IN THE SUPREME COURT OF THE STATE OF DELAWARE

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| REVLON, INC., a Delaware corporation, MICHAEL C. BERGERAC, SIMON ALDEWERELD, SANDER P. ALEXANDER, JAY I. BENNETT, IRVING J. BOTTNER, JACOB BURNS LEWIS L. GLUCKSMAN, JOHN LOUDON, AILEEN MEHLE, SAMUEL L. SIMMONS, IAN R. WILSON, PAUL P. WOOLARD, EZRA K. ZILKHA, FORSTMANN LITTLE & CO., a New York limited partnership, and FORSTMANN LITTLE & CO. SUBORDINATED DEBT AND EQUITY MANAGEMENT BUYOUT PARTNERSHIP-II, a New York limited partnership, | No. 353 & 354, 1985 |
| Defendants Below, Appellants, | |
| v. | |
| MACANDREWS & FORBES HOLDINGS, INC., a Delaware corporation, | |
| Plaintiff Below, Appellee. | |

## THE FORSTMANN LITTLE APPELLANTS' OPENING BRIEF


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## NATURE OF PROCEEDINGS AND ORDER TO BE REVIEWED

This expedited interlocutory appeal arises from the decision of the Court of Chancery of October 23, 1985, issued in the context of an extended contest for control of defendant Revlon, Inc. ("Revlon"). The aspirants for control are Pantry Pride, Inc. ("Pantry Pride"), an affiliate of plaintiff MacAndrews & Forbes Holdings, Inc., and defendants Forstmann Little & Co. and its affiliated limited partnerships ("FLC").

In relevant part, the opinion below granted preliminary injunctive relief against the enforcement of certain provisions contained in a merger agreement between Revlon and FLC. These provisions induced FLC to commit to the highest price offered to Revlon stockholders, as of that date. Specifically, the court below enjoined, among other things, an asset option obtained by FLC for certain health care divisions of Revlon as part of the Revlon-FLC merger agreement executed on October 12, 1985, and the payment to FLC of a $25 million cancellation fee for which FLC contracted in the event that the merger was not consummated. The opinion contains no finding, explicit or implicit, that FLC engaged in any wrongdoing.

## SUMMARY OF ARGUMENT

The Court of Chancery's decision reaches several unprecedented -- indeed startling -- results.

1. It deprives FLC -- a third party having no relationship to Revlon, its management, or its directors other than having negotiated an arm's-length merger transaction with Revlon and against which no finding of wrongdoing whatever has been made -- of its contractual rights and benefits after it has performed its side of the bargain by producing hundreds of millions of dollars for Revlon shareholders.

2. It enjoins the payment of the cancellation fee to Forstmann Little without even purporting to make the basic findings necessary for such relief. There is not a single word dealing with "likelihood of success" or "inadequate remedy at law." Indeed, since the court stated that it believed a cancellation fee to be "not unusual in a transaction of this magnitude," and since only a fixed money amount is involved, it is obvious that these basic prerequisites for injunctive relief are patently lacking.

3. It invalidates a type of bargaining process -- the grant of an asset option following a bidding process which achieved a substantially higher price for shareholders -- which the undisputed and overwhelming independent expert testimony demonstrated is of critical importance in today's takeover

environment. Such options are recognized to be a proper inducement to "white knights" to join in takeover contests. They provide millions of premium dollars to shareholders, which is precisely what happened in the case at bar.

4. It impermissibly substitutes the judgment of the court for the business judgment of the board of directors as to how to achieve the best price for shareholders in a takeover context.

Although it is difficult to understand the unprecedented results reached by the court below, it may be because the court seriously misapprehended the factual record which was hastily put before it. Indeed we can only believe, as the factual statement in the opinion suggests, that the court was influenced by events which took place long before FLC came on the scene -- such as poison pills, self-tenders, restrictive note covenants and golden parachutes -- which are sometimes considered to promote management entrenchment.* Yet these events have nothing to do with the transaction here under review. There is no entrenchment whatsoever; management is

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* The court may also have been influenced by actions which took place after the Revlon board approved the transactions at issue here and indeed after the argument below, such as Pantry Pride's new offer of $58 per share. The law, however, is clear that the board is entitled to make its decision based on all the facts known to it at the time the decision was made.

receiving no equity participation in the transaction, nor are there any promises of continued employment. What we have, instead, is an arm's-length, fully negotiated, third party transaction providing substantial benefits to shareholders -- the type of transaction which has never been enjoined by the courts. We respectfully submit that the Chancery Court committed clear error in issuing the preliminary injunction here on appeal.

## STATEMENT OF FACTS

We will not burden this Court by referring to all of the relevant facts in this recital. But the facts as they relate to FLC are of critical importance because FLC is the only party harmed by the Chancery Court's injunction although no findings of wrongdoing were or could have been made against it. Notwithstanding the conspicuous absence of any such findings, FLC has been deprived of its contractual rights after it has been used to provide hundreds of millions of dollars to Revlon's shareholders.

### The Level Playing Field

The lower court's opinion appears to be rooted in the inexplicable presumption that FLC and Revlon acted in some collusive fashion to tip the scales in FLC's favor. In fact, every step of the bidding process to date has resulted from protracted arm's-length negotiations, including negotiations involving Pantry Pride. In connection with the original merger agreement entered into by FLC and Revlon on October 3 (the "Original Merger Agreement") (A 402)*, Revlon refused to accede to the majority of requests made by FLC so that Revlon could promote additional bidding and keep the playing field level for <u>all</u> possible bidders, including Pantry Pride. Indeed, both before and after entering into the Original Merger Agreement, Revlon publicly invited offers to purchase the Company. <u>See</u> Minutes of October 1 at 6 (A 841); Loomis Affidavit ¶7 (A 944); Minutes of October 3 at 32-33 (A 876-877); Minutes of October 12 at 28 (A 907). Revlon acted in an even-handed fashion as demonstrated by the following facts:

> (i) In connection with the Original Merger Agreement, Revlon refused to grant FLC an option to purchase Revlon assets as requested by FLC, because it believed additional substantial bidding might be forthcoming. Minutes of October 3 at 3 (A 847); Loomis Affidavit ¶5 (A 943); Forstmann Affidavit ¶12 (A 1011-12).
>
> (ii) Similarly, Revlon refused to agree to a conventional "no-shop" clause which would have prohibited Revlon from soliciting or encouraging other bids. Indeed, Revlon insisted upon a provision unique in FLC's experience which expressly <u>permitted</u> Revlon to

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* Hereinafter, references to the Joint Appendix submitted by the defendants will be referred to as "A --."

continue to shop the company. Original Merger Agreement at 38 (A 439); Minutes of October 3 at 14 (A 858).

(iii) Because FLC had not formulated its final plans with respect to the holders of Revlon's 11.75% Subordinated Notes (the "Notes") as it had advised Revlon's investment bankers, it intended to do, Revlon did not waive or agree to waive the Note covenants on October 3, contrary to the Chancery Court's opinion. Minutes of October 3 at 17 (A 861); Original Merger Agreement at 57-58 (A 439); Loomis Affidavit ¶7 (A 944).

(iv) When on October 12 Revlon did waive the Note covenants, it did so in favor of any and all bidders, (including specifically Pantry Pride), who would provide equal treatment to noteholders. Minutes of October 12 at 15-16 (A 894-95).

(v) Revlon redeemed the "poison pill" rights previously issued for the FLC transactions and for any other transaction providing at least $57.25 per share to Revlon shareholders, including any such transactions with Pantry Pride Minutes of October 12 at 14-15 (A 893-94).

(vi) Revlon's agreement to sell its Cosmetics Division to a group led by Adler & Shaykin for $900 million (as to which negotiations commenced before FLC was first approached) is not conditioned upon FLC's merger but will inure to the benefit of any acquiror, including Pantry Pride. Minutes of October 3 at 3, 20 (A 847, 864).

