IN THE SUPREME COURT OF THE STATE OF DELAWARE

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

THE REVLON APPELLANTS' OPENING BRIEF

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TABLE OF CONTENTS

TABLE OF AUTHORITIES

TABLE OF AUTHORITIES

NATURE OF THE PROCEEDING AND ORDER TO BE REVIEWED

Revlon, Inc. and its director-defendants appeal from the decision and order of the Court of Chancery granting a preliminary injunction against, among other things, an asset option agreement entered into between Revlon and Forstmann Little & Co. The appellee, MacAndrews & Forbes Holdings, Inc., controls Pantry Pride, Inc., a bidder for Revlon. The Chancery Court, in staying its order, recognized that its decision was one of first impression that should be reviewed promptly.

In its opinion, the Chancery Court found that the Revlon Board had not acted to entrench itself and had "achieved a significant premium in the value of Revlon's shares since Pantry Pride's initial approach -- from $42 to $57.25, and now to $58 per share." Op. 26.* The Court recognized that issuance of Revlon notes -- the October 12 treatment of which by the Board is central to the Court's finding of "self-interest" and violation of the directors' "duty of loyalty" -- was a "device fashioned by the Revlon directors to provide increased value to the shareholders." Op. 24. The Court, moreover, recognized that the Board acted in an informed manner (Op. 24) and that the directors had been confronted with a non-negotiable

* References to the opinion of the Chancery Court are cited in the form "Op. __." References to the Appellants' Joint Appendix are cited in the form "App. __." Citations to draft minutes of Revlon Board of Directors meetings will also include an indication of the date of the meeting and the number of the page as it appears in the minutes.

offer from Forstmann which required, among other things, that the Board accept Forstmann's offer and agree to the asset option by October 12. Op. 11-12, 22. The Court also found that the Board concluded on October 12 "that Forstmann Little's latest offer was more favorable to Revlon's shareholders than Pantry Pride's tender offer at $56.25 because Forstmann Little's offer was for a higher price, it protected the Noteholders, and its financing was firmly in place." Op. 12.

Nevertheless, the Court granted a preliminary injunction, holding that the Board's decision on October 12 "seems highly questionable" (Op. 20); that the Board, in making that decision, did not conform to its "duty of loyalty" and was motivated by "self-interest" (Op. 24); that the Board "permitted other considerations to dictate its approach" and thereby "failed in its fiduciary duty to the shareholders." Op. 24, 26. This conclusion of the Court was based on its interpretation that the directors had no legitimate responsibility to take into account the interests of noteholders, and that in doing so, the directors were motivated by a desire "to rid themselves of a vexing and potentially damaging source of litigation" from noteholders, the value of whose notes had declined. Op. 21-24. The Court ruled that a "lock-up provision," while not _per se_ illegal, could not -- in light of the self-interest which the Court attributed to the directors -- be agreed to by directors in an "active bidding situation." Op. 25.

SUMMARY OF ARGUMENT

1. The Chancery Court was incorrect in finding that the Revlon Board, in agreeing to the "lock-up" option, was motivated by a fear of litigation liability to Revlon noteholders. As an evidentiary matter, the prospect of noteholder lawsuits did not motivate the Revlon Board; as a legal matter, the prospect of such lawsuits does not constitute "interest" and thereby vitiate the protections of the business judgment rule. The Court was led into error on this issue (which plaintiff raised for the first time below in a reply brief served the morning of the argument).

2. The Court erred in holding that, since the noteholders' rights "had been fixed as a matter of contract," "[b]y agreeing to a lock-up and no-shop clause in exchange for protecting the rights of the Noteholders, the Revlon Board failed in its fiduciary duty to the shareholders." Op. 24. The Court's factual premise is inaccurate: the "lock-up" and "no-shop" clauses were actually granted in return for the entire Forstmann offer. Moreover, the very "contract" under which the notes had been issued to shareholders entrusted the independent directors with the decision whether to waive the protective note covenants -- and such waivers had been demanded by both Pantry Pride and Forstmann. It cannot be the law of Delaware that the directors were prohibited from acting reasonably and in good faith in obtaining protection for the value of the notes in exercising their judgment to grant waivers.

3. The Revlon directors acted entirely reasonably and properly in accepting Forstmann Little's proposal as best for stockholders and noteholders. There was no acceptable alternative: (a) Forstmann Little was offering $100 million in additional value -- over the existing Pantry Pride bid -- to Revlon's shareholders and noteholders; (b) even absent a "lock-up," there was no reasonable prospect of any higher bid other than a "nominal" raise by Pantry Pride; (c) if the directors refused the lock-up, Forstmann Little would "walk away" -- not only would the $100 million in additional value be lost, but there was the real prospect that Pantry Pride would then once more move back down in price from its existing offer. Moreover, Forstmann Little's financing was "firmly in place"; Pantry Pride's financing was still incomplete and contingent. The Chancery Court incorrectly substituted its judgment for the Board's reasonable business judgment.

4. The grant of a "lock-up" option by a board of directors, when necessary to secure a higher bid for the company, falls within the protections of the business judgment rule.

5. The Court incorrectly granted injunctive relief against enforcement of Revlon's Note Purchase Rights Plan and covenants in Revlon's notes.

