IN THE SUPREME COURT OF THE STATE OF DELAWARE

REVLON, INC., a Delaware corporation, MICHEL 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,	)	
Defendants Below, Appellants,	)	
v.	)	Nos. 353 & 354, 1985
MACANDREWS & FORBES HOLDINGS, INC., a Delaware corporation,	)	
Plaintiff Below, Appellee.	)	

OPENING BRIEF OF APPELLEE

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Dated: October 28, 1985

TABLE OF CONTENTS

TABLE OF CONTENTS (Cont.)

TABLE OF CONTENTS (Cont.)

TABLE OF CASES

TABLE OF CASES (Cont.)

TABLE OF OTHER AUTHORITIES

NATURE AND STAGE OF PROCEEDINGS

This action was begun on August 22, 1985 by MacAndrews & Forbes Holdings, Inc. ("MacAndrews and Forbes"), holder of approximately 30,000 shares of Revlon, Inc. ("Revlon"). As originally filed, the action sought, inter alia, to invalidate Note Purchase Rights adopted by the Revlon Board on August 19, which were an obstacle to Pantry Pride's any and all cash tender offer announced August 23. (B 7-28).* The Complaint was subsequently amended twice to reflect permutations in Revlon's takeover responses: failing to lift the Rights for Pantry Pride, Inc. ("Pantry Pride") when doing so for Forstmann Little & Co. ("Forstmann") and granting a lock-up to Forstmann. (B 29-113). These subsequent events were also the subjects of plaintiff's motion for a preliminary injunction.

The preliminary injunction hearing was held October 18, and an opinion favoring plaintiff was issued by Justice Walsh on October 23. (B 1019-1050). An order was entered October 24 (B 1051-1053), and an interlocutory appeal by defendants certified. (B 1054-1055). The order was stayed pending determination of the appeal by this Court. (B 1056-1057).

Defendants' appeal was accepted and a brief schedule set.

This is plaintiff's opening brief.

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* Defendants moved to dismiss or stay the complaint. That motion was later denied. (B 61-74).

SUMMARY OF THE ARGUMENT

I. The lock-up granted to Forstmann, which had the purpose and effect of shutting Pantry Pride out of the bidding for Revlon, was illegal as not reasonable in relation to any threat posed but rather was harmful to Revlon stockholders.

II. The lock-up was intended to preclude Pantry Pride from making another, higher bid which the Revlon directors were advised Pantry Pride would make and, thus, was in violation of the directors' duty in selling the company to seek the best price for the stockholders.

III. The Revlon directors failed to conduct the sale of Revlon in a manner reasonably designed to secure the best price for the stockholders -- in particular by refusing to negotiate with Pantry Pride -- and, thus, violated their duty of due care.

IV. The lock-up violated the directors' duty of loyalty to put the stockholders' interests before their own.

STATEMENT OF FACTS

Preliminary

Pantry Pride now has outstanding an offer to purchase any and all of Revlon's common stock for $58 per share in cash. The Pantry Pride offer, which aggregates approximately $1.74 billion, is due to expire on October 31 at midnight. The effect of the order of the court below is to allow Revlon's stockholders the opportunity to tender into the Pantry Pride offer. Revlon and Forstmann appeal that order, hoping to deny the Revlon shareholders the opportunity to tender.

It is understandable that Forstmann appeals from that order, since at the bottom of it is the annulment of the bargain basement lock-up giving Forstmann the right to purchase Revlon assets for $75-$175 million less than their fair worth. But Revlon's appeal is ironic. For by continuing to join forces with Forstmann, it seeks to deprive its stockholders of the ability to reap the benefit of Pantry Pride's offer. The Forstmann leveraged buyout merger, which has a face value of $57.25 per Revlon share but is really worth $54-$55 because it is time delayed and uncertain (B 730-731, 969-970), is undeniably less than the $58 Pantry Pride offer. So Revlon is in the unusual position of trying to deprive its stockholders of the higher Pantry Pride offer in favor of the lower Forstmann offer.

This effort to defend against Pantry Pride and, more recently to do a deal with Forstmann "at all costs," as the Chancery Court

described it, fits the pattern of Revlon's conduct leading up to the decision of the court below and, now, this appeal.

Revlon - A Brief Description Of Its Business And Its Board

Revlon is a Delaware corporation, with two lines of business, beauty products and health care. (B 422). Revlon currently has outstanding 28,453,136 shares of common stock, 1,402,830 shares issuable on the exercise of outstanding options, and 1,739,000 shares into which Revlon's $9 preferred shares are convertible. (B 658).

Revlon's Board consists of fourteen directors. Six are Revlon officers. Michel C. Bergerac is Chairman of the Board, President and Chief Executive Officer of Revlon, and five other directors are also senior vice presidents of Revlon. (B 180-183). Of the balance, five have business relations with Revlon which are described in Revlon's proxy statement. (Id.).

Pantry Pride's Early Attempt To Negotiate; Revlon's Response - The Poison Pill Rights Dividend

Beginning in June of 1985, Ronald O. Perelman, Pantry Pride's Chairman, attempted to meet with Michel C. Bergerac, Revlon's Chairman, to explore a possible acquisition of Revlon by Pantry Pride. Although one meeting was held in June, Mr. Bergerac subsequently refused to discuss the acquisition with Mr. Perelman. (B 744, 754-756). On

August 14, the Pantry Pride Board authorized an offer by Pantry Pride to acquire Revlon, while at the same time Perelman sought a meeting with Bergerac to discuss a possible negotiated acquisition. (B 757-758). Such a meeting was scheduled for August 19, but shortly before it began Revlon's counsel notified Pantry Pride that Revlon's Board had acted and the meeting was canceled. (B 759).

The action taken by the Revlon Board on August 19 consisted of the adoption of a Note Purchase Rights Plan which involves the declaration of a dividend of "rights" to common stockholders (the "Rights"). The Rights entitled stockholders to exchange their stock for $65 in Revlon notes if an acquiror bought over 20 percent of Revlon stock without announcing and, ultimately, consummating a transaction paying the remaining shareholders $65 per share ("trigger price"). The Rights had a "poison pill" effect since they are above Revlon's liquidating value. (October 12 Minutes, B 920).

The "trigger price" in the Rights was high -- as the later developed management leveraged buyout evidences. At the time the Rights were adopted, Revlon's investment banker stated that the $65 trigger price under the Rights "was not intended to be the only sales price that would be acceptable to the company but just a reasonable asking price" and that the company could receive fairness opinions at lower prices. (August 19 Minutes, B 285-307).

The purpose of the Rights was to prevent tender offers at less than $65 -- even any and all cash tender offers -- without the prior approval of the Revlon Board. Having taken on the plenary power to

negotiate on behalf of shareholders, the Revlon Board promptly proceeded to abdicate its responsibilities in that regard. Contemporaneously with adopting the Rights, on August 19 the Board issued a press release announcing that Revlon was not for sale and that it did not wish to entertain any offers for the sale of the company. (B 203-206).

The August 23 Pantry Pride Tender Offer - $47.50 Cash, Any And All Shares

Four days after the Revlon Board adopted the Rights, Pantry Pride on August 23 commenced a cash tender offer for any and all shares of Revlon common stock at $47.50 per share. (B 308-340). The offer was conditioned upon the redemption, rescission or judicial voiding of the Rights.* (Id.).