Revlon's October 3 announcement of the Original Merger Agreement, with the conspicuous absence of any asset option or no-shop clause, constituted a clear signal to the market that Revlon was still for sale -- much against FLC's wishes* -- to a higher bidder. In fact, as of October 3, there was still a third party other than Pantry Pride from whom Revlon hoped to receive a bid, and Revlon and Lazard Freres & Co. ("Lazard"), Revlon's investment banker, did in fact continue to shop the company. Loomis Affidavit ¶7 (A 944); Minutes of October 3 at 32-33 (A 876-77); Minutes of October 12 at 28 (A 907). In Lazard's view, the Original Merger Agreement constituted an option to "put" Revlon to FLC at a price of $56 per share in the event that Lazard and Revlon were not able to produce a better offer for Revlon's shareholders. Id.

Moreover, Pantry Pride's claims that it was never permitted to negotiate with Revlon (which the Chancery Court appears to have found persuasive) is belied by the evidence supplied by Pantry Pride itself. The affidavits of Pantry Pride's Ronald Perelman (A 1148) and attorney Donald Drapkin (A 1132-34), and the minutes of Revlon's October 12 board meeting (A 886, 908-09, 917), reflect that negotiations with Pantry Pride did in fact take place after the Original Merger

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* See Forstmann Affidavit ¶12 (A 1011); Minutes of October 3 at 14 (A 858); Minutes of October 12 at 13 (A 892).

Agreement was announced.*

The fact that these discussions did not result in Pantry Pride's emergence as the highest bidder as of the October 12 board meeting is in no way attributable to any conduct by FLC or Revlon but to the fact that Pantry Pride flatly declined to produce a definitive, materially increased offer. Instead, Pantry Pride was willing only to follow FLC's bids and then outbid FLC by a paltry amount. This tactic was rejected by Revlon and Lazard in favor of FLC's materially enhanced offer of October 12. Minutes of October 12 at 7-8, 24, 26 (A 886, 903, 905); Glucksman Deposition at 174 (A 1510); Rifkind Affidavit ¶¶48-51 (A 776-78); Rohatyn Affidavit ¶17 (A 938-39).

In short, Pantry Pride was deterred not by any of the purported "obstacles" cited by the lower court but by its reluctance to present Revlon its best bid.

The Cancellation Fee

On September 20, Lazard requested that FLC consider evaluating Revlon as a possible candidate for a leveraged buyout. FLC advised Lazard that it would not meet with either

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* During these discussions, Pantry Pride proposed that its bid of $56.25 be accepted and that it would take FLC out of the bidding by Pantry Pride (as the winning bidder) selling to FLC the assets which later became subject to the option for $557 million.

Lazard or Revlon unless it was clearly understood that FLC would receive, in the event that FLC's bid was agreed to by Revlon but could not be completed through no fault of FLC's, fees sufficient to make it worthwhile to engage in the process of analyzing the company, structuring a transaction, and committing FLC's resources and reputation. Forstmann Affidavit ¶9 (A 1009). The record is clear that FLC would not have entered into the bidding contest -- indeed, would not even have considered an acquisition of Revlon -- unless Revlon was prepared to compensate FLC for the commitment of $445 million of its capital and its time, expertise and lost opportunity costs. Forstmann Affidavit ¶¶6-7, 9 (A 1007-08, 1009); Loomis Affidavit ¶4 (A 942). It is highly significant that Pantry Pride's willingness to go forward with its $56.25 bid is not conditioned upon the termination of FLC's cancellation fee. Perelman Affidavit ¶9 (A 1147). Pantry Pride Supplement at 10-13 (A 227-30). The provision for such a fee, thus, in no way deterred Pantry Pride from continuing to pursue Revlon.

The Asset Option

Following Pantry Pride's October 7 amended offer, FLC was asked by Lazard to make a further offer. This FLC was extremely reluctant to do* in light of the economic risks perceived and in light of statements made to FLC by Pantry Pride that it was prepared to counter whatever offer FLC made by a mere $0.25. Loomis Affidavit ¶9 (A 946); Minutes of October 12 at 7, 8, 38 (A 886-917). Accordingly, FLC advised Revlon and Lazard that it would be willing to increase its merger price only if it received an option on Revlon's Vision Care and Health Labs divisions in order to avoid being used as a stalking horse by Pantry Pride with its "nickel and dime" threat.** As one of Revlon's outside directors (who heads his own financial firm) testified, ". . . I am in this same business . . . [and] I know the one thing you cannot do is be shopped to death." Glucksman Deposition at 154 (A 1490).

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* The impression conveyed by the Chancery Court -- that FLC, on its own initiative, enthusiastically offered to increase its price -- is incorrect. The decision to make a further offer was a difficult one made with a good deal of reluctance. Forstmann Affidavit ¶16 (A 1014).

** Mr. Forstmann has testified that the option agreement was "absolutely critical" to FLC's willingness to offer the price of $57.25. Forstmann Affidavit ¶2 (A 1005). This fact was recognized by Revlon's directors. Rifkind stated: "Mr. Forstmann stated his 'bottom line' very clearly. He had to have a lock-up option on Revlon's Vision-Care and National Health Laboratories Divisions in order to avoid being used as a stalking horse by Mr. Perelman . . . . Otherwise, FLC would withdraw its offer and leave Pantry Pride as the sole bidder -- with the inevitable consequences." Rifkind Affidavit ¶49 (A 777). <u>See also</u>, Glucksman Deposition at 154 (A 1490); Forstmann Affidavit ¶15 (A 1014); Minutes of October 12 at 7, 32, 37-38 (A 886, 911, 916-17).

The purchase price for the option was heavily negotiated by Revlon and Lazard with FLC.* The $525 million price ultimately agreed to represents the net consideration which Revlon would receive if the option were exercised, since the sale may be accomplished as a transaction which are intended to be virtually tax free. FLC reluctantly agreed to two limitations on the option insisted upon by Revlon: (i) the option would not be exercisable unless another person acquired at least 40% of Revlon's shares; and (ii) even after a person acquired 40% of Revlon's shares, the option may not be exercised unless and until that acquiror has the opportunity to structure the sale of the assets to FLC on a substantially tax-free basis. Loomis Affidavit ¶11 (A 947-48); Forstmann Affidavit ¶18 (A 1015-16).

The asset option was required by FLC if it was to increase a bid which it thought already represented full value. Minutes of October 12 at 8, 37, 39 (A 887, 916, 918); Forstmann Affidavit ¶¶12, 17 (A 1011-12, 1014-15). It is a simple fact, confirmed by the affidavits from five major investment banking firms -- and a firm specializing in leveraged buyouts -- having no interest in this transaction,

* Forstmann Affidavit ¶¶2, 12, 18 (A 1005, 1011-12, 1015-16). (The negotiations started at $400 million and ended with an agreement at $525 million.) Id.

that third parties such as FLC are unwilling to get involved in a bidding situation where the target company is already the subject of an unsolicited offer -- and to undertake the vast commitments of funds, resources and time while assuming the risks and the lost opportunity costs -- without some form of inducement such as an asset option. Affidavits of Peter D. Goodson (Kidder Peabody & Co., Inc.) ¶3 (A 1041); Michael Hoffman (Smith, Barney, Harris Upham & Co., Inc.) ¶3 (A 1044); Roger Miller (Salomon Brothers Inc.) ¶3 (A 1047); George Weigers (Dillon, Reed & Co., Inc.) ¶3 (A 1055); Alex Brown & Sons Incorporated ¶3 (A 1052); Lewis van Amerongen (Gibbons Green Van Amerongen Ltd.) ¶3 (A 1049).