STATEMENT OF FACTS

A. Factual Errors Below

The Court of Chancery -- which heard this matter on an exceedingly expedited timetable demanded by Pantry Pride -- was unfortunately led into a series of factual errors and misunderstandings. Many of these serve as the essential underpinning for the Court's conclusions. The most critical of these, of course, was the Court's finding that the Board's motivation in agreeing to the "lock-up" was a fear of personal liability to Revlon noteholders. But the list of other illustrations is long. By way of example:

1. The Chancery Court found: "With the exit of Revlon's management from the October 12 transaction, Forstmann Little was left with the need to raise approximately $400 million before it could consummate the transaction." Op. 22. The Court was mistaken: the total cash being supplied by Forstmann Little (other than borrowings) was some $445 million, of which management's share had been contemplated to be only $18 million -- an amount which Forstmann Little immediately indicated would be otherwise available. App. 1400-03; App. 916, 919 (October 12 Minutes at 37, 40). Forstmann Little made absolutely clear to the Board on October 12 that it had the funds available for the entire transaction. App. 916, 919 (October 12 Minutes at 37, 40); App. 933, 1400-03, 1419-25, 1437, 1532-34.

2. Conversely, the Chancery Court found: "To support its $56.25 tender offer Pantry Pride was required to raise $700 million, which its investment banker, Drexel Burnham Lambert, claims to have had fully committed. . . ." Op. 22. Once again, the Court was in clear error. Only the day before the October 12 Board Meeting -- in response to express written inquiry by Revlon's investment bankers -- Pantry Pride had advised in writing that it did <u>not</u> have commitments for that $700 million and that it still lacked $350 million of such commitments. App. 525-26. Indeed, Pantry Pride's failure even at that late date to have secured necessary financing commitments was of particular concern at the October 12 meeting. App. 1442-49, 1461-63, 1471, 1490-91, 1509-10, 1542.

3. The Court found: "To help finance Forstmann's transaction, Revlon agreed to sell its Norcliff Thayer and Reheis divisions to American Home Products for $335 million". Op. 10. The Court was in error. Forstmann itself had negotiated those sales, contingent upon Forstmann's acquiring Revlon. Revlon is not a party to such agreements. App. 399.

4. The Court found: "To help finance Forstmann's transaction, Revlon agreed . . . to sell the Beauty Products Division to Adler & Shaykin in an independent transaction for approximately $900 million." Op. 10. The Court was mistaken. The Adler & Shaykin sale was an independent business transaction for an extremely attractive price (App. 875) and is in no

way contingent on consummation of the Forstmann transaction. App. 482-514; App. 847, 853-54 (October 3 Minutes at 3, 9-10). And -- contrary to the implication elsewhere drawn by the Court with respect to the consequence of this transaction (Op. 21) -- the $900 million which Revlon will realize as proceeds is as equally available to Pantry Pride (should it acquire Revlon) as it would be to Forstmann. App. 482, 865.

5. The Court found that each of Pantry Pride's offers had in common the essential term of paying cash "in increasing amounts." Op. 17. The Court was wrong. Indeed, on the heels of Revlon's Exchange Offer, Pantry Pride had decreased the price it was offering shareholders from $47.50 to $42 per share. App. 347. Once again, this recent history of Pantry Pride having reduced its offering price was of signal concern to directors on October 12: if Forstmann were to walk away, Pantry Pride -- once it had the field to itself -- could well decide to reduce its $56.25 offer. App. 777, 931-33, 938, 1384-89, 1456-57, 1491, 1566-67.

6. The Court recited that by October 12, the sharp drop in the market price of the notes that had occurred subsequent to the announcement of the October 3 merger agreement had given rise to "the threat of litigation by the Noteholders" and had become "a source of concern to the outside directors, some of whom had retained separate counsel." Op. 20. The record, however, shows that counsel was retained by director

Glucksman prior to the October 3 meeting (i.e., prior to the events giving rise to the supposed "concern") and was actually present at that October 3 Board meeting. App. 849. Moreover, the reason for such retention of counsel had nothing to do with any such "concern." App. 1485-87.

7. The Court in its opinion repeatedly recites that the Board at its October 3 meeting had supposedly "waived the covenants on the Notes limiting Revlon's ability to incur additional debt." Op. 9, 10, 23. In the Court's understanding, the directors' "concern" to protect the noteholders thus only arose in the days immediately prior to the October 12 meeting and was occasioned by a "concern" of litigation liability stemming from the decline in the market price of the notes subsequent to the announcement of the October 3 transaction. Op. 10, 20, 24. The Court was in error as to its factual premise. The directors at the October 3 meeting did not waive the notes covenants. While waiver of the covenants was a condition to an ultimate consummation of the proposed merger, the directors on October 3 expressly declined to waive at that time. The Board was advised that such waiver should only be considered "in response to a specific capital structure" or a specific proposal for dealing with the notes so that the directors "could be sure that the 11.75% Notes would be protected." App. 861 (October 3 Minutes at 17) (emphasis added). See also App. 772, 944-45, 1511. The record is, thus, quite clear that the Court misunderstood the actual sequence of events and that

the directors' "concern" with protecting the notes was a concern that antedated the market price drop and any threat of litigation.

8. The Court found that Revlon's management refused to "share financial data with Pantry Pride as it did with Forstmann Little." Op. 19. This finding ignores the uncontradicted record evidence that Revlon had offered to share all internal financial data with Pantry Pride if Pantry Pride would eschew its hostile tender offer and enter into negotiation with the company as Forstmann was doing. Pantry Pride refused. App. 791-92 (August 19 Minutes at 10-11); App. 867-69 (October 3 Minutes at 23-25); App. 1368-72, 1403-05, 1538-40.