The August 26 Revlon Exchange Offer; The Poison Pill Provisions In The Notes And Preferred Stock

Three days after the announcement of the Pantry Pride tender offer, the Revlon Board met on August 26 and determined to make an exchange offer for up to 10 million of Revlon's outstanding common shares, or more than 25 percent of the shares outstanding. Each share would be exchanged for $47.50 principal amount of 11.75 percent Revlon notes ("the Exchange Notes"), and one-tenth of a share of Revlon's new

* This suit, seeking the judicial voiding of the Rights, was commenced at the same time as the $47.50 Pantry Pride tender offer.

$9 preferred stock with a stated value of $100 per share. (Revlon Offer to Purchase dated August 29, 1985, B 355-483) (the "Exchange Offer").

In making the Exchange Offer, Revlon's Board knew that it would reduce the stockholders' equity from $1.035 billion to $460 million. This reduction of equity meant that common shares not tendered would be devalued after completion of the exchange. (August 26 Minutes, B 341-354). For that reason, approximately 87 percent of Revlon's shares were tendered and 10 million shares accepted for exchange.

Not content with the Rights Plan, Revlon's Board wrote into the Exchange Notes and preferred stock pervasive restrictive covenants for the express purpose of inhibiting Pantry Pride from offering for Revlon's stock.

> Mr. Brownstein [of Wachtell, Lipton] pointed out that the terms of the securities that were being offered in the exchange offer contained certain provisions that were designed to deter or make more difficult an unsolicited takeover attempt, including the Pantry Pride takeover attempt.

(August 26 Minutes, B 345-346). (See also B 350).

Under the restrictions, Revlon's ability to incur debt is blocked (with a few limited exceptions including the debt represented by the Rights), it cannot raise the level of its dividends, it cannot buy its own stock, and it cannot sell more than two percent of assets, together with other prohibitions. (B 403, 410). The key to escape from these self-shackling restrictive covenants took the form of a provision

that allowed otherwise prohibited transactions if approved by a majority of the "independent directors." As counsel explained to Revlon's Board, independent directors are "the independent directors on the board ... today and successors nominated for election by them or by successor independent directors." (August 26 Minutes, B 354-355).

The Second Pantry Pride Tender Offer - Pantry Pride's Continuing Efforts To Negotiate

Three days after the conclusion of the Exchange Offer, Pantry Pride on September 16, 1985 commenced a new tender offer, again a cash offer for any and all shares at $42 per share. The new tender offer was not conditioned upon the redemption or invalidation of the Rights, but it was conditioned upon a minimum of 90 percent of the outstanding common shares being tendered, so that no more than 10 percent of the Rights would be outstanding after the consummation of the tender offer. (Pantry Pride Offer to Purchase dated September 16, 1985, B 484-533). The $42 cash offer was, as Revlon acknowledged, the "unchanged" equivalent of the $47.50 tender offer announced in August taking into account the effect of the Exchange Offer. (September 24 Minutes, B 854).

After the announcement of its tender offer, Pantry Pride renewed its efforts to bring Revlon to the bargaining table.

- On September 27 Pantry Pride offered to enter negotiations with Revlon toward a possible merger which would give Revlon's stockholders $50 a share. (B 534).

- On October 1 Pantry Pride, in effect bargaining against itself, raised the offering price to $53 per share. (B 535).

The Revlon Board, having made itself the negotiator for the stockholders by adopting the Rights Plan and the restrictive covenants in the Exchange Notes and preferred stock, proceeded to ignore the Pantry Pride efforts to negotiate.*

Bergerac's Approach To Forstmann;
Revlon's September 24 Board Meeting

In the summer of 1984 Michel Bergerac had been in contact with Forstmann about a possible leveraged buyout of Revlon. (B 116-118). Beginning on September 15, 1985 management negotiated secretly with Forstmann to put together a management buyout of Revlon. (Bergerac, B 1117A). Refusing to provide any financial information to Pantry Pride without a standstill, Revlon provided the same information to Forstmann without such an agreement. (Bergerac, B 1103).

It was not until September 24 that the Revlon Board authorized management to pursue the sale of all or part of the business. (B 861). However, this determination to sell all or part of the company did not include negotiations with Pantry Pride. Notwithstanding Pantry Pride's advice to the Revlon Board that it would increase its tender offer to $50, and then to $53, the Revlon Board entered into no negotiations with Pantry Pride.

* In fact, director Rifkind and attorney Liman approached Perelman to convince him he was offering too much for Revlon. (Perelman Aff., ¶ 8, B 957).

Revlon's October 1 And October 3 Board Meeting

Revlon's Board met on October 1. For the first time the directors were advised of a potential leveraged buyout, but the identity of the acquiror and the price were not disclosed. Advised of Pantry Pride's $53 offer, the Board was told it should not be stampeded into accepting any bid on that day. Rather, management was to be given time to top the Pantry Pride offer (which had been publicly announced). (Rifkind, B 1077-80; October 1 Minutes, B 845).

After negotiating with itself overnight, on October 3 management presented to the Board a leveraged buyout proposal. No attempt had been made to negotiate with Pantry Pride in the interim, and the Board did not inquire about any such attempt. (October 3 Minutes, B 864-897; Rifkind, B 1085). Revlon's directors remained uninterested in the Pantry Pride proposal or the prospects of improving that proposal. Rather, on October 3 the Board approved a management-sponsored leveraged buyout with Forstmann.

The October 3 Leveraged Buyout

The merger agreement of October 3 is long and complex. It provided $56 per share for Revlon's stockholders, if and when the merger was consummated. (B 539). Revlon's investment bankers opined that the $56 price was fair to the common stockholders. If the merger were "terminated" for any reason other than a breach by Forstmann, Forstmann

would receive a $25 million "cancellation fee" in addition to having its expenses paid by Revlon. (B 611, 614).

The merger agreement provided for the sale of Revlon's beauty division. (B 586-587). Revlon contemporaneously executed an asset sale agreement for the beauty division with Adler & Shaykin for $905 million. (B 882-883). Revlon also gave Adler & Shaykin a check for $2 million to cover its "expenses" (B 885), and agreed to a $20 million penalty if Revlon backed out. (B 650). Following the merger, a sale of two health care subsidiaries, Norcliff Thayer, Inc. and Reheis Chemical Company, to American Home Products was also contemplated by Forstmann for $355 million so as to help fund the purchase. (B 869).

Management reaped huge rewards from the leveraged buyout:

- Forstmann agreed that the leveraged buyout merger would trigger the golden parachutes of management. (B 586). Without this self-dealing agreement, management would have received nothing on its parachutes, since the ripcord would not have been pulled unless "within three years after the change of control the Executives' employment terminated otherwise than by death, disability, discharge for cause or resignation without good reason...." (B 677). This "gift" from their buyout partners gives management some $42 million, of which Bergerac will get about half. (B 675-676).

- Adler & Shaykin agreed that management could participate in its $905 million purchase. (B 1112).

- Forstmann agreed that management would have 25 percent of the surviving company, and agreed to consider loans to help management make its purchase. (B 670-671).

To make the merger work Revlon had to provide relief to Forstmann from the Rights and restrictive covenants in the Exchange Notes. It did so by agreeing to redeem the Rights for the Forstmann offer (B 582), elect Forstmann's nominees as "independent directors" immediately before the merger (B 550), and waive the debt covenants so as to allow Forstmann to leverage the transactions by borrowing on Revlon's assets. (B 595-596).