Moreover, the $57.25 price offered by FLC on October 12 was viewed by Lazard as being at the highest range of value for Revlon, and Lazard advised Revlon that it was unlikely that additional bids would be made materially in excess of $57.25. Rohatyn Affidavit ¶16 (A 936);* Rifkind Affidavit ¶50 (A 777-78). The record is clear that FLC simply would not have continued in the bidding process and would not

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* Lazard further advised Revlon that if the FLC transaction were consummated within 50 days, it represented a higher cash value than Pantry Pride's offer even after discounting for present value. Rohatyn Affidavit ¶11 (A 930-31); Minutes of October 12 at 21 (A 900). It also advised that the Pantry Pride $56.25 price should be discounted for failure to have firm financing.

have increased its offer in the absence of an asset option. Forstmann Affidavit ¶17 (A 1014-15); Rifkind Affidavit ¶43 (A 777); Loomis Affidavit ¶11 (A 947-48).

The Notes

FLC's provision for Noteholders in no way represents consideration which otherwise would have gone to Revlon's common shareholders. It was always FLC's intention to make some provision for Noteholders* for reasons that related solely to the structure of the transaction. To finance the acquisition, certain Revlon assets had to be sold. To the extent assets are sold, the $475 million in Revlon debt represented by the Notes would be almost impossible to maintain. Thus, some alteration of the terms of the existing Notes -- which are not callable for five years -- would have been required irrespective of the price per share offered to Revlon's common shareholders.

Prior to October 3, FLC advised Lazard that FLC intended to make some provision for the Noteholders, but that its plans had not been fully formulated. Loomis Affidavit ¶7 (A 944-45); Minutes of October 3 at 17 (A 861). The record is clear that both FLC and Revlon contemplated that the

* See Loomis Affidavit ¶7 (A 944-45); Minutes of October 3 at 5 (A 849).

Noteholders would be provided for and treated separately long before there was any change in the market value of the Revlon Notes. Loomis Affidavit ¶6 (A 943-44); Minutes of October 3 at 17 (A 861).*

In connection with the negotiations leading up to the October 12 Amendment, FLC proposed an exchange offer, pursuant to which each Note may be exchanged for a new note bearing increased interest rates (the "New Notes"). The terms of the New Notes indirectly generated additional savings which permitted FLC to raise its price to $57.25. The existing Notes contain a "liquidated damage" clause requiring a $56 million payment if the Notes are redeemed within five years (Revlon Offer to Purchase at 52 (A 139)) which, as noted above, they must be. The terms of the New Notes permit FLC to redeem the New Notes at any time without penalty. <u>See</u> Revlon October 13 Press Release at 2 (A 519). The $56 million saved by virtue of the exchange offer would provide the additional $1.25 per share which FLC would provide to Revlon's common shareholders and FLC so advised Revlon's management.

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* It should be noted that the decline in the market price of the Notes was nowhere near as cataclysmic as the Chancery Court stated. Slip op. at 10 (A 1175). The closing price of the Notes on October 2 was $93.5. By October 8, the closing price had declined to $87. By October 11, however, the closing price had <u>come back</u> to $92.5. <u>See</u> Trading History of Revlon, Inc. Senior Subordinated Notes, attached hereto as Exhibit A.

Thus, the Note issue is nothing more than a red herring raised at the last minute by Pantry Pride,* in an effort to create an alleged self-interest on the part of the Revlon board which did not in fact exist.

FLC's Financing

From the outset, FLC had committed financing which would enable it to consummate the merger: FLC committed in excess of $445 million of its own money and had, as it now has, commitments from major banks for the remainder. Forstmann Affidavit ¶15 (A 1014). FLC entered into a commitment to sell Revlon's Norcliff Thayer business to American Home Products for an additional $335 million. Id. This was all the money that was needed without any further funds from the banks. Forstmann Affidavit ¶22 (A 1017-19). To no extent was the money which would have been invested by Revlon's management -- who at their

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* Significantly, Pantry Pride advised the Chancery Court at the hearing below that it had determined to make an exchange offer "equal to that proposed by Forstmann Little." Perelman Affidavit ¶17 (A 1152). As has occurred again and again in this case, Pantry Pride clearly has availed itself of FLC's economic analysis and has recognized -- as FLC always has recognized -- the economic necessity of providing for Revlon's Noteholders and, further, has adopted for itself the economic advantages of the particular provisions proposed by FLC. See Rohatyn Affidavit §¶12(c), 17 (A 933-34, 938-39).

request are no longer participants in the transaction* -- required by FLC to finance the transaction. Forstmann Affidavit ¶22(iv) (A 1018).**

By contrast, as of October 12 and beyond, Pantry Pride's "junk bond" financing, after almost two months of trying, was not in place. Rohatyn Affidavit ¶12(b) (A 933); Minutes of October 12 at 5-6 (A 884-85); Pantry Pride's October 11 letter to Loomis (A 525). Moreover, one of Revlon's outside directors recalled participating in a transaction in which the same investment banking firm representing Pantry Pride had been unable to raise the financing there at issue. Glucksman Deposition at 181 (A 1511F). Accordingly, the Chancery Court's finding (slip op. at 21 (A 1186)) that the

* Historically, FLC has wanted management of the surviving entity to have an equity participation for which they pay. Minutes of October 3 at 26-27 (A 870-71); Minutes of October 12 at 35-36 (A 914-15); Forstmann Affidavit ¶20 (A 1016-17). Revlon's management would never have received a special deal or inducement, but merely the opportunity to participate with FLC as partners. Notwithstanding the foregoing, in order to remove any possible suggestion of self-interest in this transaction, FLC reluctantly agreed, in connection with the revised Merger Agreement, that no member of the board or senior management would have the opportunity to participate in the equity of the new company. Id.

** The court's finding that "[W]ith the exit of Revlon's management from the October 12 transaction, FLC was left with the need to raise approximately $400 million before it could consummate the transaction," is also, thus, demonstrably in error. Slip op. at 22 (A 1187).

Revlon board was without basis to conclude that FLC's financing was more firm than Pantry Pride's is plainly erroneous.

Benefits to Revlon's Shareholders

In short, as a result of FLC's participation in the bidding process for Revlon, Revlon's Board achieved the following benefits for Revlon's shareholders:

(i) FLC committed in excess of $445 million of its partners' capital to the transaction,* and obtained the remaining financing necessary to enable it to make a $56 and, subsequently, a $57.25 per share offer which put over $400 million additional cash in the hands of Revlon's shareholders.

(ii) FLC participated in the negotiations with the group led by Adler & Shaykin as a result of which Adler & Shaykin increased the price it was willing to pay from its original proposal by approximately $75 million, or more than $2 per Revlon share. Forstmann Affidavit ¶22 (A 1017-19); Minutes of October 3 at 10 (A 854). That agreement will inure to the benefit of Pantry Pride or any other entity which acquires Revlon.

(iii) FLC obtained a commitment from American Home Products to purchase Revlon's Norcliff Thayer business at a very favorable price to Revlon. Forstmann Affidavit ¶44(iii) (A 1013).

(iv) FLC devised a tax structure for the transaction which permits the sale of the Cosmetics Division and perhaps other divisions in transactions which are intended to be virtually tax free, again resulting in additional dollars to shareholders.

* Forstmann Affidavit ¶6 (A 1007-08); Minutes of October 12 at 35 (A 914).

(v) FLC devised the strategy of conducting an exchange offer for the Notes which both returns their trading value to par or near par and provides that FLC or any other acquiror can redeem the Notes without the necessity of paying a $56 million penalty, thus making more money available for payment to Revlon's shareholders.

To deprive FLC, as the court below did, of its hard won, arms-length negotiated contractual rights notwithstanding those benefits to shareholders is patently unfair and, as demonstrated below, without precedent in law.

