IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

IN AND FOR NEW CASTLE COUNTY

MACANDREWS & FORBES HOLDINGS, INC., a Delaware corporation, Plaintiff, v. 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.	Civil Action No. 8126

PLAINTIFF'S REPLY BRIEF IN SUPPORT OF
ITS MOTION FOR A PRELIMINARY INJUNCTION

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A motion for a temporary restraining order was filed Tuesday morning. The Court heard oral argument at 9:30 a.m. by Forstmann Little, which to that point had purposefully absented itself from these proceedings ... except as an observer. In the end the Court entered an order restraining the escrowing of the lock-up.

NATURE AND STAGE OF PROCEEDINGS

Since the opening brief (served Monday afternoon), new events have occurred, and "old" facts discovered.

On Monday, October 15, plaintiff had moved for sanctions against defendants for failure to make discovery. (Failing to produce documents; terminating the Bergerac deposition on a claim that there were not "proper" answers to questions at the Perelman deposition; refusal by Forstmann Little to produce documents, and motion in New York to quash subpoena issued pursuant to Commission from this Court resulting in nonoccurrence of the Forstmann Little depositions).

Monday evening defendant Revlon made limited document production relating to the October 12 amendment to the October 3 merger agreement about which, to that point, plaintiff knew only what Revlon's Sunday press release had said. The Monday document production included the text of the amendment, and the new Forstmann Little option. It also included escrow agreements which, when read with the option, said that the stock of Vision Care and National Health Laboratories and Forstmann Little's $25 million termination fee were to be deposited in escrow not later than Tuesday at 10:30 a.m. They could serve no purpose except to remove these assets from the reach of this Court's orders.

PRELIMINARY STATEMENT

Pantry Pride's effort to acquire Revlon has been underway for nearly two months. At no time has Revlon's board permitted the normal market forces to operate. From the first, the board's response has been to stop Pantry Pride from bidding. They have finally achieved that end through a completely unfair "lock-up" option given to Forstmann Little.

In all the pages of self-serving affidavits offered by the defendants, nowhere do the defendants mention the single crucial fact that condemns the "lock-up." Revlon gave Forstmann Little the right to buy for $525 million assets its own investment bankers valued at $600 to $700 million. On October 12, William Loomis of Lazard Freres advised the Revlon board that:

> regarding the proposed lock-up, $525 million was, in Lazard's point of view, a favorable price from the perspective of Forstmann Little. He noted that the estimate of Lazard Freres was that they could achieve a price as high as $600 to $700 million from the sale of the two divisions together.

(October 12 Minutes at 22, Exhibit E).*

* Unless otherwise indicated, all references to exhibits are to Plaintiff's Reply Appendix.

In no case defendants cite has any court ever condoned the sale of company assets at such a grossly unfair and inadequate price.

It is not in dispute that the purpose for the lock-up was to deter further bidding by bringing that process "to an end." (October 12 Minutes at 26). The board was told by Mr. Brownstein of Wachtell, Lipton that the "option agreement would likely be a deterrent" to another offer even as high as $60 per share. (October 12 Minutes at 16). Mr. Lipton was more direct:

> The effect of the lock-up option, Mr. Lipton stated, was to deter a bid at a higher price than $57.25 .... He noted that the Board was dealing with something designed to deter further offers.

(October 12 Minutes at 25). The unspoken reason why the lock-up is so effective is plain: no one can now compete with Forstmann Little's deal because Forstmann Little is, in effect, given a $75-175 million head start.

Equally remarkable is the fact that the option was given to "lock-up" an inferior bid. Defendants now waste a lot of breath explaining how the Forstmann Little $57.25 bid is better. The record they carefully constructed flatly contradicts them. On October 12, Mr. Loomis advised the board:

> that Mr. Perelman's offer was for cash now at $56.25 and that Forstmann Little's would be cash in 35 days at the least. If these two offers were compared in present value terms and if it were assumed the merger would take place in 40 to 60 days or more, $57.25 could be slightly less than $56.25, assuming a 12% rate. Each month was approximately $0.57 to $0.58 per share. He noted that it was the intention of Forstmann Little to attempt to close the merger in 35 days, but that it was impossible to know how long the review process at the SEC would take.

(October 12 Minutes at 21-22).

Defendants' next excuse for their "lock-up" is the completely disingenuous argument that Forstmann Little's bid was "fully financed" while Pantry Pride's was not. The facts tell a different story. Revlon's board never saw a single piece of paper evidencing Forstmann Little's financing commitments. (Rifkind Dep. 64-73, Exhibit G). If they had, they would have realized that Forstmann Little was missing $400 million of the $1200 million needed. All Forstmann Little had was a "best efforts" agreement from its banks to raise the other $400 million. If those efforts failed, none of the money would be available. (Commitment Agreement, Exhibit K). Moreover, the October 12 amendment to the merger agreement provided as follows:

> 2. The Price. The Price shall be $57.25 per share net to the holder in cash. FL&Co. Companies covenant that they will use their best efforts in connection

> with the financing to have sufficient funds to consummate the transactions contemplated hereby at the Price and FL&Co. Companies represent that they can obtain such funds.

In other words, the merger agreement as amended, was subject to financing and, contrary to all the defendants' public statements, was not "fully financed."

In contrast, there was no financing condition to the Pantry Pride offer and, by October 10, all but $350 million of the funds needed were committed. For the rest, Drexel, Burnham, Lambert & Co. had expressed a view that it was "highly confident" that commitments could be obtained. Revlon now tries to take the position that the board was concerned that Pantry Pride could not raise the money. This attack is flatly contradicted by Revlon's own board minutes. The board was repeatedly told that Drexel would raise the money. (August 19 Minutes at 2 and 12, Exhibit N; August 26 Minutes at 12, Exhibit O; September 24 Minutes at 10, Exhibit L). The board was even told the reason why Pantry Pride had not yet obtained all of its financing: commitments are expensive and Pantry Pride was waiting to see if Revlon's defensive maneuvers would block its bid before it paid for the commitments. (September 24 Minutes at 8). Director Rifkind, in a break from the current party line, has admitted that he never had any doubt about Pantry Pride's ability to raise the money. (Rifkind Dep. 30).

In any case, Pantry Pride now has all the necessary financing commitments and stands ready to take down shares next week.

On a particularly cynical tack, the defendants also protest some fear that Pantry Pride would lower its offer if they refused the "lock-up" option and Forstmann Little withdrew. This, of course, implies that Forstmann Little was free to withdraw when it was not. Forstmann Little was a party to a merger agreement. Even if this were otherwise, it is nonsense to think that Pantry Pride would lower its offer. As Revlon's investment banker told the board on September 24, the earlier change from $47.50 to $42.00 was done to adjust for Revlon's exchange offer and the poison pill rights. (September 24 Minutes at 5). Defendants admit in their brief that "essentially the offer price was unchanged." (Def. Ans. Br. 28). Pantry Pride has never threatened to lower its bid from $56.25. There is no evidence to the contrary. In fact, the evidence shows that Pantry Pride consistently indicated a willingness to negotiate a deal at a higher price. (Perelman Aff. ¶¶ 15, 16).

The board's last excuse is their newly found concern over the noteholders. There are two answers to this. First, the "concern" over the noteholders ·· the October 12 meeting was motivated by a public outcry from noteholders which had created concern about personal liability on the part of the directors for inadequate disclosures in Revlon's exchange offer. (October 12 Minutes at 16; Rifkind Dep. 91-99, 103 and 104). Forstmann Little's offer was to satisfy a potential liability of the directors, and the directors' ready agreement to lock-up that deal was an interested decision. *Second*, the board's advisers actively refused to enter into negotiations with Pantry Pride officers to reach a similar accommodation for the noteholders. To make a deal, Pantry Pride was ready to give the board all the comfort they needed on the noteholders. This fact was told to Revlon's advisers but never, apparently, conveyed to the board. (See Drapkin Aff. ¶¶ 4, 5; Perelman Aff. ¶¶ 16, 17).

The whole posture of the directors as a neutral board doing their best for everybody is a sham. This board's first step was to adopt a poison pill rights plan designed to block the marketplace and give them a plenary power of negotiation. At every turn that power was manipulated by the board and its advisers to shut Pantry Pride out of the bidding and advantage management and their hand chosen partners. Fees of the most excessive character, far beyond any reasonable amount of "expenses," were handed out to the favored bidders. Defendants studiously ignore the fact that Pantry Pride has promised to return that money to the stockholders if its payment to Forstmann Little is enjoined.

Despite the new duties assumed by the board, they consistently refused ever to negotiate at all with Pantry Pride. They concede that they chose not to attempt any negotiations with Pantry Pride. (Def. Ans. Br. 75). At the same time, they refused to let Pantry Pride compete in the marketplace, always keeping their poison pill defenses carefully placed to block the market.

Moreover, even assuming that it was the intent of the Revlon board to produce a higher value for shareholders throughout this period, the decision to grant a lock-up to Forstmann Little was an incredible betrayal of that purpose. The lock-up option was granted to Forstmann Little without granting Pantry Pride any opportunity to respond. When asked for some explanation of the failure to approach Pantry Pride, Judge Rifkind gave this response:

> Well, [Mr. Perelman] had already announced what he would do. He indicated if Forstmann Little put down $57.25, he would say $57.26, that we understood and knew. That's what we had been informed by Mr. Perelman.

(Rifkind Dep. 88). Thus, this lock-up option was granted to Forstmann Little because Forstmann Little and the board believed that Forstmann Little would bid higher than Forstmann Little if allowed to do so.

The defendants attempt to frighten the Court into sanctioning this conduct by exclaiming that any contrary ruling would mean that "the powers and responsibilities of a target company's directors evaporate in a takeover situation." (Ans. Br. 7). But plaintiff does not contend that the directors of Revlon should not have a role in responding to tender offers. Indeed, Pantry Pride has consistently sought to engage the Revlon board in precisely that role -- a role the board refused when it announced that the company was not for sale on any terms. The issue in this case is not whether the directors should have any role, the question is whether the directors should have the only role. The Revlon board, exercising total control, has steadfastly used every means available to prevent the stockholders from choosing to end the competition.

Finally, the assets to be sold pursuant to the "lock-up" together with the Beauty Products division to be sold to Adler & Shaykin constitute "all or substantially all" of Revlon's assets under § 271. These transactions require a stockholder vote; Revlon illegally refuses to provide one.