Unlike the amended agreement approved only a week later, the merger agreement did not contain any lock-up for Forstmann and its management partners, nor did it contain any "no shop" clause, although there had apparently been discussion between management and Forstmann about such provisions. (B 1082).* Indeed, the agreement provided that Forstmann would be given notice of any other bid for the company so that Forstmann could compete with that bid. (B 576). As Simon Rifkind testified, this provision "was designed ... to maximize the opportunities the stockholders had." (B 1086). Judge Rifkind explained that the absence of any lock-up and "no shop" clause were "presented as virtues of that agreement, and I recognize them as virtues. Because at that time they were, in effect, offering what you might call in an equity sale -- what it is called, the bottom price, and inviting everybody else to surpass it. That was a very good position for Revlon to be in." (B 1084).

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* Produced during the litigation was a draft "Option Agreement" dated October 1 which granted to Forstmann a lock-up on the same assets ultimately locked up on October 12. (Rifkind, B 1081).

Pantry Pride's October 7 Bid (Of $56.25 Per Share)

With the announcement of the leveraged buyout and the selective lifting of the Rights and restrictive covenants, Pantry Pride became aware that new obstacles had been put in the way of its bid. Nevertheless, Pantry Pride, frustrated in its attempts to negotiate with Revlon's Board, "negotiated" in the marketplace by raising its tender offer price to $56.25 per share, again on an any and all basis for cash. (B 655-680). The offer in cash terms was a quarter above the Forstmann proposal. On the basis of value, however, it was much higher. Because the leveraged buyout would take considerable time to consummate, and was less than certain, Wall Street valued the Forstmann offer at $52-53 per share. (Abecassis Aff., ¶ 10, B 730). Taking the high end of that valuation, the Pantry Pride offer topped Forstmann by almost $100 million (about 30 million shares times $3.25).

The Decline In The Price Of The Notes

Revlon's Board found themselves with a new, but predictable problem. The Exchange Offer notes, which had been issued August 26, were intended to trade at par. When the leveraged buyout with its heavy borrowing on Revlon's assets was considered, the Board was advised that the leveraged buyout "capital structure would adversely affect the market price of the [Exchange Notes] ..." (October 3 Minutes, B 881), which "might not be as secure as they would be now and that there might

be some complaint from bondholders." (Id.). Despite this anticipated effect on the Exchange Notes, Mr. Lipton advised the Board that approval of the leveraged buyout would signal Forstmann that the restrictive covenants in the Exchange Notes would be lifted for the necessary financing. (October 3 Minutes, B 880-881). Failure to do so would cause Revlon to forfeit the $25 million cancellation fee to Forstmann. Loomis, of Lazard, advised that all the Board need be concerned with was Forstmann's ability "to repay principal and interest" on the notes. (Id., B 896).

The announcement of the October 3 leveraged buyout had a dramatic impact on the market price of the Exchange Notes. While the Board anticipated the devaluation of the Exchange Notes, it had not anticipated the ensuing "firestorm" of protest. According to Mr. Rifkind:

> Since our meeting of October 3, the Notes had dropped to as low as $87 -- a decline of about $60 million below par. I was deluged with telephone calls from irate holders who had exchanged shares for 11.75% Notes which they believed would be worth par, and who now saw a 13% erosion in the value of their Notes.

(Rifkind Aff., B 840). Noteholders, including major financial houses which had been trading in the notes, threatened suit. As reported in an article appearing in The Wall Street Journal on October 10,

> Revlon's 11-3/4% notes, which the company's offering material indicated were likely to trade at or near face value, have actually traded on a when-issued basis at a discount of roughly 10% [$47.5 million] to 15% [$71.25 million] since Forstmann Little's proposal.
>
> . . . .
>
> Some of those institutions and larger holders [of the Notes] already have asked several attorneys to consider legal action against Revlon, and at least a few institutions say that they may ask a court to block the settlement of the new securities, pending trial.
>
> . . . .
>
> many investors feel Revlon should have amended its offering materials to specifically indicate that such a move [as the Forstmann deal] was possible or probable.

(The Wall Street Journal, October 10, 1985, B 940).

The Board faced potentially tremendous damage claims -- as much as $50 million, according to Mr. Lipton -- by investors. Contrary to the suggestions made by Revlon in its brief below, the problem, as the Board understood it, was not that the independent directors owed a "duty" to noteholders to protect the value of the notes (a duty which presumably existed on October 3 as well as October 12), but rather that claims were being made that disclosures with respect to the Exchange Offer may not have been adequate. (See October 12 Minutes, B 924). Specifically, investors threatened claims that the Exchange Offer had failed adequately to disclose possible courses of action by Revlon, such as its approval of the Forstmann deal, which might result in a waiver of

the covenants or otherwise adversely affect the value of the notes. (Id., B 924).

The independent directors became nervous and started to balk. Four of them -- Messrs. Glucksman, Wilson, Loudon and Zilkha -- hired their own counsel. (B 899). By October 10 they were refusing to waive the indenture covenants in favor of any deal that would not ensure that the notes would trade at or near par. (Drapkin Aff., ¶¶ 4-5, B 942-43). Revlon's Board had put itself into an intolerable position -- it had approved a merger agreement containing a $25 million bust-up provision, but faced potentially tremendous liability to noteholders if it waived the restrictive covenants, as required by the merger agreement. Thus, on October 12 the Board faced two unpalatable choices -- to not waive the covenants in the Exchange Notes and forfeit $25 million to Forstmann or to waive the covenants and face the certain claims of the noteholders. (October 12 Minutes, B 903).

The Resurrection Of The Lock-Up Option

After Pantry Pride had topped the management-sponsored leveraged buyout and after the "firestorm" from noteholders, the lock-up option for the vision care lines previously considered by management and Forstmann but not submitted to the Board was resurrected. Forstmann and its management partners engineered a change in the leveraged buyout. Management would withdraw as "equity investors" in the "merger financing." (B 834 and 786). With that withdrawal, Forstmann then demanded

a lock-up option. That demand was delivered to the management of Revlon during the afternoon of Friday, October 11. (B 905). It was coupled with a proposed increase in the merger price from $56 to $57.25 and a new feature, the product of the outcry from noteholders, an exchange of new debt, designed to trade at par after the leveraged buyout was consummated, for the Exchange Notes. It was this proposal which was submitted to the Revlon Board the next day.

After Forstmann made this proposal and before the Board meeting the next day, the management of Revlon had the ability to seek a better bid from Pantry Pride, but did not do so. The existing merger agreement with Forstmann did not prohibit such a contact. Indeed, precisely such a "bidding contest" was envisioned by the Board. Supra at 12. And, Pantry Pride, in conversations earlier that week with Revlon, had advised Revlon that, because of Pantry Pride operating loss carryforwards, it was in a position to top any offer which Forstmann could propose. (B 904 and 960). Notwithstanding this announced intention of topping any Forstmann bid, Revlon management never approached Pantry Pride. In fact, Revlon's counsel and investment bankers failed to return calls from Pantry Pride's counsel on Friday. (B 941-942). And, in this litigation, Revlon made every effort to prevent Pantry Pride from learning of Forstmann's proposal by obstructing discovery. (See Plaintiff's Motion for Preclusionary Sanctions, B 114-170). In fact, so concerned was Revlon that its counsel, at the preliminary injunction scheduling conference, did not want to advise Pantry Pride's counsel of the date of the Board meeting

at which the lock-up would be considered out of fear that Pantry Pride might bid again. (B 1069-71).