## Argument

## I.

## THE CHANCERY COURT ERRED IN PRELIMINARILY ENJOINING ENFORCEMENT OF THE CANCELLATION FEE AGREEMENT.

### Standard and Scope of Review

The court's entry of a preliminary injunction against the cancellation fee without making the required finding presents a question of law. The court must review such legal holdings for errors of law *de novo* and should reverse the trial court if such errors of law are found. Rohrer v. Neimann, Del., 380 A.2d 549, 552 (1981).

* * *

Although our main complaint is with the unprecedented injunction against the asset option, we start with a discussion of the injunction against the enforcement of the cancellation fee agreement since we do not wish it to be overlooked, or treated off-handedly. The court below granted an injunction against the cancellation fee without even purporting to find that Pantry Pride had satisfied the two necessary prerequisites for a preliminary injunction.* In fact, Pantry Pride has not shown, has not attempted to show, nor could it possibly show either a reasonable probability of success on the merits or irreparable injury if preliminary relief was not granted on this issue. The impossibility of Pantry Pride's demonstrating that there is no adequate remedy at law against the present defendants on a $25 million claim, alleging the improper payment of money alone, is manifest. This factor alone is dispositive.**

The Chancery Court has not made any findings as to likelihood of success or irreparable injury with respect to the cancellation fee agreement, nor would any such findings have been supportable. Significantly, the court acknowledged that

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* <u>Van deWalle v. Unimation, Inc.</u>, Del. Ch., C.A. # 7046, Hartnett, V.C., slip op. at 1-2 (Feb. 14, 1983); <u>Weinberger v. United Financial Corp.</u>, Del. Ch., 405 A.2d 134, 137 (1979); <u>Sandler v. Schenley Industries, Inc.</u>, Del. Ch., 79 A.2d 606, 610 (1951); <u>Allied Chemical & Dye Corp. v. Steel & Tube Co.</u>, Del. Ch., 122 A. 142 (1923).

** <u>Bayard v. Martin</u>, Del. Supr., 101 A.2d 329, 335 (1953), <u>cert</u>. <u>denied</u>, 347 U.S. 944 (1954) (denial of preliminary injunction affirmed where "there has not been even a shadow of a showing that [defendant] is unable to respond in damages"); <u>Wayne v. Cornwall Equities, Ltd.</u>, Del. Ch., C.A. Nos. 6258, 6285, Brown, C. (Oct. 30, 1980).

such fees are ordinary practice in takeover situations: "A cancellation fee, _per se_, is not unusual in transactions of this magnitude." Slip op. at 29 (A 1194). In fact, we know of no case, and neither the court nor Pantry Pride cited any, in which such a fee has been set aside.

The court, in support of its ruling, said only that, "[s]ince the asset lock-up will now be enjoined it is appropriate to preclude distribution of the cancellation fee until the merits of that aspect of the dispute have been resolved." _Id_. This, with all due respect, is a _non sequitur_. Even if the grant of a preliminary injunction against enforcement of the asset option were appropriate (which, we submit, it is not) FLC's contractual right to the cancellation fee is a separate issue as to which the appropriateness of preliminary relief must be separately addressed. Having failed to do so, the court's grant of an injunction cannot be permitted to stand. Injunctions are extraordinary and drastic remedies and are granted only if earned.

The fact that the cancellation fee and the shares of the subsidiaries representing the optioned assets were placed in escrow at or about the same time, shortly following the execution of the October 12 amendment to the Original Merger Agreement is of no legal significance. It hardly could justify a tag-along injunction, if such an injunction ever could be justified. In fact, the cancellation fee and the optioned stock are subject to separate escrow agreements and their release from escrow is independently triggered based upon different contingencies. More importantly, as the court acknowledges (slip op. at 29 (A 1194)), the cancellation fee was included in the Original Merger Agreement, at a time when the Revlon board refused to grant the asset option because it believed that there still might be additional substantial bidding for the company. Loomis Affidavit ¶7 (A 944-45); Minutes of October 3 at 14, 29 (A 858, 873). Indeed, FLC made it clear from the outset that it would not even consider coming into the situation, in light of the enormous required expenditure of time, money, and effort, unless it was assured of such a fee. As Mr. Forstmann stated:

> We view cancellation fees, such as the $25 million fee that we requested and insisted upon from the beginning of our discussions with Revlon, as analogous to the commitment fees that are paid to lenders irrespective of whether the funds committed to the borrower are drawn upon. For similar reasons, we simply do not commit our resources and those of our partners to a transaction without economic recompense for having provided the shareholders with an opportunity to receive substantially more than the then existing bid for their company while assuming the risks and the lost opportunity costs. Our arrangement with our partners* is that they receive a substantial

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* FLC's partners include some of the largest pension funds in the country (e.g., the pension funds of General Electric

Footnote Continued

share of any such fees that we receive.

Forstmann Affidavit ¶7 (A 1008). The fee was not intended to have, nor did it have, the effect of deterring further bidding by Pantry Pride.

There was no challenge made to these fundamental facts, nor was it denied that FLC's entry into the takeover contest resulted in hundreds of millions of additional dollars to Revlon shareholders. If for some reason, inconceivable to us, the cancellation fee is ultimately held to be invalid, despite the benefits it produced for shareholders, there may be a finite $25 million damage claim. But the injunction against a fee which has been contracted for and earned -- unsupported by factual findings, law or logic -- is, we submit, the plainest of errors.

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* Footnote Continued From Previous Page

Co., Standard Oil of Indiana, AT&T, Boeing, Texas Instruments, 3M Corp. and Hughes Aircraft). Forstmann Affidavit ¶4 (A 1006).

II.

## THE INJUNCTION AGAINST THE ASSET OPTION IS UNSUPPORTABLE IN FACT AND LAW.

Standard and Scope of Review

This Court's review of the asset option raises a mixed question of law and fact. The applicable standard of review was as stated by this court in Levitt v. Bouvier, Del. Supr., 287 A.2d 671, 673 (1972): "this court has the authority to review the entire record and to make its own finding of fact in a proper case. In exercising our power of review, we have the duty to review the sufficiency of the evidence and to test the propriety of the findings below." Further, this Court will not hesitate to draw its own inferences and reach its own conclusions where a finding of fact by the court below is based on a deduction, a process of reasoning or an inference. Nelson v. Murray, Del. Supr., 211 A.2d 842, 844 (1965). Finally, where the lower court's findings were based on documentary evidence as opposed to live testimony, as was the case here, this Court will not defer to the findings below. Hob Tea Room v. Miller, Del. Supr., 89 A.2d 857 (1952).

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A. <u>The Chancery Court's Finding that the Asset Option Foreclosed Further Bidding was Clearly Erroneous.</u>

Asset options have never before been invalidated, because they play a fundamental role in the takeover process, assuring that companies will not be purchased at bargain prices by the initial bidder. But if they are ever to be invalidated it certainly should not be here, where the bidding had run its course, no significant additional bids appeared to be forthcoming, and the option served nevertheless to produce millions of dollars of additional value to shareholders.

By October 12, the public and private bidding for Revlon shares appeared to be over. FLC had offered $56 per share -- $14 per share more than the only actual offer that had been made by Pantry Pride. Pantry Pride, which had been continually implored to put its best offer on the table, had stated its intention not to engage in meaningful bidding, but rather to merely top FLC's offer by an insignificant amount. Minutes of October 12 at 7-8 (A 886-87). It had already demonstrated this "nickel and dime" strategy by increasing FLC's bid by 25 cents per share, with financing still not in place. Most significantly, the "major American corporation" thought to be on the scene on October 3, when the asset option was refused, had determined not to go forward. Minutes of October 12 at 29 (A 908); Rohatyn Affidavit ¶16 (A 936).