9. More generally, the Court found that Revlon did not "invite Pantry Pride to participate on the same level of negotiation [as Forstmann]." Op. 19. As noted above, the record establishes that Revlon did precisely that; Pantry Pride refused -- preferring to maintain its stance of having the gun of a hostile tender offer pointed at the head of the Board. But even then, the record shows that Revlon did negotiate with Pantry Pride. During the week prior to the October 12 meeting, numerous meetings of the parties took place: Pantry Pride was repeatedly invited to better its bid; to raise its price per share; to take steps to restore full value to the notes. No new offer was ever proffered by Pantry Pride; indeed, just the day before the October 12 meeting, Pantry Pride in writing had rejected taking any steps to restore value to the notes.

App. 523-26; App. 886, 908-09, 917 (October 12 Minutes at 7, 29-30, 38); App. 991, 1132-34, 1148-49, 1383, 1405-08, 1552, 1564-68.

B. <u>Background to the October 12 Decision</u>

On August 19, 1985, Pantry Pride announced a tender offer for Revlon common stock at $47.50 per share conditional upon, among other things, Pantry Pride raising $900,000,000 of additional financing. App. 807-09. The Revlon Board, prior to that announcement, had adopted a Note Purchase Rights Plan to help protect against two-tiered tender offers and tender offers at inadequate prices. App. 296, 763-64; App. 795-804 (August 19 Minutes at 14-23); App. 926-28.

On August 26, the Revlon Board met to consider the Pantry Pride offer. Lazard Freres, Revlon's investment banker, gave its investment banking opinion that the Pantry Pride offer was grossly inadequate. App. 813-14 (August 26 Minutes at 8-9). The Board rejected the offer and, in response thereto, authorized, as a partial alternative to Pantry Pride's offer, an exchange offer in which Revlon would exchange two newly issued securities for up to 25% (10,000,000 shares) of Revlon's common stock (the "Exchange Offer"). App. 764-66; App. 818-19 (August 26 Minutes at 13-14); App. 1543.

The securities issued in the Exchange Offer were: (a) a Senior Subordinated Note, with a coupon rate of 11.75%, in the principal amount of $47.50 (hereinafter, the "Notes") and

(b) convertible preferred stock. App. 88. These securities were designed to trade at par and to give Revlon shareholders a value of $57.50 for each Revlon share exchanged. App. 149-51, 764-65; App. 813 (August 26 Minutes at 8); App. 1438-39, 1543. As the Court below correctly found: the Exchange Offer was "a device fashioned by the Revlon directors to provide increased value to the shareholders." Op. 24.

The Notes contain covenants restricting Revlon's ability to incur additional debt, pay dividends and sell assets. Indisputably, one purpose of these covenants was to deter or make more difficult unfair or inadequate tender offers such as Pantry Pride's. App. 91, 135-36; App. 810-11 (August 26 Minutes at 5-6). In addition, the covenants were intended to protect the value of the Notes (especially in the face of a takeover attempt such as Pantry Pride's, which was being financed by "junk bonds" and, if successful, would result in a highly leveraged company); to obtain investment grade ratings from rating agencies; and to make the Notes saleable.* App. 940-42.

The Exchange Offer was substantially oversubscribed and Revlon accepted the 10,000,000 shares for purchase on September 13. App. 975. Consummation of the Exchange Offer did not deter Pantry Pride, however. That same day, Pantry Pride announced that it was terminating its $47.50 tender offer

* The covenants could only be waived by "independent directors" of Revlon, including successors to present-day independent directors. App. 98-99, 766.

and commenced a new offer -- at $42.00 per share. App. 347. At a directors' meeting on September 24, Lazard opined that $42.00 was a grossly inadequate price for the remaining Revlon shares. The directors rejected the $42.00 offer. App. 767; App. 825-26, 831 (September 24 Minutes at 5-6, 11).

Revlon pursued numerous options to preclude Pantry Pride from acquiring the company at a $42 price, including liquidation and seeking a white knight which would acquire all of Revlon in one piece. All of these possibilities were rejected or failed. App. 837-38, 841-42 (October 1 Minutes at 2-3, 6-7); App. 848 (October 3 Minutes at 4); App. 907-08 (October 12 Minutes at 28-29); App. 1453-54, 1472-73, 1546-50.

In the latter part of September, Revlon commenced parallel discussions with Adler & Shaykin for the sale of Revlon's beauty products division and with Forstmann Little for a leveraged buy-out of the company. App. 1009-13, 1416b. Negotiations were ultimately successfully conducted: Adler & Shaykin would acquire the division for $905 million -- an exceedingly attractive price (App. 875); Forstmann Little would enter into a merger agreement to acquire all Revlon shares for $56 per share in cash. App. 402, 482. Pursuant to Forstmann Little's customary practice upon a leveraged buy-out, key members of Revlon's management would participate with Forstmann Little in the transaction. App. 710, 847, 915.

Pantry Pride, apparently fearing that a transaction far superior to its $42 bid was being discussed, wrote to Revlon on September 27 that it would be prepared to pay $50 per share, then, on October 1, $53 per share in a merger -- but only if the Board would accept the $53 that same evening.* These proposals were, moreover, conditioned on redemption of the Rights and waiver of the Note covenants. App. 397, 398. Pantry Pride did not, however, raise its outstanding $42 per share tender offer under which it would by October 4 be entitled to purchase shares. App. 347.