In addition to announcing an intent to top any Forstmann proposal, Pantry Pride counsel had advised Revlon's counsel that Pantry Pride was prepared to provide whatever comfort was necessary for the holders of the Exchange Notes. (B 943). But Revlon would never disclose to Pantry Pride the Forstmann proposal it would have to match. Only in a letter of October 9, in which a myriad of issues were discussed, did Revlon obliquely inquire about Pantry Pride's intent to "refinance" the Exchange Notes. (B 721-722). Pantry Pride's response, that it was prepared and able to pay the principal and interest on the Exchange Notes (all that the Board had considered necessary at its October 3 meeting (October 3 Minutes, B 864-897)), was reported to Revlon's Board as a refusal to do anything for the noteholders. (October 12 Minutes, B 902-903; October 11 Gittis letter, B 723-724).

The October 12 Amendment To The
Leveraged Buyout Merger Agreement

The transaction which had been negotiated between Forstmann and Revlon's management on Friday, October 11 was put before the Revlon Board at a meeting the next day. Forstmann was invited to make a presentation. (B 931). Pantry Pride was neither invited to make its own presentation, nor even advised that the meeting was to occur.

The amended proposal provided for a merger consideration of $57.25. (B 786). While a dollar above Pantry Pride's $56.25 tender

offer, it was according to Wall Street and Drexel either worth much less than Pantry Pride's offer because of the delay and uncertain interest in it (B 970), or possibly "slightly less" according to Revlon's investment banker, Lazard. (B 918-919).

Management would no longer be equity investors in financing the merger, although they would continue to participate in the Adler & Shaykin leveraged buyout and get the benefit of their $40 million parachutes. Forstmann also agreed to do the exchange offer for the notes, thus addressing the Board's concern about liability to the noteholders. (B 835, 906).

Again the Board agreed to redeem the poison pill rights, and waive the debt covenants for the new Forstmann offer, as was done for the October 3 $56 merger proposal, but not for Pantry Pride's $56.25 tender offer.* (B 835).

The merger agreement was amended to include a "no shop" clause prohibiting any negotiation by Revlon with any other party. (B 786-792).

Finally, it gave a lock-up to Forstmann, which, because it is now the central issue before the Court, warrants more detailed consideration.

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* Revlon agreed to do likewise for any other $57.25 offer. This made Pantry Pride's tender still subject to the rights and debt restrictions, although the Pantry Pride $56.25 offer was either superior to or (at least) equal to the Forstmann delayed $57.25 offer.

The Forstmann Lock-Up

Forstmann, as part of the October 12 changes to the leveraged buyout, was given the option to purchase three Revlon subsidiaries (Barnes-Hind, Coburn Optical and National Health Laboratories) for the aggregate price of $525 million. (B 811). This is $100-$175 million less than the value placed upon those assets by Lazard, Revlon's investment banker. (B 919).

Not only is the option granted at a price grossly below the admitted value of the assets, the option survives for one year, extending to three years if anyone acquires a 19.9 percent interest in Revlon. Thus, the option would survive the defeat of or failure to consummate the Forstmann merger proposal. There could be no legitimate reason for providing Forstmann with an option that survives the offer it was intended to protect except as a further takeover defense, for management's benefit. At least one Revlon director expressed incredulity at the prospect that the option would survive the defeat of the merger and refused to believe the plain words of the agreement. (B 1088-1089 and 811-812).

There is no dispute as to the purpose and effect of the lock-up option: it is to lock out Revlon stockholders from receiving the benefit of Pantry Pride's bid for their shares. Indeed the Board was told that the reason Forstmann sought the option was the conviction that Pantry Pride would top any offer Forstmann made. (B 904-905). The Board was explicitly advised:

> The effect of the lock-up option, Mr. Lipton stated, was to deter a bid at a higher price than $57.25, and that the directors must consider the favorable sale to Forstmann Little. He noted that the board was dealing with something designed to deter further offers.

(October 12 Minutes, B 922) (emphasis added).

As a result of the amended merger and accompanying option agreement, if someone acquires 19.9 percent of Revlon's stock, Forstmann would receive its $25 million cancellation fee for doing nothing, and the Revlon Board would receive long-term takeover protection because the lock-up would remain in effect for three years. By contrast, Pantry Pride, for its part, would be closed out of the bidding, and Revlon's stockholders would receive no premium for their stock. Thus, the benefits flowing from the amended merger and option agreements redound to the exclusive advantage of Forstmann and the Board.

Pantry Pride's Current Bid -
$58 Cash For Any And All Shares

It is obvious that Pantry Pride cannot compete with Forstmann in the face of the lock-up which had the purpose of ending the bidding, and will have the effect of doing so unless it is enjoined. It is equally obvious, and was known to Revlon's Board, that Pantry Pride proposed to top any Forstmann bid assuming the bidding were done on a level field -- lowering of the poison pill defenses for Pantry Pride, as they were being lowered for Forstmann.

Pantry Pride has now raised its any and all cash tender offer to $58 per share. (B 1058-1068). It has also agreed to exchange for the Exchange Notes so that they will trade at par, or cash them out at par. (Id.). Plaintiff understands that Revlon agrees that its poison pill defenses cannot even arguably operate to impede such an offer.

All that remains to prevent Revlon's stockholders from obtaining the benefit of the Pantry Pride offer is the asset lock-up. That lock-up should be enjoined.

A R G U M E N T

THE LOCK-UP, WHICH HAD THE PURPOSE AND EFFECT OF SHUTTING PANTRY PRIDE OUT OF THE BIDDING, VIOLATED THE FIDUCIARY DUTY OF THE REVLON BOARD TO ACT IN THE BEST INTERESTS OF REVLON'S SHAREHOLDERS.

Standard And Scope Of Review

The grant or denial of a preliminary injunction rests within the sound discretion of the Chancery Court. See, e.g., Gimbel v. Signal Cos., Del. Ch., 316 A.2d 599, 601-02, aff'd, Del. Supr., 316 A.2d 619 (1974). The scope of appellate review of discretionary orders, including orders granting or denying injunctions, is whether the court below abused its discretion. See, e.g., Gimbel v. Signal Cos., 316 A.2d at 620; Daniel D. Rappa, Inc. v. Hanson, Del. Supr., 209 A.2d 163, 166 (1965).

Concerning the findings of fact by the court below:

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

Levitt v. Bouvier, Del. Supr., 287 A.2d 671, 673 (1972); see also Unocal Corp. v. Mesa Petroleum Co., Del. Supr., 493 A.2d 946, 958 (1985).

Introduction

The decision of the court below and the determination of this appeal turn upon the particular facts of the transaction at bar, and not upon any novel legal issue. By whatever legal standard measured and regardless of the conceptual framework through which this transaction is viewed, the grant of a lock-up option to Forstmann was impermissible because of three crucial and undisputed facts which are unique to this case:

(a) The lock-up option was granted at a time when the Board knew that another bidder, Pantry Pride, was prepared to make a bid higher than the bid being "locked up." Indeed, even without another bid by Pantry Pride, Revlon's investment banker advised the Board that Pantry Pride's pending tender offer might be worth more than the leveraged buyout, discounted to present worth. Never has a court sanctioned the knowing lock-up of an inferior bid. On the facts of this case, there can be no proper purpose for locking out a bidder known to be willing to increase the bid above the price being "locked up."

(b) Between the time Forstmann increased its offer to $57.25 (which was a Friday afternoon) and the Board meeting at which a decision from Revlon was demanded (which was held the next evening), Revlon was free, under its then existing merger agreement with Forstmann to ask Pantry Pride to top the Forstmann bid, with respect to the offer for the common shareholders, the noteholders or both. Indeed, the terms of the merger agreement and the Board itself, on October 3, anticipated

that precisely such negotiation and bidding would occur. However, notwithstanding Pantry Pride's attempts to reach Revlon's advisors, Revlon sought no bid from Pantry Pride. In fact, in this litigation and elsewhere, Revlon made every effort to prevent Pantry Pride from learning of Forstmann's latest bid and topping it. If this omission was deliberate, it evidences a lack of commitment to the best interests of the shareholders. If this omission was an oversight, it constitutes a greater degree of gross negligence than conduct previously condemned by this Court. In either event, it was improper.