Pantry Pride is ready to close its offer at midnight on Monday, October 21. They money is available. Pantry Pride is also prepared to give full assurances that the noteholders have an opportunity to receive par value in the transaction. (Perelman Aff. ¶ 17). Only two obstacles remain: the lock-up option and the poison pill rights. The Rights were never valid and certainly can have no validity in the current circumstances. The Pantry Pride offer is at a price Revlon's board has already concluded is fair and is at least equal in value to the Forstmann Little deal. Moreover, in the October 3 merger agreement the board indicated its willingness to "pull the pill" for any transaction at $56 or above. As to the "lock-up," Pantry Pride is prepared to buy if Revlon and Forstmann Little are preliminarily enjoined from taking any steps to exercise it.

Without that injunction, there is simply no fair way for Pantry Pride or any other bidder to proceed. With the injunction, Pantry Pride can finally makes its offer effectively to the stockholders of Revlon who, after all, are the owners of the corporation. The stockholders will not be harmed by that injunction. Rather, it will permit them to decide between Pantry Pride's offer and any other offer that is made, including the Forstmann Little merger proposal. They can accept it or not as they see fit. The noteholders will not be harmed by that injunction. They will be in the same position as in the Forstmann Little merger proposal and will have the opportunity to receive par for their notes.

The only one to be disadvantaged by that injunction is Forstmann Little. All Forstmann Little stands to lose is the opportunity to buy the lock-up assets now at a bargain basement price. Their only injury is delay pending final hearing. Of course, if the Rights are voided and the lock-up enjoined, Forstmann Little will still be able to compete with Pantry Pride where it counts -- in the marketplace.

STATEMENT OF FACTS

The October 12 Board Meeting: Revlon Locks Up An Inferior Offer

On October 12 the Revlon board met and approved an offer by Forstmann Little that, although superior to its original offer, was concededly inferior to Pantry Pride's $56.25 offer. The board also granted to Forstmann Little a lock-up option which it knew would end the bidding for Revlon. The board took these actions in order to avoid substantial personal liability to Revlon noteholders, whose notes had declined in market value after the announcement of the original Forstmann Little transaction and who had brought suit. The Revlon board, in effect, bought comfort for themselves and let the shareholders pay the price.

The Revised Forstmann Little Offer

On October 12 the Revlon board was asked to consider and approve a revised Forstmann Little offer. Its principal new terms were:

(a) The merger consideration was raised from $56 to $57.25.

(b) The original agreement had no financing contingency. The amended agreement, despite demonstrably verbal representations that financing was secured, contains only a "best efforts" commitment on financing.

(c) The surviving entity would, after the merger, make an exchange offer pursuant to which the 11.75 percent notes issued pursuant to the Exchange Offer would be exchanged for new notes designed to trade at par.

(d) In connection with the offer, Forstmann Little would be granted an option to purchase Revlon's Vision Care Group and National Health Laboratories for $525 million, a price as much as $175 million less than Lazard's valuation (a valuation of which Lazard was highly confident on October 1). (October 1 Minutes at 7, Exhibit P).

(e) No members of the board or of management would participate in an equity interest in connection with the financing of the merger.

(f) Revlon agreed that it would neither solicit other bids nor negotiate with other bidders.

(g) The $25 million "cancellation fee" would be placed in escrow and released on termination of the merger agreement or if a person or group acquired 19.9 percent of Revlon's shares.

Events Leading To The Revised Offer

The board's approval of Forstmann Little's October 12 proposal was its desperate response to a predicament that it had brought upon itself, through its overreaching conduct in opposing Pantry Pride at any cost to Revlon's shareholders.

The board had earlier responded to what it obviously viewed as the "threat" of a Pantry Pride takeover with first a poison pill, next a coercive exchange offer and the issuance of securities with poison pill covenants, and then the October 3 Forstmann Little-management leveraged buyout.*

The Forstmann Little-management leveraged buyout deal, however, quickly proved to be a nest of problems for Revlon.

-- Harsh Public Criticism Of The $85 Million Parachutes. The October 3 leveraged buyout deal provided that Revlon's management's golden parachutes would be triggered, even though the beneficiaries of the parachute payments would not only be employed by but also would own "approximately 25% of the equity of the Surviving Corporation." (Revlon Schedule 14D-9, Amendment No. 5, Opening Brief Appendix, Exhibit N, p. 2). Moreover, loans from the surviving corporation to finance their equity investments were anticipated. (*Id.*). The package of payments to be made to Revlon's management in connection with the buyout

* These defensive strategies are described in detail in plaintiff's opening briefs.

totaled approximately $84.5 million. (*Id.*; *see also* Table of Payments, Exhibit A). Bergerac *alone* was to receive more than $32.7 million.

A torrent of criticism ensued concerning the self-interested nature of the agreement with Forstmann Little. The *Wall Street Journal* reported that "[s]ome analysts said they were shocked that Mr. Bergerac's golden parachute will be triggered by a buyout plan he helped put together." (*The Wall Street Journal*, October 8, 1985, Opening Brief Appendix, Exhibit Q). One described it as "incredibly outrageous." (*Id.*). Bergerac responded: "Don't jump to any conclusions that I did this *all* for my personal benefit." (*Id.*) (emphasis added).

Against this backdrop of public criticism of Revlon's board, Pantry Pride sued to enjoin payments that were to be made under the golden parachute contracts. The *New York Times* spoke on behalf of many when it asked,

> What gives with Michel Bergerac?
>
> Just two months ago, the 53-year-old chief executive of Revlon Inc. reacted to a hostile takeover bid for the cosmetics and health care giant by saying that "We are not going to sit around and let these bust-up artists take away the company at a bargain-basement price."
>
> Now he and the rest of the Revlon board are backing a buyout proposal from another bidder at a price $9 a share below the $65 Mr. Bergerac had said Revlon

> was worth. And what Mr. Bergerac and the board endorsed looks very much like the bust-up of Revlon that he seemed determined to avoid.

(New York Times, October 5, 1985, Exhibit B). The explanation for this apparent about-face seemed clear: "Bergerac and his group have taken the cream." (Id.).

-- The Exchange Offer Notes Plummet. Not only was public reaction to the benefits to be enjoyed by management harsh, but announcement of the October 3 transaction had a dramatic impact on the market price of the notes issued in Revlon's August 29 Exchange Offer. The board, though, had been forewarned.

On October 3, the board was advised:

> [A]lthough the Board was not taking action at this time, they were indicating acceptance of the Forstmann, Little capital structure and ... Forstmann, Little was being led to believe that the Board would waive the covenants .... Mr. Lipton noted that the waiver of the covenants and the LBO capital structure would adversely affect the market price of the 11.75% Notes, but this had been provided for in the documents which fully disclosed the possibility of waiver.

(October 3 Minutes at 17-18, Exhibit C).

> In response to a question of a director regarding what the waiver of the covenants would do to the security of the 11.75% Notes, Mr. Lipton noted that the 11.75% Notes might not be as secure as they would be now and that there might be some complaint from bondholders.

(October 3 Minutes at 18).

Thus, informed of both the possible adverse effect on the market price of the notes and possible noteholder dissatisfaction, the board nevertheless approved the $56 Forstmann Little transaction.

Mr. Lipton's words were prophetic. 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.

(Affidavit of Simon H. Rifkind, sworn to on October 16, 1985, at ¶ 42). 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, Exhibit D).

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 answering brief, 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, but rather that the disclosures to shareholders who had received the exchange offer may not have been adequate. (See October 12 Minutes at 27, 31, Exhibit E). 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 Little deal, which might result in a waiver of the covenants or otherwise adversely affect the value of the notes. (Id. at 32; 33).

The independent directors became nervous and started to balk. Four of them -- Messrs. Glucksman, Wilson, Loudon and Zilkha -- hired their own counsel. 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 par. (Drapkin Aff. ¶ 5). Revlon's board had put itself intc 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 poison pill covenants, as required by the merger agreement. As of October 12, the dilemma had not been resolved and the covenants had not been waived. (October 12 Minutes at 6).

-- Pantry Pride Tops Forstmann Little's Offer. To further complicate matters for Revlon, on October 9 Pantry Pride amended its offer, raising the price offered to $56.25. Pursuant to Revlon's merger agreement with Forstmann Little, and the board's commitment reported in Revlon's Schedule 14D-9, Amendment No. 4 (Exhibit F), Revlon would have to redeem the Note Purchase Rights in connection with Pantry Pride's $56.25 offer.

-- Forstmann Little Offers A Way Out. On Thursday, October 10, Forstmann Little indicated its desire to make a new offer. (October 12 Minutes at 7). Revlon's representatives outlined the noteholder dilemma. (Id. at

8). Forstmann Little indicated its willingness to address the problem, but demanded a bargain-basement lock-up option on key Revlon businesses before it would present the solution to the board's problem. (Id.). Apparently neither Wachtell nor Lazard batted an eye; perhaps, as Revlon's counsel suggested at the temporary restraining order hearing Tuesday, the fact that "white knight" Forstmann wanted it was enough. (October 15, 1985 Transcript, pp. 11-12, 22). In any case, Wachtell knew Thursday night that a sweetened Forstmann Little bid with a showstopper lock-up was in the wings and, with Revlon's other advisers, commenced steps to ensure it could be brought to center stage.

-- Forstmann's Friday Offer. On Friday, October 11, 1985, Ted Forstmann presented to Revlon representatives what he claimed was a non-negotiable offer. In essence, in exchange for a $1.25 increase in Forstmann's offer price and a way out of the board's dilemma with respect to the noteholders, Forstmann demanded:

- That he be given a "poison pill" option on two key Revlon businesses at a price concededly $75 million to $175 million below fair value,.

- That the previously negotiated $25 million cancellation fee be converted into a $25 million "poison pill," payable to Forstmann.

- That the stock of the businesses subject to the "poison pill" option and funds for the $25 million "poison pill" be deposited into escrow, plainly to prevent any other acquiror from refusing to abide these outrageous provisions.

- A provision prohibiting Revlon from either soliciting or negotiating any other deal.

- The option term is for one year, extending to three years if anyone acquires a 19.9 percent interet in Revlon. Thus, the option would survive the defeat of the Forstmann Little merger proposal. There could be no legitimate reason for providing Forstmann Little with an option that survives the offer it was intended to protect. However, if the option were intended as a takeover device to protect management, even if the merger were voted down, the extended term makes sense, although it would hardly be proper. Judge Rifkind expressed incredulity at the prospect that the option would survive the defeat of the merger and refused to believe the plain words of agreement. (Rifkind Dep. 112-113, Exhibit G).