It had been almost two months since Pantry Pride's initial offer for Revlon shares and during that time it is undisputed that although other bidders were actively sought, only FLC had come forward with a substantial and bona fide commitment. Indeed, Revlon had structured the Original Merger Agreement to maximize its ability to continue to solicit competitive bids, and in the particular hope that the "major American corporation" -- American Home Products -- would produce a substantial additional bid. Yet even that effort failed to produce other bidders, and American Home Products determined instead to negotiate only for the purchase of certain divisions. Minutes of October 12 at 29 (A 908).

In spite of the utter absence of new bidders, Revlon still determined to seek an even higher offer for its shareholders. To do so Revlon turned to the offeror that had dealt with it in good faith, had solid and full financing, had a proven record of completing such transactions and had already increased Revlon's shareholder consideration from $42 to $56 per share. FLC demanded, as a non-negotiable condition of its willingness to increase its offer, the asset option which had been refused when Revlon thought that substantial additional bidding might be available from other parties.

At this point, the issue for the Revlon board was a clear one. By granting the asset option,* Revlon was able to

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* It should be noted here that the assets which are the subject of the option granted to FLC are not sought by

Footnote Continued

obtain $1.00 per share more for its shareholders than they otherwise would have received.* It bears continued emphasis in this regard that it was only after the bidding process -- initiated in the first instance by FLC's participation -- had come to an end that the Revlon board granted the asset option it previously refused to give. Without this added inducement, the bidding was over at $56.25; Pantry Pride's reluctance to raise its bid until after the oral argument on the preliminary injunction motion is vivid testimony to this fact. While the court's opinion appears to suggest that Revlon should have "shopped" the $57.25 FLC offer to Pantry Pride, in the hope of obtaining another "nickel or dime" increase, not only would this have been dealing in the worst of faith with FLC, but, more significantly, FLC, understandably unwilling to act as a

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* Footnote Continued From Previous Page

Pantry Pride for synergistic reasons. Indeed, Pantry Pride had offered to sell them to FLC for $557 million. Thus, the Revlon board was not pulling out of a prospective bidder's hands the very assets for which that bidder was willing to pay a substantial premium.

* FLC's merger price of $57.25 was in fact greater than Pantry Pride's $56.25 tender offer price based on the facts available to the board on October 12. First, Pantry Pride's financing was not complete and thus it could not purchase shares immediately if at all. Second, FLC's commitment to accomplish the merger within 30 to 35 days, even assuming a discount on the $57.25 price, would still make the FLC offer financially superior to Pantry Pride's offer from the standpoint of the shareholders. Rohaytn Affidavit ¶15 (A 935-36).

"stalking horse", simply would have withdrawn, leaving Pantry Pride to take the company at whatever price it chose.

In sum, the court's basic factual determination that the option was "extended to foreclose further bidding in an active bidding situation" (slip op. at 25 (A 1190)) is simply contrary to the record. At $57.25, the October 12 FLC offer was clearly the best one available, with no prospect of a substantially higher bid. Pantry Pride had been unwilling to substantially increase the October 3 $56.00 price. Indeed, it is conceded that the $57.25 price was in the highest range of fairness for the company.* Having obtained such an additional sum, Lazard specifically opined as to the fairness of the totality of the transaction including the asset option, and affirmatively recommended that the FLC transaction be accepted. Minutes of October 12 at 24, 34 (A 903, 913). In this situation, the Board's determination cannot rationally be questioned.

All of the foregoing would be true no matter how the Court views the question of the noteholders. Putting aside the additional benefits to noteholders, it is for the board, expressing its business judgment, and not the court, to balance

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* Rohatyn Affidavit ¶17 (A 937); Loomis Affidavit ¶12 (A 948); Rifkind Affidavit ¶50 (A 777-78); Glucksman Deposition at 134-137 (A 1475A-75C).

the advantages of obtaining over $30 million for shareholders, at a time when no additional bidding was forthcoming, against the "grant" of an asset option at a price determined by extensive negotiations.* We would have thought that the Revlon board, in its arm's-length negotiations with FLC, did it just right -- it refused the option when it thought substantial additional consideration might be forthcoming, and granted it when it later became apparent that it was not. But, in any event, this is precisely what the concept of business judgment, as articulated in countless Delaware cases, is all about, and if the courts are now to draw this balance instead of the directors, the business judgment rule as we know it will have been dealt a crippling blow.

B. Chancery Court Erred in Finding that the Agreement Relating to Noteholders Took Money Away from Revlon Shareholders.

We respectfully suggest that the court was in error on the noteholder question as well. In the first place, if being a potential defendant in a lawsuit arising out of a takeover

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* While the option price was lower than Lazard's liquidation value estimates, it was within the range of value estimated by the investment bankers for both FLC and Pantry Pride, and was close to the price for which Pantry Pride had offered to sell these assets to FLC. It can hardly be said, therefore, that the price reached was outside of the normal realm of negotiations. Minutes of October 12 at 23 (A 903).

struggle is now deemed to make directors "interested" for the purpose of the business judgment rule, this would be a startling change in Delaware law, particularly when the directors had the opinion of two eminent law firms that there was no potential liability. Lawsuits have been brought charging target company directors with some kind of wrongdoing in almost every takeover battle, and this has never been thought to taint in any way the directors' judgment in these contests.*

Secondly, the court was in error in its factual finding that between the announcement of the Original Merger Agreement and the October 12 board meeting, the notes had fallen in price from par ($100) to $87, "a decline of about $60 million below par." In fact, the proper, and undisputed, figures are 93.5 before the October 3 announcement, and 92.5 on October 11,** the last trading date before the October 12 meeting -- a decline which hardly can serve as the predicate for the drastic consequences of the court's decision.

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* The mere fact that a director is sued does not make him "interested" for the purposes of the business judgment rule. Aronson v. Lewis, Del., 473 A.2d 805, 815 (1984); Phillips v. Bradford, 62 F.R.D. 681, 688 (S.D.N.Y. 1974).

** The notes had fallen as low as 87.375 on October 8, but had increased in price to 92.5 by October 11. See Trading History of Revlon, Inc. Senior Subordinated Notes, attached hereto as Exhibit A.

Moreover, although the court's opinion at times seems to suggest that Revlon and FLC somehow agreed to take money out of shareholders' pockets and give it to noteholders, this is directly contrary to the facts. In fact, as Revlon and its advisors knew, it was always in FLC's interest to refinance the notes, and FLC always intended to do so.* Indeed, the exchange offer to be made to Noteholders -- an offer which Pantry Pride has also agreed to make -- avoided the $56 million prepayment penalty on the outstanding notes, and thus actually facilitated the increase in FLC's price to shareholders to $57.25 per share.**

In sum, the noteholder issue -- put forth at the last minute by Pantry Pride in its reply brief, perhaps without sufficient time to permit appropriate analysis -- cannot possibly be a proper basis for the court's disregard of the business judgment rule.

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* See pp. 13-15, supra.

** Pantry Pride also recognizes the economic advantage to it of an exchange offer for the notes since it also has agreed to make one. Presumably it is counting on the same $56 million savings in order to increase its bid.

## C. It is Undisputed that Options Stimulate the Marketplace and Benefit Shareholders.

The court compounded its factual errors with a misconception of how asset options operate. This misconception, if allowed to stand, would severely curtail the economic freedom of the marketplace -- to the detriment of all shareholders.

While recognizing the legality of options in concept, the court hypothesized that "a lock-up provision, however, must advance or stimulate the bidding process, not retard it . . . ." But this distinction is fanciful, since almost by definition an option agreement must necessarily do both. In bringing a new participant into a takeover contest and securing a higher offer to shareholders by use of the option, the bidding process is stimulated. However, the potential loss of the asset can dampen the initial bidder's interest.* This is the way that all asset options or other inducements to a second bidder operate.