(c) The assets are being sold at a price which is admittedly from $75 million to $175 million less than the fair value placed upon those assets by Revlon's investment banker. No court has sanctioned an asset lock-up at such an admittedly inadequate price.

In the argument which follows, plaintiff will demonstrate that the lock-up violated the duty of Revlon's Board (1) to adopt takeover defenses which are reasonable in relationship to the threat posed (Argument A), (2) to seek the best price for its stockholders (Argument B), (3) to exercise due care (Argument C), and (4) to put the interests of Revlon's stockholders first (Argument D).

A. The Lock-Up Was Not Reasonable In Relation To The Threat Posed

1. Unocal

Unocal Corp. v. Mesa Petroleum Co., Del. Supr., 493 A.2d 946 (1985), is this Court's most recent expression of a board's duty when

confronted with a tender offer from an unwanted source. There, Mesa, a putative acquiror which the Court found had a history of greenmailing, had commenced a two-tier, front-end loaded tender offer for Unocal's stock. Unocal defended by making a self-tender to all stockholders except Mesa. This Court sustained the defense. In so doing it returned to the first principle of corporate governance.

> In the board's exercise of corporate power to forestall a takeover bid our analysis begins with the basic principle that corporate directors have a fiduciary duty to act in the best interests of the corporation's stockholders. Guth v. Loft, Inc., Del. Supr., 5 A.2d 503, 510 (1939). As we have noted, their duty of care extends to protecting the corporation and its owners from perceived harm whether a threat originates from third parties or other shareholders. But such powers are not absolute. A corporation does not have unbridled discretion to defeat any perceived threat by any Draconian means available.

Id. at 955 (footnote omitted). Refining the standard, the Court went on to explain: "If [the] defensive measure is to come within the ambit of the business judgment rule, it must be reasonable in relation to the threat posed." Id.

Here the court below, giving recognition to the Unocal standard (Opinion at 15, B 1035), invalidated the lock-up. It carefully gauged the "reasonableness" of each of the Revlon Board's responses to Pantry Pride's entreaties, and determined to enjoin the lock-up based on a finding that the lock-up was "not proportionate to the objective needs of the shareholders." (Id. at 24, B 1044).

The court below never suggested that a lock-up set at a "fair" price cannot be "reasonable" in appropriate circumstances. Its holding was neither radical nor disruptive of normal bidding practices. As the court below observed, "[a] lock-up agreement is not per se illegal ...." Id. Indeed, "its use as a bargaining tool to encourage the participation of a prospective bidder has been approved." Id. The court noted further that, in order that it be permissible, a "lock-up provision ... must advance or stimulate the bidding process, not retard it, and toward that end the interests of the shareholders are best served through encouraged competition." (Id. at 25, B 1045) (citations omitted). By contrast, a lock-up should not be given to "foreclose further bidding in an active bidding situation ...." (Id.). Thus, the court below concluded that a lock-up must be used to secure what genuinely is the highest offer in order to satisfy the Unocal standard of "reasonableness." It may not be used, as here, to lock out a bidder which has promised to "top" any pending offer and which has continually been kept uninformed concerning the status of pending offers with which it sought to compete. As the lower court fully appreciated, this is not a case of a bidder who was outbid. It is a case of a bidder who never was permitted to bid.

Further, in assessing the propriety of the response under Unocal, the character of the threat also must be considered. In Unocal that threat took the form of a two-tier, front-end loaded tender offer from an alleged greenmailer. Here, the opposite is true. All Pantry Pride's offers have been all cash, for all of Revlon's stock. There is

not a hint that Pantry Pride is a greenmailer. Revlon will be acquired by Pantry Pride, Forstmann or another bidder if the lock-up is annulled and by Forstmann at a lower price for Revlon's stockholders if it is not. Pantry Pride is a threat only in the sense that Revlon favors Forstmann.

Unocal requires that the Forstmann lock-up be condemned.

2. Revlon's Lack Of Justification For The Lock-Up

Revlon claimed that there were three reasons for agreeing to the lock-up: (1) Forstmann's "superior" financing; (2) the potential loss of Forstmann as a bidder, thus permitting Pantry Pride to lower its bid; and (3) the need to make the noteholders whole. The court below properly rejected each of these makeweight "justifications."

First, the Revlon Board contended that Forstmann's offer was fully financed but Pantry Pride's was not. As the court below concluded, this contention does not "withstand hard analysis." (Opinion at 21, B 1041). Forstmann did not have full financing; "it need[ed] to raise $400 million before it could consummate the transaction." (Id. at 22, B 1042). By contrast, as of October 11 Pantry Pride had commitments for all but $350 million of the funds needed and, as to the rest, Drexel Burnham Lambert, its banker, was "highly confident."* By October 18,

* Director Rifkind testified he had no doubt Pantry Pride could raise the necessary funds. (Rifkind, B 1076). The Board previously had been so advised by Revlon's counsel. (September 24 Minutes, B 857, 859).

Drexel had succeeded in acquiring firm commitments for the entire financing. (Abecassis Aff., ¶ 5, B 969). Thus, the financing for Forstmann's offer was certainly no better than Pantry Pride's. Moreover, the court below properly viewed the Revlon Board's asserted concern that Pantry Pride had "junk bond" financing as "of little concern to shareholders when the offering price is attractive." (Opinion at 22, B 1042).

The second rationale offered by the Revlon Board for the lock-up was that Forstmann would "walk away and no longer compete with Pantry Pride for the Company if their proposals were not accepted at the meeting." (October 12 Minutes, B 923). Forstmann could not walk away. It was contractually bound by the terms of the October 3 Agreement of Merger.

The court below gave short shrift to Revlon's supposed belief that Pantry Pride had lowered its offer before (following the exchange offer) and that it therefore might do so again if Forstmann were to disappear. First, Forstmann was contractually obligated not to "disappear." Second, Pantry Pride had not lowered the value of its tender offer after the Revlon exchange offer -- as the Board was advised by Lazard:

> in its new [$42] offer, Pantry Pride had simply adjusted its original $47.50 price to take account of the Company's purchase of 10 million shares and to reflect the premium that would likely be required to acquire the preferred stock issued in the Company Offer, so that essentially the offer price was unchanged.

(September 24 Minutes, B 854) (emphasis added).

That the supposed concern that Forstmann would walk away was not the actual motivation guiding the Board is demonstrated fully by the fact that Revlon could have come to Pantry Pride on Friday or Saturday, after receiving Forstmann's proposal, to seek a merger agreement on more favorable terms. Revlon has never explained why it failed to negotiate a higher bid with Pantry Pride. We can only conclude that the Revlon Board did not do so because it did not wish to allow Pantry Pride the opportunity to acquire Revlon.

The last of Revlon's justifications was that Forstmann had proposed a note exchange offer through which the noteholders would receive notes that would trade at par. As the court found, the Board owed no legal duty to noteholders. (Opinion at 24, B 1044). The $60 million the noteholders received as a result of the modified agreement with Forstmann came at the expense of Revlon stockholders. Rather than being a justification, this fact further condemns the lock-up. In any case, Pantry Pride had told Revlon's counsel it was "willing to satisfy Revlon's concern for the noteholders and that the issue should not block the deal." (Drapkin Aff., ¶ 5, B 943). However, Revlon never told Pantry Pride what Forstmann had offered the noteholders. Revlon's Board simply was not interested in offers by Pantry Pride. As the court concluded, no legitimate justification was offered in support of the lock-up.