-- The Friday Stonewalling. Revlon's strategical response to the prospect of the new Forstmann Little offer to halt the action was immediate and consistent: in no event was word of the showstopper arrangements to leak to

Pantry Pride, until all the arrangements were in place. Thus, on Friday alone:

- Scheduled deposition discovery of Mr. Bergerac was unilaterally terminated by the simple expedient of Mr. Wachtell's announcement after less than twenty pages of transcript that Mr. Perelman was not being responsive; hence he was also terminating Mr. Bergerac's deposition. (Perelman Dep. 19, Exhibit H).

- Notwithstanding court orders to produce relevant documents, nothing of substance was produced until approximately 6:00 p.m. Monday -- when Revlon's lawyers thought the coast was clear.

- Revlon postponed a hearing in the federal court on its own frivolous motion for a preliminary injunction against the Pantry Pride tender offer.

- At a scheduling conference before this Court on Friday afternoon, Revlon counsel argued that there was no need to schedule a hearing on the application before the Court, as there was every possibility (he said) that the board would render the application moot. (Transcript 14).

In addition, Revlon and its representatives categorically refused (as they had from the outset) to negotiate in good faith.

-- Revlon's Failure To Negotiate In Good Faith. Since mid-August, Pantry Pride representatives have made continued efforts to negotiate a friendly acquisition with Revlon. Revlon has resisted every effort; remarkably, Revlon concedes in its brief that it affirmatively "decided not to attempt any negotiations with" Pantry Pride. (Revlon Ans. Br. at 75).

After Pantry Pride amended its tender offer, Revlon's determination to prevent any negotiated acquisition intensified. (See generally Perelman Aff.; Drapkin Aff.; Gittis Aff.).

Specifically, defendants tried to defraud Pantry Pride into selling Vision Care and National Health Laboratories -- sight unseen -- at a ridiculously low price. (Perelman Aff. ¶¶ 13-14). They categorically refused to negotiate with Pantry Pride, despite Pantry Pride's specific representation that due to its tax situation, it stands ready to top any bid by Forstmann Little. (Id., ¶ 15). They refused to provide the Pantry Pride representatives with the business information concerning Revlon which Forstmann Little considered so valuable in formulating its bid and refused, in the critical day before the October 12 meeting, to deal with Pantry Pride's representatives, notwithstanding that they consistently sought to be given an opportunity to bid on an equal footing with Forstmann Little. (E.g., Drapkin Aff., ¶¶ 4-10).

-- The Lazard Letter And Pantry Pride's Open Response. In addition to transmitting its amended offer, Pantry Pride's Mr. Perelman had a letter delivered to Revlon describing Pantry Pride's willingness to respond to any questions the board might have concerning the Pantry Pride offer. That evening, Lazard Freres delivered a letter request to Pantry Pride communicating questions regarding Pantry Pride's financing, intentions respecting the notes and preferred stock, and how Pantry Pride would fund its debt.

No such letter was sent to Forstmann Little when its offers were received; instead, Forstmann Little was invited to make a presentation to the Revlon board. Pantry Pride has not been privy, as Forstmann Little was, to financial information and projections of Revlon and its businesses. Pantry Pride was not told of Forstmann's answers to the questions posed in the Lazard letter (if indeed they were ever posed to Forstmann Little) nor what assurances the Revlon board was seeking. In short, the Lazard letter was designed to disadvantage Pantry Pride in the bidding process by seeking to have it disclose information not reciprocally disclosed to it by the other bidder, Forstmann Little.

Nevertheless, Howard Gittis, vice chairman of Pantry Pride, Inc., responded by letter on October 11, 1985 to all of the questioned posed by Lazard. (Opening Brief Appendix, Exhibit S). Moreover, Revlon's counsel Mr. Lipton was given specific assurances by Pantry Pride representatives that Pantry Pride would be willing to negotiate on each of the points he had raised, and that Pantry Pride would respond to the concerns of Revlon's board and attempt to structure a deal to meet those concerns. (Drapkin Aff., ¶¶ 5-7).

The Board's Adoption Of The Amended Merger Agreement Has Ended The Bidding For Revlon

In approving the revised Forstmann Little offer on October 12, including the lock-up option, the Revlon board intentionally put an end to the bidding for Revlon. That was in stark contrast to its stated desires just nine days earlier. According to the minutes of the meeting of October 3, in approving the Forstmann Little $56 transaction, the Revlon board was particularly concerned to avoid granting a lock-up. It wished to keep the bidding open. Revlon's chairman, banker and lawyers all emphasized this aspect of the original Forstmann Little proposal:

> [The Chairman noted that] the proposed transaction did not have any lock-up and did not prevent the Board from considering an alternative more favorable offer for the Company.

(October 3 Minutes at 3).

> Mr. Rohatyn noted that the Forstmann Little deal was not "locked-up" and that the risk of that deal was greatly enhanced by the Adler & Shaykin transaction. He noted that there was a likelihood that pharmaceutical or other companies would come in at a price greater than the $56 a share price now that there was a firm contract to sell the beauty group. Mr. Lipton noted that the deal would have been changed and that Forstmann Little could have been given a lock-up. This had not been done. The reason this had not been done was so that the deal would be open to other bids.

(October 3 Minutes at 32-33).

Nine days later the board did an about-face and granted a lock-up. Their restraint at the October 3 meeting, contrary to the self-laudatory report in the minutes, had been dictated not by a concern to keep the bidding open but by that fact that even the defendants knew that a "lock-up" of a management deal <u>by</u> management would not pass muster in any court in the land. On October 12 that obstacle was gone.

On that day the board was explicitly advised, and understood, that in giving the lock-up option it was selling the company to Forstmann Little:

> Mr. Brownstein emphasized that the option agreement that he would next describe to the Board <u>would likely be a deterrent</u> to any such offer [other possible offers, such as a $60 offer].

(October 12 Minutes at 17).

> 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 at 25).

The Board Locked Up A Lower Deal

The deal the Revlon directors locked up is, as Revlon's own investment banker advised the directors, worth less than Pantry Pride's $56.25 cash tender offer. Mr. Loomis of Lazard told the board, on October 12,

> that Mr. Perelman's offer was for cash now at $56.25 and that Forstmann Little's would be cash in 35 days at the least. If these two offers were compared in present value terms in 40 to 60 days or more, $57.25 could be slightly less than $56.25, assuming a 12% discount rate. Each month was approximately $0.57 to $0.58 per share. He noted that it was the intention of Forstmann Little to attempt to close the merger in 35 days, but that it was impossible to know how long the review process at the SEC would take.

(October 12 Minutes at 21-22). Revlon's Schedule 14D-9, as amended on October 15, also states that the board "recognized that the present value of the consideration per Share payable pursuant to the Amended [Forstmann Little] Proposal, depending on the assumed discount rate and on the timetable for the transaction, could be somewhat less than the Revised [Pantry Pride] Offer price." (Revlon's Schedule 14D-9, Amendment No. 7, Exhibit I, dated October 15, 1985 at 9-10).

The Optioned Assets Were Locked
Up At A Grossly Inadequate Price

The option given to Forstmann Little will deter bidding for Revlon because it makes it impossible for any other potential acquiror to compete with Forstmann Little on an economically rational basis. This results from the fact that the exercise price for the lock-up option -- $525 million -- is grossly inadequate. Again, Revlon's own investment banker, Lazard, advised the board, on October 12,

> that, regarding the proposed lock-up, $525 million was, in Lazard's view, a favorable price from the perspective of Forstmann Little. He noted that the estimate of Lazard Freres was that they could achieve a price as high as $600 to $700 million from the sale of the two divisions together.

(October 12 Minutes at 22). Thus, based on Lazard's own estimates, the value of Revlon will be diminished by $75 to $175 million (or approximately $2.70 to $6.30 per share) if the option is exercised. In the face of this potential waste of assets, no party can compete realistically with Forstmann Little for control of Revlon.

The "Financing" Factor Is A Red Herring

In locking up the Forstmann Little deal the board justified its action, in part, on the basis that "Pantry Pride still did not have commitments for all of its financing," whereas "Forstmann Little had obtained commitments for all its financing." (Revlon's Schedule 14D-9, as amended on October 15, 1985, at 10). This justification is no justification at all. In the October 12, 1985 amendment to the agreement of merger Forstmann Little covenanted only:

> that they will use their best efforts in connection with the Financing to have sufficient funds to consummate the transaction contemplated hereby at the Price [$57.25 per share] and FL & C. Companies represent that they are highly confident that they can obtain such funds.

(Amendment to Agreement of Merger ¶ 2, Exhibit J).

The Commitment Agreement, dated October 2, among Forstmann Little, Manufacturers Hanover Trust Company and Bankers Trust Company shows that the banks each committed to provide only $400 million of the total $1.2 billion required by Forstmann Little:

> The Credit Facilities will consist of secured term loans of up to $1,200,000,000, of which BTCo and MHTC will each provide up to $400,000,000. BTCo and MHTC will together use their best efforts to arrange a syndicate of commercial banks to provide the balance of $400,000,000.

(Commitment Agreement, Exhibit K).

Moreover, on October 11, Pantry Pride informed Revlon's banker that it:

> has ~~received commitments for the purchase~~ of $350 million of Pantry Pride Notes and has been informed by Drexel Burnham Lambert Incorporated that based upon current conditions Drexel Burnham is highly confident that it can obtain commitments for the purchase of an additional $350 million of Pantry Pride Notes.

(Opening Brief Appendix, Exhibit S). And now Pantry Pride is fully financed. (Abecassis Aff., ¶ 6; Perelman Aff., ¶ 16).

If there were any question as to the self-serving nature of the "financing" factor, again the answer rests in Revlon's own board minutes:

> Responding to a question as to whether MacAndrews & Forbes was prepared to supply additional funding, Mr. Lipton reiterated that the advice given to the Board assumed throughout that required funding could be made available, through Drexel Burnham or other sources.

(Minutes of Regular Meeting of Board of Directors of Revlon, September 24, 1985 ("September 24 Minutes") at 10, Exhibit L). The board was advised that only the poison pill stood in the way of Pantry Pride's completion of its financing:

> [Mr. Liman] observed also that the Note Purchase Rights had already accomplished a tactical purpose, because Pantry Pride's uncertainty that it ultimately could

> invalidate them had deterred Pantry Pride from paying the commitment fees that would have permitted Drexel Burnham to obtain firm financing for the takeover attempt.