The asset option involved here is no different than those used in countless takeover situations to achieve

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* Despite the court's comments, it is unlikely that this "dampening" effect was significant here, if it existed at all, since, as noted, in the discussions between them initiated by Pantry Pride, it offered to sell FLC the assets in question for $557 million, an amount very close to the ultimate option price.

substantial premiums for shareholders. Indeed, asset options have recently been utilized by such companies as Northwest Energy, SCM, Richardson-Vicks, Macom, Pneuno Corporation, SCA Services, Continental Group, Coopervision, Stokely-Van Camp, Carter Hawley Hale, General Host, Liggett and Pullman. (A 1294). The directors of these companies would, we submit, be surprised to learn that they were acting contrary to the interests of their shareholders.

In these transactions, boards of directors and white knights, such as FLC, have relied upon long-established economic norms, the well-recognized legitimacy of arm's-length contractual negotiations and the applicability of the business judgment rule to accomplish their objectives. Now the court has cast all this aside, or at least raised substantial doubt as to whether any asset option, or other similar inducement to stimulate competive bidding, is valid. For it bears emphasis that this is the most benign of options, granted at the end of a lengthy process when it was clear that the high range of value had been reached, and when it was most unlikely that there would be any additional significant bidding.

If an asset option ever is to be invalidated, it would be, one would think, an option which had been granted at the outset of the takeover, before the board had explored the available alternatives and before the marketplace had been allowed to determine the range of values that was likely to be obtained. Even then the courts have not interfered, but, in any event, if the present option cannot stand, granted after a two-month process had produced a $16 per share increase for shareholders, it is hard to conceive of any option, or other similar inducement, that will pass muster.

The undisputed expert testimony demonstrates the critical importance of asset options and other similar inducements, and the fact that their invalidity will have dire consequences to all shareholders. The affidavits of the investment banker experts -- none of whom have an interest in this transaction -- make this clear. (A 1040-56).

There can be no challenge to the fundamental principles expressed by these experts. And while the concept of an abstract auction for the target company, where bidding is unfettered by inducements or limitations, may be seductive in theory, it has no relation to the way in which these transactions are actually conducted. For if this were required, and inducements were somehow prohibited, it is undisputed that the "auction" process would, in most cases, never start at all, and the original bidder would be the unchallenged winner at its original price.

The present case provides a compelling demonstration of this principle. Pantry Pride opened the bidding at $47.50. It then <u>reduced</u> its offer to $42.00. For over six weeks, no competition appeared. Although Pantry Pride suggested --

without the financing to back it up -- a possible bid of $53.00, it made no offer above $42.00 to the shareholders until FLC entered the bidding. FLC's initial offer of $56.00 thus increased the actual consideration being offered to shareholders by <u>$14.00 per share</u>. In response, Pantry Pride raised its offer to $56.25 -- a mere 25 cents per share.

It was only after Pantry Pride's tagalong position became manifest, and it became clear that no additional significant bids would be made, that Revlon agreed to the asset option. FLC then increased its price to $57.25; the total result was increased benefits to shareholders of hundreds of millions of dollars. This is precisely how the process should take place, <u>and the undisputed evidence is that it would never even have started if inducements such as termination fees and asset options had not been available</u>. If this had been the case, Pantry Pride would now have the company, at a price essentially of its own choosing, and Revlon shareholders would have been the losers.

D. The Court's Determination to Enjoin the <u>Option is Unprecedented and Contrary to Law.</u>

The cases, until now, have recognized these economic realities, and no prior court has ever enjoined an asset option agreement as a breach of directors' fiduciary duties. Thus, for example, in <u>Whittaker Corp. v. Edgar</u>, 535 F. Supp. 933 (N.D. Ill. 1982), a white knight secured for itself an agreement to purchase the crown jewel asset of the target in the event that its competing tender offer failed. In sustaining the white knight transaction, the court held:

> When confronted with a threatened change in control, a board of directors of a target company may engage in a corporate transaction with a third party that the board determines in its business judgment to be in the best interests of shareholders. <u>In so doing, the board of directors may enter into various arrangements with the third party to promote consummation of the transaction even though to do so might cause the hostile tender offeror to withdraw</u>.
>
> <u>The sale of an asset which has the result of making a company less attractive to a tender offeror can be a proper exercise of a board of directors' business judgment</u>.

Id. at 951 (citations omitted) (emphasis added).

In <u>Treadway Companies v. Care Corp.</u>, 638 F.2d 357 (2d Cir. 1980), the court upheld, as a reasonable exercise of business judgment, the decision of a target company's board to enter into a stock sale with a white knight as a necessary and proper step toward avoiding a hostile takeover and implementing a merger with the white knight. 638 F.2d at 380-84. The court reached its conclusion after reviewing the history of the transaction. As here, the target's

> board was simply not acting to maintain its own control over the corporation. Rather, in approving the stock sale, they were moving [the target] Treadway toward a business combination with Fair Lanes. Fair Lanes had made the stock sale a precondition to further merger talks. From all that appears, Fair Lanes and Treadway had every intention of carrying through with that merger.

638 F.2d at 383. The court also emphasized that -- as here -- the Treadway board had retained investment bankers to negotiate and evaluate the proposed merger, arm's-length negotiations were conducted, and the Treadway board insisted upon obtaining an opinion from the investment bankers that the merger would be fair to Treadway shareholders. Id. at 384.* In the present case, Revlon's investment bankers, Lazard, not only advised the board that the transaction was fair, but affirmatively advised the board that this was the preferable course of action. Rohatyn Affidavit ¶16 (A. 938); Minutes of October 12 at 24, 34 (A 903, 913).

Likewise, in GM Sub Corp. v. Liggett Group, Inc., Del. Ch., C.A. No. 6155, Brown, V.C. (April 24, 1980), the target, Liggett, responded to a hostile tender offer by entering into a contract to sell its prize subsidiary to a third party. The court found that it was "realistic to assume that it was contemplated by Liggett that the practical effect of the sale

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* The court further noted that:

> Courts have held that the directors can make a sufficient showing of fairness by demonstrating that the transaction was entered into for a proper corporate purpose; they need not also prove that the actual terms of the transaction were fair. See Cheff v. Mathes, supra, 41 Del. Ch. 494, 199 A.2d [548] at 554-55 [1964]; Kaplan v. Goldsamt, supra, Del. Ch., 380 A.2d [556] at 568-69 [1977].

638 F.2d at 382 n.47.

of its sought-after asset might be to cause the hostile offeror, GM Sub, to lose interest in its tender offer." Slip op. at 3. Nevertheless, the court refused to enjoin the sale.

In the present case, because the asset option was granted at the very end of the bidding process, after the upper range of value had been reached, its dampening effect, if it existed at all, was substantially minimized. Thus, it is especially ironic that the Chancery Court should cite, as support for its position, Thompson v. Enstar Corp., Del. Ch., C.A. Nos. 7641, 7643, Hartnett, V.C. (Aug. 16, 1984), a case approving an asset option granted at a far earlier stage in the takeover contest. The language of Enstar is, however, instructive:

> The test of whether the Enstar board acted reasonably on May 22nd, however, is not whether something happened on June 12th which, in hindsight, may show that the directors of Enstar should have delayed. The judgment of the directors must be measured on the facts as they existed on May 22, 1984.

Slip. op. at 9-10.

In the present case, FLC's initial participation in this transaction achieved a significant premium for Revlon shareholders while intentionally leaving the field open for others to participate. It was only after others failed to appear, and Pantry Pride responded only with its nickel and dime tactic, that the asset option was granted to extract from FLC the last dollar left to be had and to achieve for Revlon a sale of the company at a price concededly in the highest range of value. There is no case which remotely supports the invalidity of an asset option in this situation.