* * *

The court's conclusion that the disputed lock-up was not reasonable under the circumstances flowed from its strict adherence to this Court's pronouncements in Unocal. Although Justice Walsh allowed the Revlon Board considerable latitude in responding to Pantry Pride's acquisition efforts, the Board's failure to take reasonable steps necessary to secure the highest price for Revlon stockholders simply cannot be condoned under any judicial standard. To have held otherwise, the court would have been required to approve an agreement that prevented Revlon shareholders from receiving that to which they were entitled: the highest offer for their shares. Moreover, here the only offsetting gain was one that inured to the benefit of the members of Revlon's Board, who were able to rid themselves of a thorny problem of their own making. Neither this Court nor any other court ever has countenanced such conduct.

3. The Lower Court's Decision Is Consistent With Other Lock-Up Cases

The lower court's refusal to accept Revlon's purported justifications for the wasteful option given to Forstmann was not a precedent-setting condemnation of lock-ups. (Opinion at 25, B 1045). To the contrary, the decision below merely represented the court's considered effort fairly to apply this Court's ruling in Unocal. Other lock-up cases, while varying on their facts, are to the same effect.

In Thompson v. Enstar, Del. Ch., C.A. Nos. 7641 and 7643, Hartnett, V.C. (June 20, 1984, revised August 16, 1984) (Compendium,

Exhibit E), the Vice Chancellor declined to enjoin certain lock-up agreements only because at the time they were given, "[t]here was no competing bid as such. At most there was an indication by a group headed by Tesoro Corporation of an interest in acquiring Enstar." Slip op. at 8. The only other offer for Enstar was made well after May 22, 1984, the date on which the lock-up was given. Although the action of the Enstar directors had to be "measured on the facts as they existed on May 22, 1984," the court stressed, prophetically, that, "[n]eedless to say, if the subsequent offers had been made sooner a different result might be reached." Id. at 13.

The court took pains to note that "lock-up" agreements are suspect and potentially unfair to shareholders:

> Lock-up agreements have been justifiably criticized. They often prevent open bidding for assets which, of course, is usually in the best interests of shareholders. They therefore must be given careful scrutiny by a court to see if under all the facts and circumstances existing in a particular case they are fair to the shareholders....

Slip op. at 11.

The court explained that the test "whether a lock-up provision should be upheld is whether management acted reasonably." Slip op. at 12. Even in the "unusual factual situation" in Enstar, the court characterized its decision as a "close call." Id.

As the court below held, the lock-up given to Forstmann plainly required a "different result." Here, there was not only another

concrete offer at the time the lock-up was given, but also one higher than even Forstmann's revised proposal. Moreover, the Revlon Board believed that Pantry Pride would bid even higher. Revlon never gave Pantry Pride the opportunity to do so. If Enstar was a "close call," this case is not. "Careful scrutiny" of Revlon's lock-up demonstrates clearly, as the court below found, that it is unreasonable.

The policy reasons mandating careful scrutiny of lock-up options such as this, and those on which the court below relied, are crystal clear:

> Vigorous competitive bidding is in the best interests of the target's shareholders; in an unrestrained auction, shareholders will receive the highest possible premium for their stock. But lock-up options can be structured in a way that frustrates this free market objective. ... Any competing or prospective bidder will abandon or avoid the contest rather than seek to acquire a company shorn of its principal assets. These other bidders may value the target more dearly than the White Knight does, but their desire to acquire the company will evaporate if a key asset is placed out of reach. The best interests of the target's shareholders are not served if the board acts to exclude bidders and to bring the auction to a premature close.

Note, Lock-Up Options: Toward A State Law Standard, 96 Harv. L. Rev. 1068, 1077 (1983) (Compendium Exhibit F), cited with approval in Enstar and by Justice Walsh below. Thus, "a lock-up should be permissible [only] if it is reasonably structured to draw another bidder into the contest, and should be considered illegal if it [as here] is calculated primarily to exclude hostile parties from the auction." Id. at 1079.

Revlon's lock-up provides for the sale of the assets at such a steep discount that it "necessarily results in the exclusion of" not only Pantry Pride but "of all bidders other than the optionee." Id. at 1080. The Board was told as much. (October 12 Minutes, B 922). No reasonable bidder would make offers for a company which has given a competing bidder between $100 and $200 million of its assets for free. Such an unconscionable waste of corporate assets inevitably would deter Pantry Pride or any other potential offerors from bidding for Revlon.

While a "crown jewel" rather than a lock-up case, GM Sub Corp. v. Liggett Group, Inc., Del. Ch., C.A. No. 6155, Brown, V.C. (April 25, 1980) (Compendium Exhibit B), is also instructive here. There, the target company, Liggett, defended against a tender by selling a key subsidiary. The offeror sought to enjoin the sale. The Vice Chancellor denied the request, relying on evidence that the sale was made by open auction and the sale price was very favorable to Liggett. Here, by contrast, the takeover defense lock-up option is $75-$175 million below fair value. Had such been the case in Liggett, there can be no doubt the crown jewel sale would have been struck down by Vice Chancellor Brown, as was the give-away option to Forstmann enjoined by Justice Walsh.*

* Also on point is DMG, Inc. v. Aegis Corp., Del. Ch., C.A. No. 7619, Brown, C., slip op. at 5-6 (June 29, 1984) (Compendium Exhibit A). There, the disappointed bidder sought to enforce a lock-up, as Forstmann is doing here. The Chancellor observed:

> [T]he option holder was bargaining from the outset on the basis that its offer to merge ... would pos-

Continued on page 35

B. The Lock-Up Violated The Duty Of Revlon's Board To Seek The Highest Price For Its Stockholders

The trial court found on a fully supported record that Revlon's adoption of the Rights Plan had eliminated the marketplace as a forum for negotiation, relegating Pantry Pride to the Revlon Board, which refused to negotiate with Pantry Pride. These findings compel the conclusion that the Revlon directors breached their fiduciary duties to their stockholders by refusing to seek the best price from Pantry Pride and by locking up a less attractive bid. As Justice Walsh said:

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* Continued from page 34

> sibly be topped by another, and it is relying on this promise to merge under the frailties of these known conditions as constituting sufficient legal consideration to support [the option]. I must confess that I have some doubt as to whether or not a valid consideration for the ... option actually exists.

Likewise, in Whittaker Corp. v. Edgar, 535 F. Supp. 933 (N.D. Ill.), aff'd, Dkt. Nos. 82-1305, 82-1307 (7th Cir. March 5, 1982), the target company sold a subsidiary to a third party, at a price substantially in excess of the price at which the tender offeror had valued the same subsidiary. In Mobil Corp. v. Marathon Oil Co. [1981-82 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 98,375 (S.D. Ohio), rev'd on other grounds, 669 F.2d 366 (6th Cir. 1981), cert. denied, 455 U.S. 982 (1982), an option to purchase the target's major asset, an oil field, was given to a competing tender offeror to facilitate a substantially higher offer, at a price above the valuations provided by the target's investment banker, and at the upper end of the range arrived at by that banker's senior analyst. Id. at 92,274. The target company also gave a stock option at above the market price. Thus, in neither Whittaker nor Mobil did the target company enter into a transaction at a price substantially below the valuation of the target's investment banker, aimed at thwarting the higher bidder, as Revlon has done here.