The Revlon Board met again on October 3. The Forstmann Little transaction was now ripe for consideration. The Board was told that Forstmann had demanded, as a condition to its $56 offer, that it be afforded a "lock-up" option on certain Revlon assets and that Revlon agree to a "no-shop" provision. Revlon's advisors had refused, and Forstmann reluctantly had withdrawn its insistence: there would be no impediment to Revlon seeking to obtain a higher bid from some third party, including Pantry Pride. App. 942-44, 1553-56. The Board therefore reasoned that it was in substance acquiring a $56 per share "put" for the company: Forstmann was agreeing to buy if no higher price was forthcoming; the company was not obliged to sell if it could make a better deal elsewhere. App. 771-72; App. 873 (October 3 Minutes at 29) 944-45. Revlon would be

* The Revlon Board at its October 1 meeting was advised that an alternative transaction which would be superior to the $53 Pantry Pride proposal was in the offing. It nevertheless did not reject the Pantry Pride bid but requested that Pantry Pride keep the offer open. App. 836-37, 841-42 (October 1 Minutes at 1-2, 6-7).

required, however, to agree to payment of a $25 million cancellation fee (App. 474-75) -- a provision which the Court below noted to be "not unusual in transactions of this magnitude" (but nevertheless saw fit to enjoin). Op. 29. After careful and detailed consideration of all phases of the proposed transactions, they were approved by the outside directors of the Board, the management directors not participating. _See generally_ App. 845-78 (October 3 Minutes).

Forstmann had also demanded a waiver of the Note covenants. This was not agreed to. App. 943-45. While such a waiver was a condition to an ultimate closing of the Merger, the Revlon Board at its October 3 meeting declined an immediate waiver of the covenants on the following advice:

> Mr. Brownstein noted that it was a condition to the closing that certain covenants in the 11.75% Notes be waived with respect to debt to be assumed in the merger. He stressed, however, that although Forstmann Little had received binding commitment letters, they did not yet have definitive financing agreements. Action with respect to the waiver of the covenants in the 11.75% Notes or the Preferred Stock would be undertaken when the Board had the definitive financing agreements before it. _Mr. Lipton emphasized that the Board should only waive the covenants in response to a specific capital structure or proposal for dealing with the 11.75% Notes so that they could be sure that the 11.75% Notes would be protected_. Because no definitive agreements had been executed yet and not all the financing details presented, they should not therefore undertake any such action at the current time.
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> -- App. 861 (October 3 Minutes at 17) (emphasis added); _see also_ App. 771-72, 1511.

Indeed, there had already been discussions with Forstmann looking toward the potentiality of Forstmann retiring the Notes at par: "Forstmann Little had told Lazard informally that it was their intention to retire the Notes in the near term, and Lazard believed it might be possible to negotiate a formal commitment from Forstmann Little in this regard." App. 945.

Pantry Pride's response to the announcement of the $56 cash merger agreement with Forstmann Little was, on October 7, to raise its own tender offer -- to $56.25. App. 217, 1147. Moreover, Pantry Pride maintained that all withdrawal periods had already expired -- i.e., that it was free to buy shares under its "amended" offer immediately. App. 217. It inaccurately publicly announced that Revlon had already waived the Note covenants in favor of Forstmann (App. 986) and immediately sought to bring on an application for interlocutory relief that would, among other things, require an immediate waiver of the Note covenants in its favor. App. 1-32, 222. Faced with what was perceived to be the potentiality of waiver of the Note covenants in favor of either of the two leveraged transactions -- Forstmann Little or Pantry Pride -- and without any arrangement yet in place to protect their value, the market price of the Notes declined sharply. App. 1544.

Under the gun of Pantry Pride's threatened immediate purchase of shares upon its tender offer, intense discussions took place among the parties during that week of October 7.

There were tripartite discussions: as the Court below found, at such a meeting on October 9, "Perelman informed Forstmann that Pantry Pride was prepared to counter every Forstmann offer with a nominal raise." Op. 11. There were bilateral discussions between Revlon and Forstmann. There were bilateral discussions between Revlon and Pantry Pride. E.g., App. 523-26; App. 908-09 (October 12 Minutes at 29-30); App. 1133, 1148-49, 1383, 1552.

In negotiations with Forstmann, the Revlon side emphasized the need for Forstmann to come forward with its best offer -- both for the shares and with respect to protecting the value of the Notes. App. 887 (October 12 Minutes at 8); App. 945-46. Pantry Pride, too, was explicitly invited to raise its bid and was requested -- both orally and in writing -- to come forward with a plan for refinancing the Notes. App. 523; App. 908-09 (October 12 Minutes at 29-30); App. 1133, 1552. No improved bid was ever forthcoming: although in one conversation, a lawyer for Pantry Pride indicated that his client "might" be willing to make some minimal improvements to the Notes (App. 1133), this was followed the next day (October 11) by a formal letter rejecting any such concession. App. 525-26. Pantry Pride decided to stand upon its hostile $56.25 tender offer. See also App. 1525-26, 1552, 1563-68.

Negotiations with Forstmann were, however, more fruitful. They ultimately evolved into a merger proposal whereby Forstmann would increase its merger price to $57.25 in cash and would -- in exchange for an agreement to waive the covenants -- issue new higher-coupon replacement notes to bring the value of the outstanding Notes up to par. The total package was worth some $100 million more than the existing Pantry Pride $56.25 offer. App. 757, 887-88 (October 12 Minutes at 8-9); App. 1457.

Forstmann insisted, however, that it would make no improved bid unless Revlon agreed, among other things, to: (a) a "lock-up" option on Revlon's Vision Care and National Health Labs businesses; (b) a "no-shop" agreement from Revlon; (c) a waiver of the Rights for Forstmann only; and (d) a waiver of the Note covenants for Forstmann only. Mr. Forstmann made quite clear that he would not be used as a "stalking horse" for Pantry Pride and would withdraw his offer if it were not approved by the Board the next day. App. 886-89, 892-94, 911 (October 12 Minutes at 7-10, 13-15, 32); App. 947-48, 1014-16, 1391-98. Forstmann was requested to keep his offer open longer. He refused. App. 911 (October 12 Minutes at 32); App. 1493-94.