### E. The Court Impermissibly Substituted Its Judgment for that of the Board with Respect to the Details of the Bargaining Process.

In describing the function of Revlon's board as that of "an auctioneer attempting to secure the highest price for the pieces of the Revlon enterprise," (slip op. at 18-19 (A 1183-84) the court may have been saying that so long as Pantry Pride took the position that it would better each successive FLC offer by a pittance, Revlon was precluded from offering additional inducements to FLC to increase shareholder consideration. The fallacy of this conclusion is apparent: If the leader, FLC, will not raise its offer, neither will the follower, Pantry Pride. If FLC had not raised its offer -- which it indisputably would not have done, and for good reason, without the asset option -- shareholders would have received $56.25 per share, or some lower amount if FLC had withdrawn and Pantry Pride had been free to dictate its own price.

A further fallacy of the "unfettered auction" concept is that it changes the rules completely in midstream -- indeed, at the end of the game. It is undisputed that there would have been no "auction" of any sort in the first place without the inducements that brought FLC into the contest; no one else proved willing to play, with or without inducements. It does not "level the playing field," as the phrase goes, when a white knight is induced to participate in a contest on the basis of well-understood and well-accepted transactions, creates hundreds of millions of dollars of additional value to shareholders, and is then told as the contest nears its end that the rules have changed, and that it is not entitled to its part of the bargain. This is, we submit, the very antitheses of fairness.

In any event, the "unfettered auction" concept, so unrealistic in the sophisticated business world, also has never been accepted by the courts. Rather, the courts have held that there comes a point in time where a board may enter into an agreement which, if reasonably based on its assessment of all the facts and circumstances existing at that time, it finds to be advantageous to shareholders and the corporation.

Particularly instructive is Jewel Companies v. Pay Less Drug Stores Northwest, Inc., 741 F.2d 1555 (9th Cir. 1984), where, after the target had entered into an exclusive merger agreement with a white knight, the initial, frustrated bidder sought to set aside the agreement on state law fiduciary grounds. The Ninth Circuit determined that the target's board had a right to enter into such an agreement:

> [T]o permit a board of directors to decide that a proposed merger transaction is in the best interests of its shareholders at a given point in time, and to agree to refrain

from entering into competing contracts until the shareholders consider the proposal, does not conflict in any way with the board's fiduciary obligation. . .

Id. at 1563. The court recognized the substantial benefits often provided to shareholders by an exclusive board-negotiated agreement.

> A potential merger partner may be reluctant to agree to a merger unless it is confident that its offer will not be used by the board simply to trigger an auction for the firm's assets. Therefore, an exclusive merger agreement may be necessary to secure the best offer for the shareholders of a firm. Cf. Grossman & Hart, Disclosure Laws and Takeover Bids, 35 J.Fin. (1980) (competition in takeovers may deter firms from investing in research on potential target and from making initial bid). An exclusive merger agreement may also be the least costly means of merging the firm. It increases the likelihood that the firm can be merged without expensive litigation or proxy battles.

Id. (emphasis added).

The fact that a transaction may preclude or deter other possibilities is not a sufficient reason to set aside an agreement which at the time it was made was beneficial to shareholders.* The fact that a subsequent opportunity may

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* We note again that Pantry Pride was certainly not precluded from bidding by the asset option, and that it had offered to sell the same assets to FLC at a slightly higher price of $557 million -- a differential amounting to less than $1.00 a share for Revlon stock. The option price was also well within the range of values estimated by both FLC's and Pantry Pride's investment bankers, while the higher values estimated by Revlon's investment banker presumed a

Footnote Continued

possibly be lost does not diminish the enforceability of the agreement. As the Jewel court put it:

> It is true that in certain situations the shareholders may suffer a lost opportunity as a result of the board's entering into an exclusive merger agreement. As the district court took great pains to point out, subsequent to a contractual commitment unanticipated business opportunities and exigencies of the marketplace may render a proposed merger less desirable than when originally bargained for. But all contracts are formed at a single point in time and are based on the information available at that moment. The pursuit of competitive advantage has never been recognized at law as a sufficient reason to render void, or voidable, an otherwise valid contract. . . .

Id. at 1563-1564 (emphasis added).

Similarly, in Enstar, supra, the court held that the target's board had properly chosen to accept an offer from one bidder notwithstanding that subsequently, a new potential bidder appeared which might have agreed to effect the transaction on more favorable terms. Moreover, the board did not merely approve the earlier offer, but also had actively courted the bidder and facilitated the proposed transaction. In fact, in deference to the offeror's wishes, the Enstar board

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* Footnote Continued From Previous Page

hypothetical liquidation effected over a substantial period of time, rather than an immediate sale. The option price, like the transaction as a whole, was the result of extensive arm's-length bargaining, with FLC. After starting at a much lower price, FLC finally agreed to a price within its own investment banker's range of fairness.

entered into a voting trust agreement with the offeror, thereby giving the offeror indefeasible voting control over Enstar's "single most valuable asset." Slip op. at 11. This asset was ceded to the suitor for no consideration other than the signing of the agreement. The court nevertheless held that the board had acted reasonably.

The Enstar court reasoned that the board's conduct in accepting the offer should be measured based upon the state of facts known to the board, as of the time the decision was made. The court found that "[w]hile hindsight might enable me to conclude that if the directors had waited, other offers might materialize, and while I might, in the exercise of my judgment, have decided on May 22nd to postpone the decision, that is not the test. Courts cannot substitute their judgment for the rational judgment of the directors." Slip op. at 10 (emphasis added).

Again, in Simkins Industries, Inc. v. Fibreboard Corporation, Del. Ch., C.A. No. 5369, Marvel, C. (July 25, 1977), plaintiffs, who were shareholders of Fibreboard, sued individually and derivatively to require Fibreboard "to deal fairly with plaintiffs in regard to their efforts to buy one or more of the plants and equipment of the defendant which the latter proposes to sell." Slip op. at 1-2. Plaintiffs argued, as does Pantry Pride here, that the board had not dealt fairly with plaintiffs, had refused to give them certain information and was not seeking to obtain the best bid for the assets. In refusing to grant injunctive relief the Court rejected the proposition

> . . . that defendant be required by this Court to conduct its proposed sales of its carton producing assets as if defendant were a government agency, namely on the basis of sealed bids or by Court regulated competitive bidding. . .

Slip op. at 2.

There is, in short, no requirement under the business judgment rule or anywhere else that any particular type of auction be held, or that bargaining be conducted in any particular way. Indeed, Revlon did hold what was essentially an auction, with rules that made eminent sense, when on October 3 it refused to grant an asset option, and announced that the company was still for sale to a higher bidder. The fact is that no meaningful additional bidding was forthcoming.

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In sum, there is no basis, factually or in law, for the injunction against the asset option here. The option was granted after there had been full opportunity to produce the highest range in value for Revlon shareholders, and when it was evident that there would be no significant additional bidding. It was granted after everything had been done, without success, to produce additional bidders, and after the one hoped-for additional bid had not materialized. It was granted, along with the cancellation fee, to produce virtually hundreds of millions of dollars of value for Revlon shareholders. To invalidate the option in these circumstances would be to alter the takeover process as it is now understood to operate in the business and financial community, to the substantial and irreparable detriment of all shareholders.

## III. PANTRY PRIDE'S CLAIM ON THE ASSET OPTION IS, AT BEST, A CLAIM FOR DAMAGES, AND IT HAS FAILED TO ESTABLISH THAT IT DOES NOT HAVE AN ADEQUATE REMEDY AT LAW.

### Standard and Scope of Review

The court's finding of irreparable harm is a mixed question of law and fact and the standard of review is the same as that stated in argument Point II, *supra*.