> having adopted the Rights Plan the Revlon Board reached the plateau of plenary negotiating authority which Household envisioned. The Revlon Board thus assumed a great degree of responsibility by providing a substitute for the marketplace which ordinarily would judge the merits of Pantry Pride's, and any other potential acquiror's tender offer. This role took on added significance here since each of Pantry Pride's subsequent tender offers were "any and all for cash."

(Opinion at 16-17, B 1036-1037).* After Revlon's Exchange Offer had been announced and Pantry Pride's intention to proceed with its offer had become clear, "the Revlon Board proceeded on the assumption that there would be a breakup of the company. The directors' role changed ... to that of an auctioneer attempting to secure the highest price for the pieces of the Revlon enterprise." (Opinion at 18-19, B 1038-1039).

As Justice Walsh found, however, the "auction" actually conducted was systematically designed to exclude Pantry Pride -- the very entity Revlon recognized would top every bid. Revlon did not:

- invite Pantry Pride to participate on the same level of negotiations as Forstmann and Adler & Shaykin (Opinion at 19, B 1039)

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* Similarly, in Moran v. Household International, Inc., Del. Ch., 490 A.2d 1059 (1985), appeal pending, Del. Supr., No. 37, 1985, the court found that a related form of rights plan was "calculated to alter the structure of the corporation" and "results in a fundamental transfer of power from one constituency (shareholders) to another (the directors)." 490 A.2d at 1076. These findings rested on the court's conclusion that the plan's deterrent effect on hostile offers vested in the board a "plenary negotiating" power, including the power to block all hostile acquisition efforts. 490 A.2d at 1083.

- share financial data with Pantry Pride as it did with Forstmann (Opinion at 19, B 1039)

- invite Pantry Pride to the board room or permit Pantry Pride to make a face-to-face presentation to the entire Revlon Board (Opinion at 19, B 1039)

- share information with Pantry Pride concerning Forstmann's bid as it agreed to share information with Forstmann concerning what Pantry Pride was offering (Merger Agreement, ¶ 6,1(e), B 576)

Justice Walsh's findings of fact are fully supported by the extensive record and in large part undisputed; his conclusions follow a long line of Delaware cases commanding fiduciaries to pursue the best price available in disposing of assets entrusted to their care. See, e.g., Pennsylvania Co. v. Wilmington Trust Co., Del. Ch., 186 A.2d 751 (1962), aff'd sub nom. Wilmington Trust Co. v. Coulter, Del. Supr., 200 A.2d 441 (1964); Lockwood v. OFB Corp., Del. Ch., 305 A.2d 636 (1973); Robinson v. Pittsburgh Oil Refining Corp., Del. Ch., 126 A. 46 (1924); Thompson v. Enstar Corp., Del. Ch., C.A. Nos. 7641 and 7643, Hartnett, V.C. (June 20, 1984, revised August 16, 1984) (Compendium Exhibit E); Thomas v. Kempner, Del. Ch., C.A. No. 4138, Marvel, V.C. (March 22, 1973) (Compendium Exhibit D).

In the leading case of Thomas v. Kempner, supra, the plaintiff brought suit to enjoin a proposed sale of corporate assets on the ground that a third party was prepared to pay more for the assets. The defendant directors argued that they were bound by their contract. Then-Vice Chancellor Marvel disagreed, holding that the directors had made a fundamental error of business judgment by continuing to deal solely with

one buyer "after it was readily apparent that at least one other group was not only interested in acquiring the [property] in issue but was willing to top [the initial potential buyer's] offer as to cash." Slip op. at 12; see also Robinson v. Pittsburgh Oil Refining Corp., 126 A at 49 ("Where the standard of comparison is the absolute one of dollars in hand for the same identical thing, a discretion which would choose the smaller amount would be so manifestly absurd as to convict itself of fraud").

In Wilmington Trust v. Coulter, supra, relied upon in Thomas v. Kempner, this Court affirmed a surcharge on a trustee for failing to pursue a higher offer for the sale of trust assets when he was legally free to do so. At the trial level, then-Chancellor Seitz held that Wilmington Trust had a fiduciary duty "to sell at a maximum price." Wilmington Trust, 186 A.2d at 774.

The cited cases stand for the proposition, deeply ingrained in our Delaware law, that a fiduciary has a high duty to take reasonable steps to assure that the best price is obtained in the sale of an asset subject to his stewardship. That duty was violated by the Revlon Board here. The lock-up, which prevents Revlon's stockholders from benefiting by virtue of a higher Pantry Pride bid, should be enjoined and annulled.

C. The Lock-Up Violated The Duty Of Revlon's Board To Exercise Due Care

In Smith v. Van Gorkom, Del. Supr., 488 A.2d 858 (1985), this Court held directors liable for adopting a merger agreement at a price

which never was truly subject to competitive bidding. Thus, the Board had not informed themselves adequately on the issue whether the merger price was sufficient. Here too the Revlon Board failed to inform itself sufficiently concerning the maximum price it could obtain.

Both before and after approving the merger agreement with Forstmann Little on October 3, Revlon's directors had ample opportunity to negotiate with or instruct the company's representatives to negotiate with Pantry Pride in order to obtain the highest price for Revlon's assets. Since the directors were proceeding on the assumption that Revlon would be broken up, there was no excuse for not seeking Pantry Pride's highest bid* -- the information most material to the decision Revlon's directors were required to make on behalf of the company's stockholders. Once it became apparent that Revlon would be sold and broken up, the stockholders had only a financial interest in ensuring that they received the highest price for their shares.

Even as late as Friday, October 11, the directors were free to seek a final offer from Pantry Pride to top the final offer they had received from Forstmann. Nevertheless, despite their knowledge of the revised bid from Forstmann and its conditions on October 11, the directors did not inform Pantry Pride that final offers should be submitted by the October 12 Board meeting, did not tell Pantry Pride

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* Of course, the simplest way to have obtained Pantry Pride's highest bid would have been to ask for it. In any event, Revlon's directors in attempting to locate the highest bidder were under a duty to undertake "a reasonably aggressive program which [one] of prudence, discretion and intelligence would have followed in an effort to sell their own property." See Lockwood v. OFB Corp., 305 A.2d at 639.

what terms it would have to offer and did not seek the highest offer they always knew would be forthcoming from Pantry Pride. Instead, as the court below found, "[t]he Revlon board seemed to want Forstmann Little in the picture at all costs." (Opinion at 22, B 1042).

The Revlon Board's decision not to negotiate with Pantry Pride -- when it knew that Pantry Pride could and would top any offer due to its unique financial situation -- was an exercise in studied ignorance. The Board's uninformed decision to sell to Forstmann, ignoring Pantry Pride, the most promising bidder, is entitled to no protection under the business judgment rule. Smith v. Van Gorkom.

D. The Lock-Up Violated The Duty Of Revlon's Directors To Put The Stockholders' Interests First

The court below found, based on solid record support, that the Revlon directors were motivated by the threat of personal liability to the disgruntled noteholders when they granted the lock-up option. The trial court's findings on this issue both explain why the Revlon Board acted as it did and establish the Board's interest, which interest places the burden of proving the fairness of the lock-up on the directors. See Bennett v. Propp, Del. Supr., 187 A.2d 405, 409 (1962); see also Good v. Texaco, Inc., Del. Ch., C.A. No. 7501, Brown, C., slip op. at 11 (May 14, 1984) (Compendium Exhibit C).