(September 24 Minutes at 8). Judge Rifkind confirmed that from the onset he certainly knew that Pantry Pride would secure its financing. (Rifkind Dep. 30).

The Directors Acted Out Of Self-Interest In Locking Up The Inferior Forstmann Little Deal

The rationale relied upon by the defendants in approving the inferior Forstmann Little deal, and the lock-up, was that Forstmann Little 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 at 26). This makes no sense. Forstmann Little could not walk away. It was contractually bound, by the terms of the October 3 Agreement of Merger, to pursue the $56 merger agreement.

Revlon's repeated assertion in its brief that Pantry Pride had lowered its offer before, following the exchange offer, and that it therefore might do so again, in the absence of Forstmann Little as a competing bidder, is completely disingenuous. As Lazard advised the Revlon board:

> 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 at 5).

The real explanation for the board's approval of the lock-up appears elsewhere in the minutes: the directors locked up the inferior Forstmann Little deal because that deal, by means of the proposed note exchange offer, may enable the directors to avoid huge personal liability to owners of Revlon's $475 million issue of 11.75% notes, which had been exchanged with common shareholders pursuant to the August 29 exchange offer.

At the October 12 board meeting, noteholders' ability to make claims against the board was a central topic of discussion. Counsel for Revlon reported that new counsel for Messrs. Glucksman, Wilson, Loudon and Zilkha

> had previously requested a chronology from Mr. Lipton of events leading up to the Forstmann Little transaction. Mr. Lipton stated that there had been much publicity surrounding the notes, and that the Wall Street reaction had been extreme to the announcement of the LBO which negatively affected the market price of the 11.75% Notes. He said that a question had been raised regarding legality and full disclosure of the intention to waive the covenants in the Notes.

(October 12 Minutes at 27).

Mr. Lipton re-emphasized the directors' problem a few pages later:

> ~~[Mr. Lipton] stated that the directors had~~ the dilemma of not accepting the deal and not getting the $57.25 for shareholders and protections for the noteholders. He emphasized that the difference between the market value and par of the notes was approximately $50 million and that if the directors did not pursue the proposed transactions, there was the equal possibility of lawsuits if security-holders were to receive less per share or less per note.

(October 12 Minutes at 32).

The directors resolved their "dilemma" at the expense of Revlon shareholders by approving the revised Forstmann Little deal on terms that make certain that the notes will trade more or less at par -- *i.e.*, on terms that will eradicate the directors' potential $50 million plus personal liability to the noteholders -- but that locked Revlon shareholders into an inferior offer for their shares.

October 14: Revlon Transfers Assets Into Escrow

On Sunday, October 13, Revlon issued a press release announcing the new Forstmann Little deal. The next morning MacAndrews served on Revlon a document request asking for documents relating to the new Forstmann Little deal. At approximately 6:00 that evening Revlon produced to MacAndrews the amended merger agreement and option agreement which disclosed, for the first time, that the $25 million bust-up fee and the shares of stock of the optioned assets -- Revlon's Vision Care Group and National Health Laboratories -- were to be placed in escrow by no later than 10:30 a.m. on October 15.

At 9:00 a.m. on October 15, one-half hour before the time set by the Court for a hearing on MacAndrews' motion for a temporary restraining order to prevent the transfer of the $25 million and optioned assets into escrow, Revlon informed MacAndrews that the transfers had already taken place on the preceding day. To prevent further actions by the parties to transfer Revlon's assets, the court entered a temporary restraining order.

Having effected the transfer, however, Revlon did not care about the temporary restraining order. As The Wall Street Journal reported on October 16, "A Revlon spokesman said, 'The judge's decision was expected. We will wait and see what he does on Friday.'" (Exhibit M).

A R G U M E N T

I. THE REVLON DIRECTORS HAVE BREACHED THEIR DUTY OF ~~LOYALTY AND WERE GROSSLY~~ NEGLIGENT IN REFUSING TO PULL THE PILL FOR PANTRY PRIDE AND IN GRANTING THE LOCK-UP.

In plaintiff's opening brief in Arguments I(B) and (C) and II, it is argued that the directors' refusal to redeem the Rights and their grant of an asset lock-up to the low bidder at a price $100,000,000 to $175,000,000 under the value of the asset is a breach of their duty of loyalty to act in the best interests of the shareholders and a breach of their duty of care. Rather than using the Rights to "protect" shareholders and negotiate the best deal for them and rather than using the lock-up to firm up the best deal, these weapons were used to lock out Pantry Pride and close down the bidding in favor of the lower offer which benefited management by its promise to honor their golden parachutes. And to the extent that there is any question concerning which is the superior offer for the shareholders (rather than for the directors and noteholders), then the directors had a duty not to close down the market but to let the shareholders decide.

Defendants have several responses: (A) the responsibilities of a target company's directors do not evaporate in a takeover situation so as to relegate them to the sidelines; (B) the business judgment rule applies to the final lock-up with Forstmann Little since there is no self dealing; (C) the lock-up was essential to get the Forstmann Little deal and was reasonable to secure the "better" offer; and (D) the directors had no duty to negotiate with Pantry Pride, in any event. We address these four responses.

A. Non-Evaporation Of Directors' Duties In A Takeover

The argument that directors are not required in a takeover contest to sit by the sidelines is a vacuous "response" to an argument never made by plaintiff. In fact, the plaintiff's opening brief is replete with numerous references to the directors' duty of loyalty -- to "act" not "sit" -- in the best interests of shareholders. Moreover, in this case, the directors took on the role of the "plenary" negotiating agent for the shareholders when it dropped the poison pill in place which was supposed to "protect the shareholders against a low priced transaction for any and all shares." (August 19 Minutes, Exhibit G at 21). Here, rather than negotiate for the shareholders from a neutral position, there was a complete refusal to negotiate from any position. The pill was used affirmatively to exclude Pantry Pride and close down the bidding in favor of the management benefited proposal. The directors' simplistic response that their actions did not close down the bidding because Pantry Pride is still here, merely ignores the fact that the $56.25 offer of Pantry Pride is conditioned upon the pill Rights being redeemed or voided and the covenants waived -- all of which was necessary for the Forstmann Little offer and done for them, but not for Pantry Pride. That is why we are here. Therefore, this argument by the directors, under the facts here, is more a refrain of hopes not fulfilled than hopes not held.

Likewise, no one suggests that a lock-up to set a fair price cannot be "reasonable" under some circumstances to secure the highest offer. But the application of the reasonableness standard assumes that the directors have already done what is required of them to have all viable choices before them. It must be used evenhandedly to secure that best offer, not to lock in an inferior offer and lock out Pantry Pride which had been kept totally in the dark as to what offer it was supposed to match or even what the directors wanted. This is so especially because Pantry Pride had clearly stated that it would better any price offered by Forstmann Little. This is not a case of a bidder who was outbid: it is a case of a bidder who was never permitted to bid. Defendants' voluminous briefs and affidavits cannot paper over the critical fact that the Revlon directors had in hand on Friday, October 11, 1985 the revised Forstmann Little proposal to improve the price to $57.25 and to improve the noteholders' position with no obligation <u>not</u> to "shop" the proposal, but they never asked Pantry Pride to better it, never told Pantry Pride what the offer was and, indeed, never even told Pantry Pride what the directors wanted. Some negotiating!

The "canned" affidavits of various investment bankers submitted by Forstmann Little as to the value of asset options in negotiating transactions are beside the point. We do not dispute the proposition that, in the abstrct, asset options may be desirable to the negotiating process. However, what those affidavits fail totally to address -- and what is unprecedented in this case -- is that the asset (i) is locked up at a price which the target's own investment advisor believes to be some $75,000,000 to $175,000,000 below its value, (ii) was granted for the express purpose not only of deterring other bids, but in fact to end the bidding process, and (iii) was granted to end that process by locking up an offer which the target's own investment advisors acknowledged provided at best no more than equivalent value to shareholders than the competing offer. It is these particular circumstances which we believe are material to the Court's decision on the Revlon-Forstmann Little lock-up and upon which we believe any ruling should rest. The spectre of a court ruling with wide-ranging ramifications on defensive board actions, such as asset options, is neither sought by Pantry Pride nor required in this case. Defendants' contrary argument is disingenuous.

B. The Professed Lack Of Self-Interest

Defendants' entire brief rests upon the foundation that there was not even any arguable self interest involved in the directors' decision to lock up the Forstmann Little proposal. Self interest destroys the presumption of the business judgment rule and casts the burden on the directors to demonstrate the "entire fairness" of the transaction. Sinclair Oil Corp. v. Levien, Del. Supr., 280 A.2d 717, 720 (1975); see Aronson v. Lewis, Del. Supr., 473 A.2d 805, 812 (1984). The defendants do not separately address the point of the directors' "independence" other than to spot at various times in their brief the statement that there were no conflicts.

In plaintiff's opening brief (pp. 49-51), it is argued that there is a "strong element of self dealing and overreaching." At the time, even plaintiff did not know how right it was. The directors knew at the time that they waived the covenants for Forstmann Little on October 3 that there would be a precipitous drop in the market price of the exchange notes. But the directors had not counted on the outrage from Wall Street about the negative effect of their action on the market price of the notes. Judge Rifkind testified that he received calls at his office from large institutional lenders who were not stockholders of Revlon complaining about the directors' action. The directors were even threatened with lawsuits for $50 million because of this action, and Judge Rifkind stated that some directors were concerned about their liability. (Rifkind Dep. 91-99, 103 and 104). The minutes of the October 12, 1985 board meeting drafted by Revlon's own professional takeover specialists, put it (mildly) this way:

> Mr. Lipton stated that there had been much publicity surrounding the notes, and that Wall Street reaction had been extreme to the announcement of the LBO which negatively affected the market price of the 11.75% Notes. He said that the question had been raised regarding legality and full disclosure of the intention to waive the covenants in the Notes.

(October 12 Minutes at 27).

Accordingly, the directors took the Forstmann Little revised offer and locked it in, not out of any discharge of their fiduciary obligation to the shareholders, but because Forstmann Little offered a deal which benefited management and which paid off the directors' liability to the noteholders. They locked up a way out of their legal problems, ironically created by their own "poisoned" entanglements. Thus, the decision to grant the lock-up is, by their own admission, so riddled with self interest that it cannot be judged by any standard that presumes their good faith and disinterested judgment.

