at a fair price to a partial offer even if the offer is at a lower price. Even if Mesa had made an offer here for, oh, say 64 -- which it believes to be a fair price, apparently -- we probably wouldn't be here today at all.

Second, under Cheff, as we know, directors who have authorized a selective stock repurchase bear the burden of showing they acted in good faith. Here the trial court found that Unocal's directors met that burden because on the record they reasonably believed the price of the Mesa offer to be inadequate. Again, had Mesa chosen to offer an adequate price, they couldn't have made that determination in good faith. Therefore, they could not have gone ahead and adopted this particular response.

Third, there are other checks on director action which continue to apply. A board must act with due care. It must not waste assets. It can't act illegally and it can't violate fixed rights. You can't assassinate Mr. Pickens. And the response must be reasonable in the circumstances.

In other words, the exchange offer here is only effective and only legally permissible in response to, as a practical matter, inadequate offers because of the good-faith requirement. And even with respect to those offers, it does not necessarily stop them but instead assures that at least some shares will be bought for fair value, thus ameliorating the ill-effects of the offer. Therefore, this is not some sort of a doomsday device, certainly doesn't raise some sort of a constitutional issue.

In terms of irreparable injury there was an argument about unscrambling. Your Honor, unscrambling is not needed. If Mesa is viewed as a stockholder, which is where they seek to claim that they have been damaged, and if they are wrongfully excluded from the offer, then money damages will suffice to take care of that exclusion. The record is clear and it is unrebutted on that point: that there are excess assets to be able to take care of whatever damage the court might find to Mesa from being excluded in its capacity as a stockholder.

Finally, your Honor, I submit simply that Delaware law in this area cannot be static. We didn't have professional raiders in 1964 when Cheff was decided and we didn't have front-end loaded two-tier junk bond tender offers. We have them now. And I think our law has to keep up to date with that kind of reality. I think in this case it's easy, because they in effect are asking for a change in the law. And we are simply asking the court, now that it has squarely put directors in the position of having a duty to stockholders to protect them from inadequate offers, to not take away the tools to allow them to do that in good faith.

Thank you.

JUSTICE McNEILLY: Thank you.

Thank you, gentlemen. We have the case under advisement.

Gentlemen, let's have your timetable, will you please, as to when you have to have some answers.

MR. SPARKS: Your Honor, as I believe both sides in the scheduling conference with Justice Moore pointed out, we think it is critical that there be an answer at the latest some time tomorrow. Although I recognize that puts tremendous pressure on the court. Our proration date on this offer is tomorrow and the investors are going to act in accordance with that.

JUSTICE MOORE: Doesn't your exchange offer expire tomorrow?

MR. SPARKS: Your Honor, the exchange offer was to expire tomorrow. It is now expiring on the 22nd of May. But the proration date is tomorrow. Tomorrow is the date the investors who are going to tender in have to make a decision as to whether they are coming in or not coming in and will otherwise be shut out if they don't.

And the reason -- Well....

MR. RICHARDS: Your Honor, I don't believe we took the position at the scheduling conference -- although I wasn't there -- that the case had to be decided tomorrow. Indeed, I don't think it has to be decided tomorrow. The court should understand that that is a deadline imposed by Unocal because they want to adhere to their schedule. But there is nothing -- Today's Wall Street Journal reports that they have extended the deadline to May 22 so that the Supreme Court of Delaware would have more time to consider the matter.

Now, I don't know whether that is true or whether that is why they submitted it. It is true that they didn't change the proration deadline. That remains at midnight tonight. And it is true that that would affect people's decisions, because they wouldn't know to what extent they were going to be prorated. But they did extend the expiration date, as I understand it, in a supplement -- which I haven't seen -- until May 22. But whether they had or not, they could extend all of those deadlines here, right now, or at some subsequent time today at the request of the court if the court needed more time. I mean, this is a self-imposed deadline.

MR. SPARKS: Your Honor, two points. One, of course, the Mesa deadline is, I think, Thursday, May 23. Throughout this entire struggle, the spacing between these offers has remained the same. The time schedule is set forth under the federal law.

What Mr. Richards is actually asking us to do is let his offer go first or go into some position like that. We submit that we have a right, as they said in the Kennecott case in the Third Circuit, to proceed on a timetable set forth under the federal law and of course, unless we continue to be enjoined, in which case we obviously can't do that.

Secondly, I believe Mr. Richards misspoke. The proration date on our offer is midnight on Friday, not midnight tonight.

MR. RICHARDS: Yes, I did misspeak as to that.

MR. SPARKS: Thank you, your Honor.

JUSTICE McNEILLY: We have the matter under advisement.

(Hearing concluded at 11:25 a.m.)

I N D E X

State of Delaware)
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County of New Castle)

C E R T I F I C A T E

I, J. Edward Varallo, Registered Professional Reporter and Notary Public for the State of Delaware, do hereby certify that the foregoing record, pages 1 to 91 inclusive, is a true and accurate transcript of my stenographic notes taken on Thursday, May 16, 1985, in the above-captioned matter before the Supreme Court of the State of Delaware.

IN WITNESS WHEREOF, I have hereunto set my hand and seal this______day of May, 1985, at Wilmington.

____