Hard bargaining ensued. Revlon managed to obtain some concessions. The Rights would be redeemed, not for Forstmann only, but for <u>any</u> bidder (including Pantry Pride) at $57.25 or more. The covenants would be waived, not for Forstmann only, but for <u>any</u> bidder (including Pantry Pride) who would take sufficient steps to ensure that the Notes trade at par. The exercise price on the "lock-up" option would be $525 million, a higher exercise price than Forstmann had sought. In addition, whereas Forstmann demanded an immediately exercisable option, Revlon held out for an option exercisable only upon a 40% share acquisition (a high trigger point for an option of this nature). App. 893-94, 896-98 (October 12 Minutes at 14-15, 17-19); App. 1011, 1015-16, 1081-82, 1097-99, 1104-05, 1497-98.

But Forstmann Little absolutely would not budge on its other demands and _insisted_ that the "lock-up" option was a _sine qua non_ of the deal: Forstmann was not willing for a second time to be a stalking horse for a nominal Pantry Pride raise. _E.g._, App. 1014-15.

C. The October 12 Board Meeting

The Revlon directors met on October 12. It was the sixth board meeting held since Pantry Pride had made clear its intention to make a tender offer. The Board was informed of the correspondence with Pantry Pride that past week which showed (a) that Pantry Pride still did not have financing commitments for its offer and (b) that Pantry Pride was not prepared to take any steps to restore value to the Revlon Notes. App. 884-85 (October 12 Minutes at 5-6). Director Glucksman, highly sophisticated in financial matters,* found Pantry

* Mr. Glucksman is the former chief executive officer of Lehman Brothers Kuhn Loeb, Inc. App. 956. _See generally_ App. 1479-80.

Pride's lack of financing at that late date very disturbing: "I thought that this was an exceptionally fuzzy, inconclusive, alarming statement." App. 1444-45. See also App. 1442-43, 1445-49, 1461-63, 1471, 1490-91, 1509-10.

Revlon's chairman, Mr. Bergerac, noted that to remove any appearance of a conflict of interest in considering the Forstmann proposal, management would withdraw from equity participation in the surviving company. App. 881-82 (October 12 Minutes at 2-3); App. 1399, 1468-69.

The new Forstmann proposal received the most intensive analysis by the Board. Central to the discussion was the Board's recognition that Forstmann's non-negotiable demands for a "lock-up" option and a "no-shop" clause were the price for the additional $100 million in values that he was offering to the shareholders and the Noteholders. The Board was expressly advised that the "lock-up" provisions "deter further offers." App. 904 (October 12 Minutes at 25). On the other hand, the Board was aware that -- other than Pantry Pride itself -- no other bidder had emerged for the company. The Board was brought up to date on the most recent (unsuccessful) contacts in that regard. App. 907-08 (October 12 Minutes at 28-29). The Board considered whether it had any other viable alternatives, such as self-liquidation. App. 902-03 (October 12 Minutes at 23-24).

The Board focused on the exercise price which had been negotiated for the asset option for the two divisions: it was lower than Lazard's estimate of the price they believed they could obtain for those divisions. Mr. Loomis of Lazard noted that the exercise price was "a favorable price from the perspective of Forstmann Little." App. 901 (October 12 Minutes at 22). (There was a difference of opinion among investment bankers; the exercise price "was within the range of values placed on the two divisions by Goldman Sachs, Forstmann Little's investment banker." App. 901, 917 (October 12 Minutes at 22, 38).) Nonetheless, the asset option could not be viewed in isolation: it was the means to obtain greater values from Forstmann, and Lazard was of the view that the entire transaction was fair and strongly recommended approval. App. 903-04, 913 (October 12 Minutes at 24-25, 34); App. 930-34, 937-38. Moreover, as was pointed out to the Board by counsel, "[i]f the proposed merger was to be consummated, the lock-up option would not be used." App. 904 (October 12 Minutes at 25).

The Board considered the values that would be received upon the merger. The $57.25 merger offer was fair from a financial point of view. And -- even discounting for the period of time anticipated to be necessary to consummate the merger -- it was superior to Pantry Pride's $56.25 offer. App. 930-31, 935-36, 1473a-73b; App. 900-01, 916 (October 12 Minutes at 21-22, 37). Additionally, Forstmann had agreed to issue higher coupon replacement notes in an exchange offer for the outstanding Notes. The replacement notes would bring the value of the

Notes to par: the increased value was some $60 to $65 million. App. 1456-57. The _quid pro quo_ for this new exchange offer was the waiver of covenants in the old Notes:

> [Mr. Brownstein] noted that Forstmann Little had stated that in order to permit any acquisition transaction, such covenants had to be waived. Accordingly, the Company had bargained for the exchange offer that had been described to the Board.
>
> -- App. 894 (October 12 Minutes at 15).

(The covenants would also be waived in favor of Pantry Pride or any other party who would take appropriate steps to assure that the Notes would trade at par. App. 1097.)