C. Defendants' Contention That The Lock-Up Was Essential To Get The Forstmann Little Deal And To Secure The "Better" Offer

Defendants argue first that the lock-up was "reasonable" because it was "absolutely essential" to obtaining the Forstmann Little $57.25 merger proposal, with its additional, substantial benefits. (Def. Br. 67-72). Although the lock-up is undoubtedly "essential" in the sense that it was demanded by Forstmann Little, it was not "essential" to obtaining the best deal for the stockholders. The simple answer is that they could have asked Pantry Pride. It was common knowledge that Pantry Pride would better any price offered by Forstmann Little. And if Pantry Pride had known that the directors, in addition to benefiting the shareholders, wanted their own liability paid off to the noteholders and that Forstmann Little was willing to do that, Pantry Pride would have done so also -- as evidenced by their affidavit in this Court. Rather than receive the response that they did not want to hear, Lazard Freres nicely "set up" Pantry Pride to use, out of context, Pantry Pride's response to a letter of October 9. That letter inquired, with respect to a condition in Pantry Pride's current offer regarding the waiver of the covenants, what Pantry Pride's "intentions" were with respect to the noteholders and preferred stockholders. Pantry Pride responded in the context of its then-outstanding offer that it, of course, would pay the obligations when due. Lazard used this letter as an excuse not to contact Pantry Pride further and, then, represented to the board that that was the best that Pantry Pride would do for the noteholders. Actually, Pantry Pride's response was to a question concerning its own offer, not to any request that it match or exceed what Forstmann Little would do to pay off the directors' liability to the noteholders.

So the lock-up was not "essential" to lock in the best offer. And the simple answer to the argument that if they did not take the revised Forstmann Little offer, Forstmann Little would walk away is that Forstmann Little could not walk away because they signed a merger agreement at $56. The "essential" argument is eyewash.

The cases that Revlon cites in defense of its Forstmann Little lock-up are all inapposite here: none of those transactions involved, as does Revlon's, a lock-up at a demonstrably inadequate price, coupled with an intent to block an ongoing higher offer -- and to prevent that offer from being raised further.

Thus, in Thompson v. Enstar Corp., Del. Ch., C.A. No. 7641 (June 20, 1984, revised August 16, 1984), the lock-up was granted only after the board's extensive search for potential acquirors yielded "only one firm offer" -- that of the party to whom the board granted the lock-up. Slip op. at 7. That offer was also one which the target company's directors could reasonably conclude "was the best which could be obtained under the circumstances." Slip op. at 13 (a competing offer was not made until three weeks after the lock-up had been granted). Here, in contrast, at the time of the lock-up, the Revlon board already had before it Pantry Pride's publicly announced ongoing $56.25 cash tender offer, not just Forstmann Little's $57.25 draft merger proposal. Revlon's investment banker had advised the Revlon board that the present value of the Pantry Pride offer was higher than that of the Forstmann Little proposal. The Revlon board also had no reason to believe that the Forstmann Little proposal was the "best that could be obtained," because it did not ask Pantry Pride if it could increase the $56.25 offer. Accordingly, Thompson v. Enstar cannot be used to support locking out Pantry Pride from the bidding process.

Revlon also can draw no support for its position from the decision in GM Sub Corp. v. Liggett Group, Inc., Del. Ch., C.A. No. 6155 (April 25, 1980). There, target company Liggett had its investment banker appraise a key subsidiary, and then obtain bids for the sale of that subsidiary. Liggett sold the subsidiary to the highest of nine bidders, at a price "very favorable to Liggett," and one not shown to be in any way inadequate. Slip op. at 4. Here, although Revlon's investment banker also valued the assets subject to the lock-up, the facts otherwise turn the GM Sub case on its head. Revlon's banker's valuation was at $600 to $700 million, while the assets were put in the lock-up at only $525 million; that price was conceded to be favorable not to the target, but to the buyer, who was also the only bidder asked. Thus, the high-priced open auction in GM Sub cannot serve as precedent for Revlon's bargain basement giveaway here.

Similarly, in Whittaker Corp. v. Edgar, 535 F. Supp. 933 (N.D. Ill.), aff'd, Dkt. Nos. 82-1305, 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. Thus, <u>Whittaker</u> bears no resemblance to this case, where the target's investment banker, Lazard Freres, had valued the asset <u>above</u> the lock-up price. In <u>Mobil Corp. v. Marathon Oil Co.</u> [1981-82] Fed. Sec. L. Rep. (CCH) ¶ 98,175 (S.D. Ohio), <u>rev'd on other grounds</u>, 669 F.2d 366 (6th Cir. 1981), an option to purchase the target's major asset, an oil field, was given to a competing tender offeror to facilitate a substantially high 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. <u>Id</u>. at 92,274. The target company also gave a stock option at above the market price. Thus, in neither <u>Whittaker</u> nor <u>Mobil</u> did the target company enter into a transaction at a price substantially <u>below</u> the valuation of the target's investment banker, aimed at thwarting the high bidder, as Revlon has done here.

The three decisions Revlon cites that involved sales of stock or stock options also do no support its case. In <u>Buffalo Forge Co. v. Ogden Corp.</u>, 555 F. Supp. 892 (W.D.N.Y.), <u>aff'd</u>, 717 F.2d 757 (2d Cir.), <u>cert</u>. <u>denied</u>, 464 U.S. 1018 (1983), the target company issued an option to a tender offeror to acquire a block of treasury stock at its tender offer price of $32.75 per share, well above the $25 per share price of the rival tender offer. The rival offeror increased its low offer price only <u>after</u> the option had been issued and exercised.*

Notably, Revlon omits from its brief omits the fact that both the district court and the Second Circuit expressly relied on the fact that the negotiations were at arm's length <u>and</u> that the price received from the treasury stock "exceeded the cost of the stock, its book value and its normal trading price." <u>Buffalo Forge</u>, 717 F.2d at 757, 759 (2d Cir. 1983). Here, Revlon entered into its heavily discounted lock-up, even while a higher competing offer was in progress.

In <u>Crouse-Hinds Co. v. InterNorth, Inc.</u>, 634 F.2d 690 (3d Cir. 1980), the target company's exchange offer, intended to facilitate a merger and to stop a rival tender offer, would involve the issuance of target company shares at the full merger price, the adequacy of which was not at issue. Moreover, the vote of target company shareholders would be required to effectuate the exchange offer. <u>Id</u>. at 696, n. 9. In <u>Treadway Cos. v. Care Corp.</u>, 638 F.2d 357 (2d Cir. 1980), the target company sold a block of its shares, at market price, to facilitate a merger, at a time when the board had no competing offer before it. Neither case

* Similarly, <u>In re Castle & Cooke Derivative Shareholder Litigation</u>, No. C-85-0063 (N.D. Cal. June 28, 1985), involved an asset sale option at a concededly fair price, and with no other offer pending).

involved the board's taking steps to thwart an ongoing higher offer.

In sum, the rationale of Revlon's precedent would favor the invalidation of Revlon's low-price, bid-freezing lock-up. Indeed, where Delaware courts have found lock-up transactions to be inadequately priced or improperly motivated, they have not hesitated to invalidate them. Thus, in Gimbel v. Signal Companies, Del. Ch., 316 A.2d 599, aff'd, Del. Supr., 316 A.2d 619 (1974), the court enjoined the hasty sale of a subsidiary at an apparently inadequate price.

Thus, not one of the cases cited by the defendants in which a lock-up arrangement was approved involved a situation where a "white knight" or third party was granted a lock-up on an asset for a price less than fair value and no such case exists. Revlon's lock-up agreement to sell significant assets to Forstmann Little for a grossly inadequate price is thus without precedent. The approval of such a lock-up arrangement was not a reasonable action by management and should be enjoined. Thompson v. Enstar, supra at 12.

D. <u>The Contention That Revlon's Directors Had No Duty To Negotiate With Pantry Pride</u>

Revlon steadfastly has refused to negotiate with Pantry Pride. Indeed, even during the period between receipt and approval of Forstmann Little's amended merger proposal, Revlon would not engage in meaningful discussions despite its knowledge that Pantry Pride would offer a superior price. Revlon's contention that it had no duty to negotiate with Pantry Pride to obtain the best offer for Revlon stockholders has no legal support. To the contrary, the law requires directors to pursue such negotiation.

Revlon's argument is based on the obvious -- but wholly irrelevant -- point that once there exists a valid merger agreement with a "no shopping" clause, the board has no further duty or right to pursue other offers. Thus, Revlon misplaces reliance on <u>Jewel Cos. v. Pay Less Drug Stores Northwest Co.</u>, 741 F.2d 155 (9th Cir. 1984); <u>Belden Corp. v. InterNorth, Inc.</u>, 413 N.E.2d 98 (Ill. App. Ct. 1980); and <u>Mobil v. Marathon</u>, <u>supra</u>, which concerned "no shopping" clauses or similar provisions.

Here, by contrast, the issue is Revlon's duty to obtain the best offer <u>before</u> entering into a binding merger agreement. That duty is governed by the Delaware Supreme Court's landmark decision in <u>Smith v. Van Gorkom</u>, <u>supra</u>, which held that directors were liable for failing to solicit higher bids prior to entering into merger agreements with "no shopping" clauses. The decision in Van Gorkom is but the latest development in a long line of Delaware cases requiring boards to accept the highest offer,* for a duty to accept the highest offer necessarily implies a duty to seek the highest offer.

The existence of the poison pill rights and debt covenants, which "create the potential for misuse of directorial authority," imposes upon Revlon's board an even greater obligation to negotiate for the highest offer. Moran v. Household International, Inc., Del. Ch., 490 A.2d 1059, 1083 (1985). Because Revlon's board, rather than market forces, has become the arbiter of this control contest, Revlon shareholders must depend entirely on the board's faithful execution of its fiduciary responsibilities. The board's complete refusal to negotiate, particularly when the board knew that Pantry Pride stood ready to "top" any offer if given the opportunity to do so, was a breach of those responsibilities.

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* See Thomas v. Kempner, Del. Ch., C.A. No. 4138, Marvel, C. (March 22, 1983); Lockwood v. OFB Corp., Del. Ch., 305 A.2d 636 (1973); 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); Robinson v. Pittsburgh Oil Refining Corp., Del. Ch., 126 A. 46 (1924).

* * *

Accordingly, the lock-up must be enjoined and the Rights must be redeemed.