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With respect to the option agreement, just as with the cancellation fee agreement, Pantry Pride failed to show that it would be irreparably injured in the absence of injunctive relief. The court erroneously premised a finding of irreparable harm on its belief that "unless Pantry Pride is permitted to market its bid free of the restrictions imposed by the lock-up option, with its triggering mechanism, its acquisition effort is at an end." Slip op. at 28 (A 1193).

Pantry Pride, however, has an adequate remedy at law. If Pantry Pride acquires Revlon for its current offer of $58 per share and FLC exercises its asset option, Pantry Pride can pursue its litigation against the Revlon board for the difference between the $525 million in cash to be paid by FLC upon exercise of the option and any higher amount that a court holds Revlon was entitled to receive for those assets. If Pantry Pride has confidence in the claim it is asserting, it should be willing to acquire Revlon for its current offer of $58 per share, permit FLC to exercise its asset option and recover damages from the Revlon board.

Indeed, it is undisputed that Pantry Pride does not want to acquire the assets subject to the option for "synergistic" reasons but only for their resale value, as evidenced by the offer to sell them to FLC for $557 million. The fact that Pantry Pride has not complained about the sale of the Beauty Division to Adler & Shaykin underlines this point. The Beauty Division is almost double the size of the assets subject to the option granted to FLC but Pantry Pride does not object to its sale. Clearly, Pantry Pride is troubled only by the exercise price in the asset option. Where the substance of a dispute is quantifiable in money -- the amount being paid -- the complaining party should not be permitted to enlist the aid of equitable remedies but should be left to a damage claim. This is particularly true in this situation where the imposition of equitable remedies would damage a totally innocent party -- FLC -- and would leave those alleged to have breached their duties -- the Board of Revlon -- wholly unaffected.

The "novel principle" -- precisely that adopted -- that the contract rights of a third party which has engaged in arms-length dealings with a corporate board can be set aside by a shareholder alleging corporate waste, was recently rejected by Vice Chancellor Hartnett in Tomczak v. Morton Thiokol, Inc., Del. Ch., C.A. No. 7861, Walsh, V.C. (Feb. 13, 1985). Plaintiffs challenged the sale by Morton Thiokol of its household products segment to the Dow Chemical Company. Plaintiffs sought a preliminary injunction on the grounds that the Morton Thiokol directors had violated their fiduciary duties and committed corporate waste by paying "greenmail" to Dow in the form of the sale of the assets -- at a price grossly unfair to Morton Thiokol and its shareholders -- to eliminate Dow's stock position and perpetuate management in office. Plaintiffs also alleged that Dow had aided and abetted Morton Thiokol in its breach of fiduciary duty. The court held:

> It is clear, . . . that if plaintiffs do succeed in proving corporate waste by the Morton Thiokol Board, money damages will be sufficient to make the Corporation whole. Therefore, there has been no showing of the possibility of irreparable harm and this alone would preclude the entry of a preliminary injunction.

Slip op. The court went on to consider the damage to Dow who, like FLC was the purchaser of the assets, if a preliminary injunction were granted. The court noted:

> Plaintiffs seem to assert that if Morton Thiokol's Board breached its fiduciary duty, Dow was under a corresponding duty not to

> take advantage of it. No authority is given for this novel argument and in view of the mere 8% stock ownership and the armslength dealings, it is difficult to see how Dow owed any duty to Morton Thiokol or its stockholders. _See_ _Weinberger v. United Financial Corp. of Calif._, Del. Ch., C.A. No. 5915, Hartnett, V.C. (October 13, 1983).

Slip op.

The holding in _Tomczak_ accords with traditional equity principles. See, _e.g._, _Welshire, Inc. v. Harbison_, Del. Supr., 91 A.2d 404, 408 (1952) ("[A party's] legal rights must be protected in equity unless his conduct has created an estoppel against him or an equitable right in his adversary."); _Brower v. Glen Wild Lake Co._, N.J. Super., 206 A.2d 899, 902, _cert. denied_, 44 N.J. 399, 209 A.2d 139 (1965) ("[An equity court has] no right to rewrite the contract of the parties by substituting a new or different provision from that clearly expressed in the instrument.").

The situation in the present case is analogous to the one dealt with by the Delaware Supreme Court in _Weinberger v. UOP, Inc._, Del., 457 A.2d 701, 714 (1983). In that case, the Court held that equitable relief was not available where the complaint fundamentally alleged an unfair price in a business combination transaction; injunctive relief is available only in the case of "fraud, misrepresentation, self-dealing, deliberate waste of corporate assets or gross and palpable overreaching . . . ."

Nothing of the kind was or could have been shown here, and there was, we submit, no basis whatever for what the Chancery Court itself described as "the limiting of Forstmann Little's contractual rights." Slip op. at 28 (A 1193).

## CONCLUSION

For all of the foregoing reasons, the Chancery Court's decision to issue the preliminary injunction should be reversed.

Respectfully submitted,

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TRADING HISTORY OF REVLON INC SENIOR SUBORDINATED NOTES
SEPTEMBER 17, 1986 TO OCTOBER 23, 1986

[New York Exchange Volume ONLY]

REVLON INC:SRNT 11.75%

| | HIGH ($) | LOW ($) | CLOSE ($) | VOLUME (100'S) |
|---|---|---|---|---|
| DAILY: | | | | |
| 1986 | | | | |
| SEPTEMBER | | | | |
| 17 | 100.000 | 99.750 | 99.750 | 700 |
| 18 | 99.750 | 99.000 | 99.000 | 900 |
| 19 | 99.500 | 99.250 | 99.250 | 330 |
| 20 | 99.625 | 99.625 | 99.625 | 500 |
| 23 | 99.375 | 99.250 | 99.250 | 1070 |
| 24 | 99.500 | 99.250 | 99.500 | 710 |
| 25 | 99.750 | 99.500 | 99.625 | 300 |
| 26 | 100.000 | 99.625 | 100.000 | 14020 |
| 27 | 100.000 | 99.625 | 100.000 | 0 |
| 30 | 99.750 | 99.000 | 99.000 | 4160 |
| OCTOBER | | | | |
| 1 | 99.000 | 92.750 | 92.750 | 4660 |
| 2 | 94.000 | 92.000 | 93.500 | 2870 |
| 3 | 94.500 | 93.750 | 94.500 | 3370 |
| 4 | 90.000 | 88.500 | 90.000 | 24700 |
| 7 | 89.500 | 87.000 | 87.875 | 10660 |
| 8 | 87.500 | 87.000 | 87.375 | 6050 |
| 9 | 87.500 | 85.750 | 87.500 | 13700 |
| 10 | 88.875 | 86.625 | 88.875 | 12670 |
| 11 | 93.500 | 89.500 | 92.500 | 34600 |
| 14 | 95.000 | 93.125 | 93.750 | 22870 |
| 15 | 94.500 | 92.750 | 93.500 | 5430 |
| 16 | 94.000 | 93.250 | 93.625 | 6120 |
| 17 | 94.000 | 93.375 | 93.625 | 7870 |
| 18 | 94.500 | 94.125 | 94.250 | 18630 |
| 21 | 96.500 | 96.000 | 96.250 | 11710 |
| 22 | 98.000 | 96.250 | 96.750 | 7600 |
| 23 | 95.750 | 94.750 | 95.250 | 11000 |

GOLDMAN, SACHS & CO.

FORSTMANN LITTLE & CO.

CERTIFICATE OF SERVICE

I hereby certify that on this 28th day of October 1985, two copies of the within document were hand delivered to the following attorneys of record in the foregoing action at the addresses indicated:

Bruce M. Stargatt, Esquire
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P.O. Box 391
Wilmington, Delaware 19899

Stephen P. Lamb, Esquire
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