Mr. Lipton of Wachtell Lipton addressed the Board about the original Exchange Offer and the disclosure therein concerning the covenants. He noted that "a question had been raised regarding legality and full disclosure of the intention to waive the covenants in the Notes." App. 906 (October 12 Minutes at 27). Lipton made crystal clear to the directors that _there was no problem_; that, as the directors were themselves aware, at the time of acceptance of shares in the Exchange Offer, a leveraged buyout type transaction involving waiver of the covenants had not been contemplated; that, indeed, at the time, the company had been attempting to remain independent; that all appropriate disclosure had been made. App. 906-07 (October 12 Minutes at 27-28).

As the October 12 minutes reflect, Lipton stated:

> that the representatives of Cleary Gottlieb 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. He said that many of the persons in the room knew, as they had been participants, that there had been no contemplation of entering into the leveraged buyout transaction prior to September 12, 1985, the date that the 10,000,000 shares had been accepted for exchange under the Exchange Offer, and the date on which the Company became legally obligated to issue the securities. Mr. Lipton noted that at that time the Company's strategy had been for the company to attempt to remain independent. Then, when the Exchange Offer had not proved adequate to enable the Company to remain independent, the Company consider[ed] the possibility of selling its Norcliff Thayer division and issuing $100 million to $200 million of a series of preferred stock with shark repellants in it. Subsequent to that, and after the investment decisions by the shareholder with respect to tendering, the Company's advisers met and saw that Company's strategy was in trouble and that their program was not working and decided to pursue other avenues. Adler & Shaykin had contacted Mr. Lipton earlier, and on September 16 Lazard Freres had indicated to Mr. Lipton that they would be interested in speaking with Adler & Shaykin. On September 19, there had been some contemplation of the deal, and on September 20 there was a first contact with Forstmann Little. Mr. Lipton stated that in his opinion there was no problem with the disclosure in the exchange offer document, the problem had been that investors had not read it.
>
> -- *Id*. (emphasis added).

There was also reference to the fact that the Board would undoubtedly be sued whichever way it went with respect to the Forstmann proposal. If it approved the proposal, it would be sued by Pantry Pride (and perhaps others) claiming "that the lock-up option prevented receipt of a better price in the deal" and alleging a waste of corporate assets. App. 909-10 (October 12 Minutes at 30-31). If it rejected the proposal, it would be sued by stockholders and Noteholders for having failed to accept a $100 million higher bid. App. 911 (October 12 Minutes at 32).

The Board focused on where the company would stand if it did not accept the Forstmann proposal. Mr. Forstmann had made it clear that he would walk away. App. 905 (October 12 Minutes at 26). Were this to happen, not only would the improved Forstmann bid not be available, there would be the serious risk that Pantry Pride -- left without competition -- would reduce even its existing $56.25 offer. Arthur Liman, outside counsel of Revlon, had personally met with Pantry Pride that past week. His advice to the Board was set forth in a statement:

> it was his belief that based upon the events of the past few days Forstmann Little would walk away and no longer compete with Pantry Pride for the Company if their proposals were not accepted at the meeting. He felt that the Company could not afford to lose Forstmann Little, as if Forstmann Little were no longer bidding for the Company, the Company would not be able to bargain a better deal for the shareholders or the noteholders.
>
> -- App. 905 (October 12 Minutes at 26) (emphasis added).

Felix Rohatyn of Lazard Freres forcefully emphasized his firm's viewpoint:

Mr. Rohatyn stated that it was an absolute unacceptable risk for the Company to face Pantry Pride alone without Forstmann Little and that he did not believe that without Forstmann Little there would be a $56 a Share bid from Pantry Pride and that Pantry Pride might very likely lower its bid.

-- App. 912-13 (October 12 Minutes at 33-34).

The directors viewed this as a very real risk. App. 777, 1384-90, 1442-43, 1456-57, 1489-95, 1528, 1554-56.

Director Glucksman testified:

I was particularly -- I thought it particularly important to factor into what I in my own notes call the fill or kill statement by Teddy Forstmann. It was absolutely clear to me that he was either going to do a deal or walk away from the deal and he was not going to keep it open.

* * *

I was concerned with what would happen if Mr. Forstmann withdrew. I had no idea whether Pantry Pride would then cut its offer to a lower price, amend its offer, withdraw its offer, and create chaos for awhile. But I did know that we had no one who was in negotiation or conversation with us who seemed to offer -- who was offering a price for the whole company or were some combination of offers that achieved the $57.25 price.

-- App. 1489-91.

Director Rifkind, a former director of MacAndrews & Forbes who regards Mr. Perelman as a friend, attested:

Mr. Forstmann stated his "bottom line" very clearly. He had to have a lock-up option on Revlon's Vision-Care and National Health Laboratories Divisions in order to avoid being used as a stalking horse by Mr. Perelman with his "$0.25 more" threat. He also had to have a Board decision that night. Otherwise, Forstmann Little would withdraw its offer and leave Pantry Pride as the sole bidder -- with the inevitable consequences. I firmly believed that Mr. Forstmann was being sincere and candid in these statements.

-- App. 777.

They focused on whether Forstmann was bluffing: would he really walk away if they did not agree to the asset option; did they really have to give him their answer that day. App. 911 (October 12 Minutes at 32); App. 1493-95. Mr. Forstmann himself was invited into the meeting. He was firm in his presentation of his conditions; he set forth for the directors why he deemed them essential. App. 914-19 (October 12 Minutes at 35-40).