II. THE DIRECTORS' ACTION HAVE PREVENTED FAIR BIDDING AND ARE IMPERMISSIBLE UNDER THE SCHNELL CASE.

In plaintiff's opening brief (pp. 35-40), it is argued that the directors' refusal to redeem the Rights for any cash buyout other than for the one sponsored by them is a clear manipulation of the corporate machinery which prevents fair bidding and is impermissible under Schnell v. Chris-Craft Industries, Inc., Del. Ch., 285 A.2d 430 (1971) and Lerman v. Diagnostic Data, Inc., Del. Ch., 421 A.2d 906 (1980) regardless of the directors' motives. Defendants have responded with two arguments -- one factual and one legal -- neither of which has merit.

First, defendants argue factually that there is no inequality because the directors have agreed to pull the pill for any offer of $57.25 or higher. But this so-called "equality" is illusory. The defendant directors own investment bankers conceded at the October 12 meeting the following:

> [Lazard Freres] noted that Mr. Perelman's offer was for cash now at $56.25 and that Forstmann Little's would be cash in 35 days at the least. If these two offers were compared in present value terms and if it were assumed the merger would take place in 40 to 60 days or more, $57.25 could be slightly less than $56.25 ...

(October 12 Minutes at 21). Thus, in present dollars, the Pantry Pride offer at $56.25 is still higher than the Forstmann Little $57.25 but the directors still refuse to redeem the Rights for Pantry Pride.

Defendants' second argument is legal. They attempt to distinguish Lerman by saying that management's purpose was "obviously" to avoid a proxy contest, and that improper purpose is necessary under Schnell and Lerman. The answer is that the Court expressly held that motive is irrelevant and did not find the improper purpose which is "obvious" to defendants. Moreover, this Court does not read Lerman the way defendants do. In Mesa Petroleum Co. v. Unocal Corp., Del. Ch., C.A. No. 7987, Berger, V.C. (April 22, 1985) (attached as Exhibit A), this Court said:

> The Schnell holding was based upon a finding of improper purpose. In Lerman, however, certain bylaw amendments were struck down without regard to defendants' motives because of the inequitable effect of those amendments. The Lerman defendants adopted a bylaw requiring shareholders to submit their nominations for the board of directors at least seventy days in advance of the annual meeting. The annual meeting date, which was to be set by the board, was fixed sixty-three days after its announcement, thus making it impossible for a shareholder to comply with the seventy day notice requirement. The Court invalidated defendants' actions based upon a finding that their "conduct was both inequitable (in the sense of being unnecessary under the circumstances)

> and had the accompanying dual <u>effect</u> of thwarting shareholder opposition and perpetuating management in office."

Slip op. at 11-12 (emphasis added).

Thus, neither of defendants' responses have any merit, and the directors' continued refusal to redeem the Rights is still freezing out Pantry Pride's offer.

III. THE COMBINED SALE OF BEAUTY PRODUCTS, VISION CARE AND NATIONAL HEALTH LABORATORIES CANNOT BE CONSUMMATED WITHOUT STOCKHOLDER APPROVAL UNDER 8 DEL. C. § 271.

The three businesses being sold by Revlon (two of which admittedly are being given away for $100,000,000 to $175,000,000 under their value) represent (i) the sale of the name "Revlon" and the company's current flagship business, (ii) 65 percent of Revlon's total North American sales, (iii) over 70 percent of Revlon's total North American operating income, (iv) more than 61 percent of Revlon's total revenues, (v) 56 percent of Revlon's total operating profit, and (vi) 59 percent of Revlon's total divisional operating assets. Despite those facts (about which there is no disagreement), defendants argue that these sales do not require shareholder approval. Defendants claim that the three sales are "separate" transactions which cannot be aggregrated, and that even when aggregrated do not constitute a sale of substantially all of the assets of Revlon. Defendants' argument has no support in the case law and ignores realities. Taken together (as they must be) Beauty Products, Vision Care and National Health Laboratories represent the very essence of the company that was the name "Revlon," and are indeed a transfer of "all or substantially all" of the assets of Revlon. As such, stockholder approval under 8 Del. C. § 271 is required. Katz v. Bregman, Del. Ch., 431 A.2d 1274 (1981), interlocutory appeal refused.

A. The Three Proposed Sales Can And Should Be Aggregated

Defendants argue that because the sale of the Beauty Care Group was approved on October 3, and the lock-up of the other two assets did not take place until October 12, these sales are "separate" and therefore do not require shareholder approval. Under this theory, § 271 could be easily circumvented by the mere device of selling or deciding to sell all a corporation's assets on different days of the week. And defendants cite no cases to support their theory, other than to set forth what is a convenient misinterpretation of Bacine v. Scharffenberger, Del. Ch., C.A. Nos. 7862, 7866, Brown, C. (December 11, 1984). Defendants claim that plaintiffs in that case attempted to aggregate a sale of three subsidiaries with a subsequent liquidation of the selling company, for purposes of § 271. In reality, the Bacine plaintiffs merely argued that, because the asset sale was followed by a liquidation, it must have been a sale of "substantially all" the assets of the corporation. Contrary to defendants' reading, no "aggregation" argument was made at all in the <u>Bacine</u> case, and it provides no support for defendants here.

In fact, <u>Bacine</u> supports the proposition that Revlon's sales in the present case should be aggregated, because it holds that equity will look to the substance of a transaction and not to its form where considering a sale of assets governed by § 271. In <u>Bacine</u>, the sale of the three subsidiaries was to be handled through the mechanism of a merger, rather than a sale of assets. Therefore, defendants argued that shareholder approval was not required. However, the court found "considerable logic" in plaintiff's argument that the court should look to the substance of the transaction, rather than its form, but found in its § 271 analysis that the transaction did not, in fact, constitute a sale of "substantially all" of the assets.*

No other cases are cited by defendants for the proposition that the asset sales in this case must be considered as "separate" transactions. And they should not be considered as separate sales, for several reasons. First, there are common parties in both transactions. Forstmann Little is a party to both -- the Beauty Products sale is a condition to its merger agreement, and it is the

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* The decision was based on the fact that for the past three years the three subsidiaries <u>together</u> had only provided 29 percent of consolidated revenues, 35 percent of operating income and 13 percent of asset base.

buyer of the other two businesses -- while Revlon is the seller. The two transactions occurred within nine days of each other, and they provide Forstmann Little with funds needed for the leveraged buyout. Finally, the sales are unified because they are part and parcel of a single, overall transaction -- Revlon's single-minded attempt to defeat Pantry Pride's acquisition offer. The sales merely represents a different stages of one unified transaction.* To argue that they should be considered as separate transactions is ludicrous, and would defeat the purpose of § 271, which is to permit shareholders to vote on sales of all or substantially all of a corporation's assets, whether those sales be on one day, or nine days apart.

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* The intervenor alone attempts to distinguish In re Associated Gas & Electric Co., 149 F.2d 996 (2d Cir. 1945), cited in our opening brief for the proposition that separate transactions may be consolidted for purposes of analyzing whether a transfer constitutes "all or substantially all of the assets" of a company. It dismisses Associated Gas as "a 1945 bankruptcy case" that "has no precedential value in interpreting Delaware law." (Intervenor's Br. 9). Intervenor ignores the fact that the Second Circuit in Associated Gas was considering whether a restrictive covenant in a debenture prohibiting the transfer of "substantially all the assets of [the debtor corporation] as an entirey" had been violated by a sequence of asset transfers. Id. at 1003, 1004. The language of the restrictive covenant is functionally identical to that of § 271; the purposes of the covenant and the statute are similar as well. Under those circumstances, and in the absence of other authority, to ignore the analysis in Associated Gas would be foolish.

B. The Sale Is Of All Or Substantially All The Assets, Both Quantitatively And Qualitatively

At pages 61-62 of plaintiff's opening brief, and in the Affidavit of Ronald N. Goldstein (Exhibit U, Plaintiff's Appendix), Pantry Pride describes, in quantitative terms, the effect of the sale of the three Revlon divisions. Additional financial information is found in the Affidavit of William R. Loomis, Jr. filed on behalf of Revlon. Both Loomis and Goldstein are in substantial agreement with regard to the percentage of sales and operating profit attributable to the three divisions, which range, in Loomis' opinion, between 65.8 percent of sales in 1980 to 61 percent of sales in 1984, and from 67.2 percent of operating profits in 1980 to 56.8 percent in 1984. However, ignoring the sales and operating profit data, defendants choose to look only at the percentage of total assets because that is their best number. (See Revlon Ans. Br. 94). That percentage ranges, according to defendants' expert, between 48 and 45 percent. Defendants contend that the fact that the divisions being sold comprise 59 percent of Revlon's total operating assets is irrelevant.

Defendants' insistence on looking only to total assets is incorrect. The Delaware courts in examining financial data to determine whether a sale comprises all or substantially all of corporate assets look to many factors, including net revenues, operating profits and pre-tax net operating income, as well as total assets. See Gimbel v. Signal Companies, Inc., Del. Ch., 316 A.2d 599, aff'd, Del. Supr., 316 A.2d 619 (1974); Katz v. Bregman, Del. Ch., 431 A.2d 1274 (1981); Bacine, supra. The "test does not lend itself to a strict mathematical standard to be applied in every case" and "[i]f the sale is of assets quantitatively vital to the operation of the corporation and is out of the ordinary and substantially affects the existence and purpose of the corporation, then it is beyond the power of the Board of Directors." Gimbel, supra, 605-606. Defendants' attempt to preclude this court from considering the percentage of divisional assets (operating business assets) which these three divisions occupy makes no sense. Considering all the relevant financial data, including that proposed by defendants, the three divisions in 1984 constituted at least 61 percent of sales, some 57 percent of profits, 45 percent of total assets, and 59 percent of operating divisional assets. As such, they are clearly "quantitatively vital to the operation of the corporation."

Desmedt v. Gardner, Del. Ch., C.A. No. 6430, Marvel, C. (June 26, 1981), cited by defendants to lend support to the argument that the "quantitative" test is not satisfied here, is entirely inapplicable. First, that decision makes no mention of the percentage of assets being sold.* Rather, Desmedt was decided as it was because the assets sold were no longer of any importance to the corporation:

> [A] situation is presented in which feuding Italian families are competing for the right to acquire from Aeicor It~lian Habour facilities which are no longer relevant to Aeicor's business, which facilities are located at Livorno, Italy ...

Slip op. at 1 (emphasis added). For this reason, Chancellor Marvel denied preliminary injunctive relief, holding that it was "altogether possible that the provisions of 8 Del. C. § 271 do not apply." Id.

As far as the qualitative test, there can be no question but that these three divisions constitute the very core of Revlon's operations.