As the trial court found, the substantial decline in the value of the Notes following the announcement of the October 3 merger agree-

ment caused great concern among Revlon's directors. (Opinion at 10, 17, B 1030, 1037). By the October 12 Board meeting, litigation had been threatened and actually filed by noteholders, and was of sufficient concern to four outside directors that they retained separate counsel who accompanied them to that meeting. (Opinion at 20, 23, B 1040, 1043; October 12 Minutes, B 899). The potential liability was not trivial; according to Mr. Lipton, the Board faced damage claims of as much as $50 million. (October 12 Minutes, B 929). At oral argument, defendants admitted that the decline in value of the Notes was approximately 13 percent (or more than $60 million). (Transcript of October 18 Oral Argument, B 1073).

Thus, the court below concluded that the Board "used [the lock-up] to rid themselves of a vexing and potentially damaging source of litigation" (Opinion at 24, B 1044); and that the lock-up was granted "to promote an agreement which relieved the [d]irectors of the potentially damaging consequences of their own defensive policies" (Opinion at 25, B 1045). The court's findings in this regard are amply supported by the record and should be sustained. Levitt v. Bouvier, 287 A.2d at 673. They also offer the only rational explanation for the Board's conduct.

The source of the Board's "vexing" concern is not hard to find. As later developments revealed, the Board's formal approval of the Merger Agreement on October 3 put the "independent directors" and the Board as a whole in a bind. That agreement gave Forstmann the right to a $25 million cancellation fee if the "independent directors" refused

to waive the covenants for the transactions contemplated by the merger agreement. The directors knew this when they voted on October 3 and knew that they were leading Forstmann to believe that the waivers would be granted. (October 3 Minutes, B 880-881). The Board also knew on October 3, because they were told by Mr. Lipton, that "the waiver of the covenants and the leveraged buyout capital structure would adversely affect the market value of the 11.75% Notes ...." (October 3 Minutes, B 881). Thus, by unanimously approving the Merger Agreement, the directors had every reason to know that they were committing themselves to waive the covenants even though such a waiver was likely to have an adverse effect on the market value of the Notes.

Following the announcement of the leveraged buyout proposal, the reaction in the marketplace was more virulent than anticipated. Judge Rifkind said he was "deluged with telephone calls from irate noteholders." (Rifkind Aff., ¶ 42, B 840). Mr. Lipton later told the Board that the "Wall Street reaction had been extreme...." (October 12 Minutes, B 924). The "independent directors" would not approve the formal waivers required by the Merger Agreement unless the noteholders were satisfied. (B 943). But the Board's hesitation was ill-timed. If they refused the waivers, they risked the $25 million cancellation fee. If they gave the formal waivers, the noteholders would suffer a large loss.

The Board had only one sure way out -- to "lock-up" the deal with Forstmann to satisfy the noteholders. As the court below found, the evidence shows that they followed that course in order to resolve

the dilemma (and massive potential personal liability) created by their October 3 approval of the Merger Agreement.

The Directors' Lame Explanation

The directors argued below (and apparently plan to argue on appeal) that their approval of the lock-up was unrelated to their fear of personal liability. The excuse offered by them was flatly rejected by the trial judge. (Opinion at 21-24, B 1041-44).

According to the directors, they had no fear of personal liability. Rather, they demanded that the terms of the Merger Agreement be amended to cause the Notes to trade at par because they felt a "moral" or "legal" obligation to the noteholders. Thus, to satisfy this supposed obligation, they bargained to give the noteholders more than $60 million in extra value and thereby denied the stockholders the highest price for their shares. (Opinion at 23-24, B 1043, 1044; Transcript of October 18 Oral Argument, B 1075).

The Board had no legal obligation to the noteholders. The noteholders are merely creditors of the corporation. As Justice Walsh noted, their rights are fixed by contract. Wolfensohn v. Madison Fund, Inc., Del. Supr., 253 A.2d 72, 75 (1969); Harff v. Kerkorian, Del. Ch., 324 A.2d 215 (1974), modified on other grounds, Del. Supr., 347 A.2d 133 (1975); Helvering v. Southwest Consolidated Corp., 315 U.S. 194, 62 S. Ct. 546 (1942). The Indenture imposed no obligations on the independent directors to the noteholders. To the contrary, it gave the independent

directors unlimited discretion to waive the restrictive covenants. Likewise, the directors owed no fiduciary duties to the noteholders. Harff, 324 A.2d at 222. The Revlon directors' agreement which secured more favored treatment for the noteholders at the expense of the common stockholders was a gift and a waste of assets.* See Fidanque v. American Maracaibo Co., Del. Ch., 92 A.2d 311, 320-21 (1952) (payment for past services held to be a waste of assets where corporation was under no legal obligation to payee).

Whatever moral obligation the directors felt also provides no basis for subordination of stockholder to noteholder interests. "A moral commitment, as opposed to a legal one, is generally not a legally sufficient reason for a trustee to neglect his overriding duty to sell at the maximum price." Pennsylvania Co. v. Wilmington Trust Co., Del. Ch., 186 A.2d 751, 774 (1962). The directors' moral concern for noteholders at the expense of their legal duties to stockholders evidenced their divided loyalty. "Directorial interest exists whenever divided loyalties are present ...." Pogostin v. Rice, Del. Supr., 480 A.2d 619, 624 (1984). "There is no 'safe harbor' for such divided loyalties in

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* Revlon sought to counter this obvious conclusion by arguing in the alternative that the more than $60 million which Forstmann agreed to pay the noteholders in reality went to the stockholders because the two groups were coextensive. (Transcript of October 18 Oral Argument, B 1074). The trial court rejected this argument as factually incorrect. (See Opinion at 23, B 1043). When Revlon made its Exchange Offer, only 87 percent of the stockholders tendered into it and received Notes. In addition, between the termination date of the Exchange Offer and October 12, there was significant trading in both the Notes and the stock. Thus, the two groups were not coextensive.

Delaware." Weinberger v. UOP, Inc., Del. Supr., 457 A.2d 701, 710 (1983). As Justice Walsh noted:

> The board's primary responsibility after the exchange offer was to bargain for the rights of the remaining equity holders. By agreeing to a lock-up and no shop clause in exchange for protecting the rights of Noteholders, the Revlon Board failed in its fiduciary duty to the shareholders.

(Opinion, B 1044).

* * *

In the end, the Board's "explanation" requires this Court to blink at common experience and reality. The problem that the Board faced was that it had approved the Merger Agreement on October 3 and, implicitly, had undertaken to waive the covenants. That decision created the spectre of massive personal liability. As Justice Walsh found, the lock-up was granted "to promote an agreement which relieves the directors of the potentially damaging consequences of their own defensive policies...." (Opinion at 25, B 1045). The result of that interest-motivated agreement was to deny stockholders the best price for their shares. This Court should, plaintiff respectfully submits, affirm.

CONCLUSION

The grant of a preliminary injunction was premised upon application of existing precedent to the unique facts of this case. From this foundation, the court below found a probability of success on the merits. (Opinion at 26, B 1046). Balancing the equities, the court below properly concluded that the irreparable harm to the shareholders if a preliminary injunction were denied, loss of an immediate opportunity to tender their shares to the highest bidder, outweighed any limitation to the contractual rights of Forstmann caused by granting the injunction. (Id. at 28, B 1048). The grant of a preliminary injunction in this circumstance was compelled and clearly not an abuse of discretion. It should be affirmed in the clearest terms.

Respectfully submitted,

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