The crux of Forstmann's presentation was that he would not be used as a stalking horse. Perelman of Pantry Pride had told Forstmann that he would raise every Forstmann offer by $.25. This was unacceptable to Forstmann. Accordingly, he was insisting upon the "lock-up" option or he would not proceed with his $57.25 offer. "He said that it was a quid pro quo for the deal and that <u>he would accept nothing less</u>." App. 917 (October 12 Minutes at 38) (emphasis added). He also stated "that if the offer were not accepted, it would be withdrawn and that <u>the Company would be left to deal with Pantry Pride on its own</u>." App. 918 (October 12 Minutes at 39) (emphasis added). The directors believed him.* App. 777, 1384-90, 1442, 1456-57, 1489-90, 1495-96, 1498, 1554-56, 1567.

* Pantry Pride sought to argue below that the previous Forstmann $56 merger agreement provided a "floor" and that accordingly the directors could have had no legitimate concern of a Pantry Pride reduction in price. This argument ignores the business realities facing the Board: Forstmann had made it clear that he would "walk away" from Revlon entirely (<u>e.g.</u>, App. 1456-57). As a legal matter, he presumably could, if so

(footnote continued)

Forstmann also made clear -- unequivocally so -- that he had financing commitments to cover the requirements of the $57.25 proposal. App. 916, 919 (October 12 Minutes at 37, 40); App. 1375-78, 1422-25, 1518. <u>See also</u> App. 1512-14, 1535-36, 1557.

After Forstmann left, the directors discussed the proposal further. One particular area of discussion was the disruption to Revlon's business and operations which the protracted uncertainty as to the company's future had caused. App. 919 (October 12 Minutes at 40); App. 1491.

The directors unanimously approved the Forstmann deal. App. 920 (October 12 Minutes at 41); App. 778.

D. <u>Post-Board Meeting Events</u>

As noted, the Revlon Board approved the Forstmann Little merger agreement on October 12. As predicted, the agreement immediately came under litigation attack by Pantry Pride. App. 47. But it was not until Friday, October 18 -- the morning of the argument of the preliminary injunction below -- that Pantry Pride announced in its reply papers a raise in its offer: it,

(footnote continued)

motivated, find an arguable "out" among the conditions in the agreement. But, more to the point, the interests of the stockholders would not be served by a problematical lawsuit. As director Rifkind testified when asked if the October 3 merger agreement would not serve to protect Revlon shareholders against a lowered Pantry Pride bid: "I wasn't going to put the interests of the stockholders at the risk of a litigation" for breach of contract. App. 1580.

too, would take steps to bring the Notes up to par. App. 1152. The motion was argued below, Revlon's counsel pointing out to the Court that even at that late date, Pantry Pride's $56.25 offer was still inferior to the Forstmann $57.25 offer that had been accepted by the Board. E.g., App. 1291-92. Only after that Court hearing did Pantry Pride "raise" for the second time that same day: it would pay $58 per share if the asset option were enjoined.* App. 1161.

E. The Court's Critical Finding of Improper Motivation Is Wholly Without Support in the Record; All Evidence Is to the Contrary.

The key premise for the Chancery Court's conclusion of improper "self-interest" leading to a supposed breach of fiduciary responsibility on the part of the directors is the Court's perception that the directors were motivated in granting the "lock-up" option by a desire to avoid feared liability for having issued the Notes to the stockholders pursuant to a misleading exchange offer prospectus. There is no evidence in the record that would support such a finding of motivation; all evidence is to the contrary. In light of the record, the Court's finding that the directors violated their "duty of loyalty" is inexplicable.

* At the October 12 Board Meeting, the directors had been advised by counsel "that it was likely that Pantry Pride would increase its offer to $58 a share in order to obtain a favorable litigation posture, and to condition its revised offer on the invalidity of the option." App. 910 (October 12 Minutes at 31).

There is no question that the directors on October 12 were aware of the prospect of Noteholder suits arising out of the sharp decline in value of the Notes in the preceding week. As director Glucksman testified based on his 35 years of experience in the securities business: "[w]henever anything is sold, that trades at a sharp discount, immediately after the offering, somebody always sues." App. 1434. See also App. 1544, 1569-70.

But the record is absolutely crystal clear that the directors had no fear of any liability in any such suits. As had been detailed above, they were expressly advised by counsel that "there was no problem with the disclosure in the exchange offer document." App. 907 (October 12 Minutes at 28). And the directors did not believe that they had any such liability. Mr. Glucksman, under questioning upon deposition by counsel for Pantry Pride, testified squarely that "I did not think that absent the inconvenience of litigation that we had a financial liability." App. 1477.

Glucksman went on to testify:

> Q. You thought that you had no financial liability to the note holders?
>
> A. Absolutely. A liability under a settlement of a case in court. When you start talking about a liability to note holders, moral liability, legal liability, I did not think we had a liability that would be asserted against us in an actionable cause.
>
> Q. Did not think you had a legal liability to the note holders?
>
> A. I did not.
>
> -- App. 1477 (emphasis added); see also App. 1522.

Director Rifkind, a former federal judge and eminent member of the bar, also testifed repeatedly that he was personally satisfied that the disclosure in the Exchange Offer was complete:

> Incidentally, I am not aware of any deficiency in the disclosures made with respect to the exchange offer, but you may have something in mind that I don't know.
>
> * * *
>
> But I was aware of, in view of the complaint of stockholders, I was aware of the question about it and I thought it over in my own mind and I came to the conclusion that I saw no deficiency in the disclosure with respect to it. The expectations of stockholders may very well have been disappointed, but the disclosure was adequate.
>
> * * *
>
> Q. And this article indicates that some note holders were considering filing suit against the company on the basis that there was not full disclosure made in the exchange offer about the possibility of a leveraged buyout afterwards.
>
> A. It may well be. I thought there was full disclosure.
>
> -- App. 1558, 1562, 1570 (emphasis added); see also App. 1520.