In Katz v. Bregman, supra, the qualitative change of the corporation following the asset sale was from a manufacturer of steel drums, to one of plastic drums.

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* Revlon, at page 95 of its answering brief, refers to certain percentages of assets in the Desmedt case, which they say can be found in a memorandum filed in that case, but not attached to Revlon's brief. Revlon's attorneys, who were involved in Desmedt, have been unable to supply a copy of the memorandum to plaintiff, as requested following receipt of the brief. This may give the Court some feel for the desperate lengths to which defendants must reach for some of their authorities.

Finding that this would "represent a radical departure from Plant's historically successful line of business" and further that "historically the principal business of Plant Industries, Inc. has not been to buy and sell industrial facilities ...," the court held that the sale would constitute a sale of substantially all of the assets of Plant, and should be approved by a majority of its outstanding stockholders. Katz v. Bregman, supra, 431 A.2d 1274, 1276. Here, the radical departure is even more pronounced. Revlon will sell its original Beauty Products business, its name, and its entire structure will change, its remaining businesses being geographically located largely outside North America. The sale is also clearly out of the ordinary business of Revlon, which as in Katz, has never been to broker businesses.

Defendants rely on Gimbel v. Signal, claiming that there a sale of oil and gas operation did not require shareholder approval even though the company's original purpose was oil and gas. They neglect to mention that Signal earlier changed its name from Signal Oil and Gas Company "for the announced need for a new name appropriate to the broadly diversified activities of Signal's multi-industry complex." Gimbel, supra, 316 A.2d 599, 608. Moreover, the oil and gas business had fallen to third spot in revenues and earnings, and second, in assets. 316 A.2d at 607. In contrast, here, Revlon's Beauty Products division remains its flagship business, with revenues, profits and assets greater than any other business segment.

In sum, defendants attempt to mask what is, in essence, a single transaction, through which they purport to divest Revlon of assets which are the very heart of its operation in the guise of separate transactions which allegedly are neither quantitatively nor qualitatively vital to it. But this court must look "behind the masque of words ... and discover the face of the true intent." Starring v. American Hair & Felt Co., Del. Ch., 101 A. 887 (1937). Stockholder approval should be required for this sale, which is far beyond the ordinary course of business and which greatly affects the existence and purpose of Revlon.

IV. PLAINTIFF -- AND ALL STOCKHOLDERS OF REVLON -- WILL BE IRREPARABLY INJURED IF THE RELIEF REQUESTED IS NOT GRANTED.

As is customary, defendants argue that plaintiff cannot satisfy its burden of proving probability of success on the merits, irreparable harm or a balance of hardships in its favor. But if the Forstmann Little/Revlon lock-ups are not enjoined, plaintiff, as well as all stockholders of Revlon, will be seriously and irreparably harmed.

They will be precluded by the asset lock-up, the Rights, and the note and preferred stock covenants from the opportunity of obtaining the best offer for their shares. As this court has previously held, a board's failure to obtain the best price available for its stockholders, particularly when competing offers at higher prices have been made but not seriously considered, calls for the entry of a restraining order which "is essential if the best interests of the stockholders are to be served." Thomas v. Kempner, supra. Where management has failed to obtain the maximum price available, particularly in a situation where competitive bidding has been ignored, the injury to stockholders rights is such as to require this court's intervention. See, e.g., Pennsylvania Co. v. Wilmington Trust Co., Del. Ch., 186 A.2d 751 (1962); Lockwood v. OFB Corp., Del.

Ch., 305 A.2d 635 (1973). And delay, as here, in a tender offer, in itself constitutes irreparable injury. See Kennecott Corp. v. Smith, 637 F.2d 181 (3d Cir. 1980); Mesa Partners v. Phillips Petroleum Co., Del. Ch., 488 A.2d 107 (1984).

These arguments are not even addressed by defendants, who contend, contrary to this court's earlier holding, that Pantry Pride is "without standing" as a bidder to assert injury from the transactions complained of herein. But Pantry Pride (or more accurately MacAndrews & Forbes) is more than a third party bidder, it is a stockholder, suffering injury in its own right, as well as in a representative capacity. And no "speculative" transaction is being chilled as defendants claim, citing FMC Corp. v. R. P. Scherer Corp., 545 F. Supp. 318 (D. Del. 1982). Scherer concerned "vague speculative conjecture as to the existence and terms to be offered by an unknown, potential tender offeror..." Id. at 323. Defendants can hardly argue that Pantry Pride's offer can in any way be equated with the Scherer situation presented. See also, Mesa v. Phillips.

Further, defendants' claim that the Rights cause plaintiff no irreparable harm is without merit. The shareholders of Revlon are being deprived of all offers by defendants' Rights, lock-up and restrictive covenants. Significantly, Pantry Pride's offer of $56.25 is already superior in present dollars to the merger price, yet Revlon maintains the Rights as a bar. Revlon shareholders are being denied the right to accept what Pantry Pride believes is a better bid, and this denial is clearly irreparable harm.

With regard to probability of success on the merits, plaintiff has clearly shown a reasonable probability of success in an ultimate hearing. Defendants, acting in their own self interest, have entered into a merger agreement which will permit a grossly inadequate asset lock-up to the detriment of the company and its shareholders. Defendants have <u>admitted</u> their failure to seek a higher offer, and their desire to present every possible obstacle to Pantry Pride's higher offer.

Finally, on the balance of hardships, Revlon argues that its shareholders would be "deprived of the benefits" of the Forstmann Little deal should an injunction issue. That claim simply ignores the fact that it is Revlon who has consistently deprived the shareholders of any other offers. Should an injunction issue here, it would do no more than to open up the market to all bids. It is only from the unique perspective of the Revlon defendants that such a result could become a "harm" to their shareholders.

CONCLUSION

For the foregoing reasons, plaintiff respectfully requests that this Court grant plaintiff's motion for a preliminary injunction.

Respectfully submitted,

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Dated: October 18, 1985

Court of Chancery
of the
State of Delaware

Berger

UNREPORTED OPINION

Carolyn Berger
Vice-Chancellor

Court House
Wilmington, Delaware 19801

April 22, 1985

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Re: Mesa Petroleum Co., et al. v. Unocal Corporation, et al. - C. A. 7997
Date Submitted: April 18, 1985

Dear Gentlemen:

This is the decision on plaintiffs' application for a temporary restraining order enjoining defendants from enforcing those portions of certain bylaw amendments which regulate the nomination of directors and the procedures by which shareholders may present business at annual meetings. This litigation is one facet in the current effort by plaintiffs, Mesa Petroleum Co. and related entities (collectively "Mesa"), to takeover defendant, Unocal Corporation ("Unocal"), a Delaware corporation engaged in petroleum, chemical, geothermal and metals operations.

The facts, for the most part, are undisputed. On February 14, 1985, Mesa disclosed in a Schedule 13D that it had acquired approximately 12.6 million shares or 7.3 percent of the common stock of Unocal. According to that filing, Mesa acquired the stock solely for the purpose of investment. By February 22, 1985, Mesa had increased its stake to 9.7 percent, still for the stated purpose of investment only.

The bylaw amendments at issue were unanimously adopted at a Unocal Board of Directors meeting held on February 25, 1985. They provide, in relevant part:

> ARTICLE III
>
> Section 6. Voting. ...A nomination shall be accepted, and votes cast for a proposed nominee shall be counted by the inspectors of election, only if the Secretary of the Company has received at least 30 days prior to the meeting a statement over the signature of the proposed nominee that he consents to being a nominee and, if elected intends to serve as a director. Such statement shall also contain the Unocal stock ownership of the proposed nominee, occupations and business history for the previous five years, other directorships,...and all other information required by the federal proxy rules in effect at the time the proposed nominee submits said statement.
>
> Section 7. Notice of Shareholder Business. At an annual meeting of the shareholders, only such business shall be conducted as shall have been properly brought before the meeting. To be properly brought before an annual meeting, business must be (a) specified in the notice of meeting (or any supplement thereto) given by or at the direction of the Board of Directors, (b) otherwise

> properly brought before the meeting by or at the direction of the Board of Directors, or (c) otherwise properly brought before the meeting by a shareholder. For business to be properly brought before an annual meeting by a shareholder, the Secretary must have received written notice at least thirty (30) days prior to the meeting. A shareholder's notice to the Secretary shall set forth as to each matter the shareholder proposes to bring before the annual meeting (a) a brief description of the business desired to be brought before the annual meeting....Notwithstanding anything in the Bylaws to the contrary, no business shall be conducted at an annual meeting except in accordance with the procedures set forth herein.

At the time these amendments were adopted, at least some members of Unocal's board were concerned that Mesa might not continue as a passive investor much longer. If Mesa were to present a proposal at the annual meeting scheduled to be held on April 29, 1985, the directors were concerned that management and Unocal's shareholders might not be given a fair opportunity to consider the proposal. According to the affidavit of Unocal's assistant general counsel, the board was advised that these amendments would prevent Mesa from gaining an "unfair advantage" and would have the beneficial effect of promoting the orderly conduct of meetings and permitting Unocal to respond to shareholders' nominees and proposals.

On March 28, 1985, in an amendment to its Schedule 13D, Mesa disclosed that it had acquired 13.6 percent of the common stock of Unocal and that its purpose included possibly obtaining control of Unocal. On the same day, in furtherance of this purpose, Mesa provided notice to Unocal of its intention to present two proposals at the April 29 annual meeting. The proposals are (i) to adjourn the annual meeting for two months and to have a new record date set in connection with the adjourned meeting and (ii) to rescind any action taken at the meeting prior to the approval of adjournment.

Mesa's purpose in proposing the adjournment was to allow Unocal's shareholders adequate time before voting on the election of directors to consider any plan Mesa might present to acquire Unocal or effectuate a restructuring or recapitalization of the company. On April 8, 1985, Mesa commenced a tender offer for 64 million shares of Unocal at $54 per share. If the Unocal stock is purchased pursuant to the offer, which is set to expire on May 3, 1985, Mesa will then own slightly over 50 percent of Unocal's outstanding common stock. The offering circular discloses that Mesa's current intent, following the tender offer, is to propose a second step transaction whereby the remaining publicly held shares will be exchanged for securities valued at $54 per share.

By letter dated April 7, 1985, Unocal's shareholders were advised of the company's interpretation of its new notice bylaws. The letter explained that the timeliness of a shareholder proposal under the thirty day notice provision is determined by reference to the originally scheduled meeting date regardless of whether the meeting is adjourned. The letter advised that, under Unocal's interpretation of its bylaws, even if Mesa were successful in obtaining a two month adjournment of the annual meeting, it would be precluded from presenting any proposals at the adjourned meeting.

On April 12, 1985, in accordance with its previously announced intention to do so, Mesa began soliciting proxies in favor of its adjournment proposals. The proxy statement, like the earlier offering circular, states Mesa's intent to propose a second-step transaction whereby it would obtain the entire equity interest in Unocal if the tender offer is successful.

To round out the chronology of events relating to Mesa's takeover attempt, it should be noted that on April , 1985 Unocal responded to Mesa's tender offer by commencing an exchange offer for up to 87.2 million shares of its stock. Pursuant to the Unocal offer, which is conditioned, among other things, on Mesa consummating its tender offer, each share of Unocal stock would be exchanged for a package of debt securities having an aggregate principal amount of $72. Unocal's offering circular states that its board unanimously authorized the exchange offer in order to provide Unocal's shareholders an opportunity to obtain fair value for their shares following the Mesa tender offer and to make it more difficult for Mesa to complete its tender offer, which the Unocal board determined is grossly inadequate.

The foregoing is intended only to highlight the sequence of events against which Mesa's application for a temporary restraining order must be considered. Time does not permit a fuller description of the moves and countermoves of the parties including alteration of the quorum requirement for the annual meeting and the institution of no fewer than five lawsuits in various state and federal courts around the country.

It is settled law that preliminary injunctive relief will not be granted unless plaintiffs establish both a probability of success on the merits and the threat of imminent irreparable harm. Bayard v. Martin, Del. Supr., 101 A.2d 329 (1953). In support of its claim on the merits, Mesa argues that the bylaws should be struck down for any of three reasons. First, they conflict with 8 Del. C. §211(b) by limiting the shareholder-generated business which may be transacted at an annual meeting to those matters which were properly noticed thirty days in advance. Second, the bylaws operate inequitably by, among other things, imposing the notice restrictions on shareholders but not management. Finally, the bylaws allegedly were adopted for the improper purpose of thwarting Mesa's takeover bid and thereby entrenching management in office.

On the issue of irreparable harm Mesa argues that Unocal's interpretation of the bylaws notice requirements as applied to an adjourned meeting is having an immediate chilling effect on Mesa's ongoing proxy solicitation. Simply stated, if no shareholder proposals may be presented at an adjourned meeting, there is no reason to vote in favor of adjournment. In addition, Mesa contends that the bylaws' interference with the corporate franchise provide an independent basis for a finding of irreparable harm.

Unocal responds that there is insufficient evidence from which to conclude that its adjournment interpretation is having a chilling effect on Mesa's proxy solicitation.

An executive of the proxy solication firm retained by Mesa provided an affidavit stating his opinion that Unocal's bylaws interpretation will have a significant chilling effect on Mesa's proxy solicitation whereas an executive of Unocal's proxy solicitation firm submitted an affidavit expressing the opposite view.

As to Mesa's second claim of irreparable harm, Unocal points out that there is no evidence that Mesa or any other shareholder has been prevented from presenting a proposal because of the thirty day notice requirement. Mesa's adjournment proposals were noticed in accordance with the bylaws and, presumably, will be presented at the annual meeting. Based upon the present record, Mesa apparently has no interest in presenting any other proposals on April 29th and its present intent to present proposals at an adjourned meeting date are contingent not only upon the annual meeting, in fact, being adjourned, but also on the success of its tender offer. Accordingly, Unocal argues that any harm Mesa may suffer is purely speculative at this point.

In the recent case of <u>Plaza Securities Company v. Datapoint Corporation</u>, Del. Ch., C. A. No. 7932, Brown, C. (March 5, 1985), <u>aff'd.</u>, Del. Supr., No. 79, 1985, Horsey, J. (March 8, 1985), Chancellor Brown found that the irreparable injury requirement is satisfied, "[w]here the legal right granted by the law appears to be clear, where interference with that legal right will necessarily occur in the absence of injunctive protection by the Court, and where it reasonably appears that money damages cannot adequately compensate for the interference with that legal right...." Slip Op. at 15. In Datapoint, plaintiffs announced their intention to solicit consents pursuant to 8 Del. C. §228 to remove and replace the Datapoint board of directors. The company responded by adopting a bylaw which would delay the effectiveness of such a consent procedure for at least forty five days after the consents had been obtained. The Court found, among other things, that plaintiffs "undoubtedly" would be impeded in their consent solicitation effort if the Datapoint bylaw were allowed to remain in effect pending final disposition of the claim. Slip Op. at 16.

I find the analysis in Datapoint to be controlling as to both aspects of the claimed irreparable injury in this case. Notwithstanding Unocal's opinion evidence to the contrary, I am convinced that its adjournment interpretation of the bylaws will impair Mesa's ongoing proxy solicitation efforts and will cause irreparable harm if no preliminary determination is made as to the merits of Mesa's position. Undoubtedly, there are Unocal shareholders who will vote against adjournment for the sole reason that they believe that no shareholder proposals could be presented at an adjourned meeting. If that belief is misplaced, the harm to Mesa will not be adequately compensable in money damages. Thus, I find that Mesa has met its burden of demonstrating immediate irreparable harm on the claim that the bylaws are invalid as applied to a greater than thirty day adjournment of the annual meeting.

However, the same factors are not present with respect to the overall validity of the bylaws. If plaintiffs prevail as to the adjournment issue and they obtain the necessary votes to adjourn the meeting, it appears that they will have an opportunity to give the notice required by the bylaws and present at the adjourned meeting any shareholder proposal they wish to make. Even assuming that, pursuant to 8 <u>Del</u>. <u>C</u>. §211(b), Mesa has an unfettered right to present any proper business at an annual meeting without any advance notice, there is no showing on the present record that the bylaws necessarily will interfere with that right. Until such time as Mesa or another shareholder seeks to present a proposal that cannot be presented in accordance with the bylaws, there is only a hypothetical threat of injury. Based upon my finding that there is no threat of immediate irreparable harm as to this portion of Mesa's claim, I will not address the merits for to do so under these facts would be tantamount to an advisory opinion. Cf. FMC Corporation v. R. P. Scherer Corporation, Del. Ch., C.A. No. 6889, Longobardi, V. C. (August 6, 1982).

Turning to the merits of the adjournment claim, Mesa relies primarily on the decisions in Lerman v. Diagnostic Data, Inc., Del. Ch., 421 A.2d 907 (1980) and Schnell v. Chris-Craft Industries, Inc., Del. Supr., 285 A.2d 437 (1971) in support of its position that the adjournment interpretation is inequitable and thus invalid. In Schnell the Delaware Supreme Court held that management may not use corporate machinery for an improper purpose even if the action taken is legally permissible. Defendants there advanced the shareholder meeting date for the purpose of thwarting a proxy contest and in order to perpetuate management in office.

The Schnell holding was based upon a finding of improper purpose. In Lerman, however, certain bylaw amendments were struck down without regard to defendants' motives because of the inequitable effect of those amendments. The Lerman defendants adopted a bylaw requiring shareholders to submit their nominations for the board of directors at least seventy days in advance of the annual meeting. The annual meeting date, which was to be set by the board, was fixed sixty three days after its announcement, thus making it impossible for a shareholder to comply with the seventy day notice requirement. The Court invalidated defendants actions based upon a finding that their "conduct was both inequitable (in the sense of being unnecessary under the circumstances) and had the accompanying dual effect of thwarting shareholder opposition and perpetuating management in office." Lerman v. Diagnostic Data, Inc., Del. Ch., 421 A.2d 907, 914 (1980).

Mesa argues that the Lerman holding is directly on point. Unocal's adjournment interpretation was not announced until April 7, 1985, thereby making it impossible for Mesa to comply with the thirty day notice requirement. The adjournment interpretation is inequitable because it is unnecessary to the stated purpose of the notice bylaws. If thirty days advance notice is sufficient to allow the shareholders and the company to evaluate and respond to any proposals or nominees, then it would seem that thirty days notice before the adjourned meeting date would accomplish that purpose. Instead, under Unocal's interpretation, ninety days advance notice is being required under the facts of this case. Finally, as in Lerman, the adjournment interpretation is impeding Mesa's takeover attempt and thereby helping to perpetuate management.

Unocal strenuously objects to this characterization. The bylaws were adopted on February 25, 1985 at a time when Mesa purportedly was a passive investor. There were no bylaw amendments adopted or other board actions taken on April 7, 1985. All that happened was that Unocal disclosed its interpretation of the bylaws — an interpretation that Mesa clearly anticipated and that, in Unocal's view, is mandated by Delaware law. Thus, Unocal did nothing to make it impossible to comply with the thirty day notice requirement and to the extent that Mesa now finds itself in a difficult position, it is a problem of its own making.

However, Unocal's efforts to distinguish Lerman do not address the equitable principles applied there and equally applicable here. The notice bylaws do not expressly provide how they are to operate in the case of an adjournment and there is no settled Delaware law from which Unocal's interpretation could have been determined with any reasonable certainty. Although there is authority for the proposition that an adjourned meeting is considered a continuation of the original meeting, Atterbury v. Consolidated Copper Mine Corp., Del. Ch., 20 A.2d 743 (1941), there is also a statutory requirement that new notice be given for an adjourned meeting if the adjournment is for more than thirty days. 8 Del. C. §222(c). Thus, there was a reasonable basis for either interpretation of the new notice bylaws. Under these circumstances, and with the knowledge that Mesa believed it would be possible to present a shareholder proposal before the adjourned meeting, Unocal's failure to announce its interpretation of the bylaws until after the thirty day notice period had run was inequitable. Nor does it matter that on April 7th there was only an announcement as opposed to some board action. The effect of that announcement was the same as if Unocal had adopted a new bylaw amendment governing the notice requirements for adjourned meetings.

Based upon the foregoing, I find that Mesa has established a likelihood of success on the merits on its claim that the adjournment interpretation of the bylaw amendments is invalid. As noted earlier, I also find that Mesa is threatened with immediate irreparable harm as a result of the adverse impact that Unocal's adjournment interpretation is having and will continue to have on Mesa's proxy solicitation. A temporary restraining order will issue upon the posting of a bond in the amount of $10,000. I request that Mesa submit a form of order in accordance with this opinion, on notice, as promptly as possible.

Very truly yours,

Carolyn Berger

CB:rsb

Xc: Register in Chancery