Likewise, notwithstanding assiduous efforts by Pantry Pride's counsel, the directors were unequivocal that "fear of litigation" played no part whatsoever in their efforts to procure protection of values for the Noteholders. Judge Rifkind testified (App. 1576-77):

> The suggestion that I was resisting was your suggestion that the board voted for this in order to escape personal liability. That to me makes no sense.

See also App. 1572-73. And Glucksman testified:

> I have talked in my deposition about concern about an obligation to the note holders, not because of fear of litigation but what I looked on as the equity of the situation. Those note holders received a piece of paper which in good faith we hoped would trade for par. These were trading at a value that I thought was closer to 86. And the solution offered by Mr. Forstmann, which was a costly one in the transaction, to bring them up to par value, would advantage note holders. . . .
>
> -- App. 1491-92 (emphasis added).

Moreover, as previously noted, the inference sought to be drawn by the Court below that Mr. Glucksman had retained counsel subsequent to the October 3 meeting because of a supposed concern with liability arising from the market drop in the price of the Notes was manifestly mistaken: not only does Glucksman's testimony show that the purpose was entirely otherwise, but counsel was indisputably retained prior to the October 3 meeting and actually attended that meeting of the Board. App. 849 (October 3 Minutes at 5); App. 1486-87.

Likewise, Revlon's negotiations with Forstmann Little with respect to the rights of Noteholders antedated the October 3 meeting and had nothing whatsoever to do with any question of liability either of the company or the directors for a misleading prospectus. Rather, the discussions arose out of Forstmann's request for a waiver of the protective covenants in the Notes. App. 943-45. Prior to the October 3 meeting, Forstmann had tentatively indicated receptivity to the concept of redeeming the Notes at an early date at par (App. 945); the Board on October 3 -- contrary to the mistaken finding of the Court below, <u>see</u> pp. 8-9, <u>supra</u> -- accordingly <u>declined</u> (in Forstmann's presence) to waive the covenants at that time until "they could be sure that the 11.75% Notes would be protected." App. 861 (October 3 Minutes at 17).

Thereafter, in the negotiations leading to the October 12 modification, Revlon, in return for its agreement to waive the covenants, had obtained from Forstmann Little its agreement to issue higher coupon replacement notes to bring the Notes up to par. The directors' "concern" for the Notes thus stemmed in no way from a fear of personal litigation liability for a supposedly misleading prospectus. Rather, the directors' "concern" was to act responsibly, under the guidance of counsel, to fulfill their obligations to the Noteholders in connection with any waiver of the Note covenants. App. 766, 1379-82, 1427-32, 1458-59, 1521, 1586.

It is respectfully submitted that there was absolutely no warrant on the record before the Court below to brand these directors as having failed in their "duty of loyalty" and having been led into a breach of fiduciary duty by supposed "self-interest".

The <u>true</u> motivation of the directors is absolutely clear on the record. As the Chancery Court recognized, the directors found the Forstmann Little deal to be the best that had been offered in the two months of bidding. Op. 12. It provided $100 million more for Revlon securityholders than Pantry Pride had offered. Every witness who testified on the subject perceived a real risk that Forstmann Little would walk away if the lock-up option was not agreed to. The result would be that shareholders would get less than $57.25; perhaps less than the $56.25 which Pantry Pride then had on the table. *E.g.*, App. 777, 931-34, 937-38, 1384-90, 1456-57, 1482-83, 1487-93, 1527-28, 1567.

Moreover, as the Chancery Court stated (Op. 11), Pantry Pride had made clear that it would only "nominally" raise any Forstmann offer; no Pantry Pride "bonanza" was being shut out. Indeed, the bidding process had run its course and the price which had been achieved was a full and fair price for Revlon. App. 937-38, 1499. It is undeniable that Pantry Pride -- which had "nickeled, dimed and quartered" Revlon every step of the way -- would not have raised its $56.25 offer by a penny if the Forstmann Little deal of October 12 had been turned away.

Under these circumstances, had the directors refused Forstmann's demands and not agreed to the terms of its higher offer, they would be in this Court today with an indefensible position. The directors' decision was not only reasonable, it was absolutely correct.

ARGUMENT

Standard of Review

In reviewing factual determinations based solely on a paper record -- which is all that exists here -- this Court "may make [its] own conclusions, if the requirement of doing justice requires it and if the findings below are clearly wrong." Moreover, with respect to "findings arising from deductions, processes of reasoning, or logical inferences, it is [the Court's] duty to review them, and, if the requirement of doing justice requires it and if the findings below are clearly wrong, then to draw [its] own inferences and reach [its] own conclusions." Application of Delaware Racing Ass'n, Del. Supr., 213 A.2d 203, 207 (1965). See also Smith v. Van Gorkom, Del. Supr., 488 A.2d 858, 871 (1985); Levitt v. Bouvier, Del. Supr., 287 A.2d 671, 673 (1972). Finally, the lower court will be reversed for an error of law. See, e.g., Tri-State Vehicle Leasing, Inc. v. Dutton, Del. Supr., 461 A.2d 1007, 1008-09 (1983); Rohner v. Niemann, Del. Supr., 380 A.2d 549, 552 (1977).

POINT I

THE COURT'S CONCLUSION OF A BREACH OF FIDUCIARY DUTY BY THE REVLON BOARD IS UNWARRANTED ON THE FACTS AND THE LAW.

In approving the transaction at issue here, the independent Revlon Board of Directors indisputably stood at arm's length vis-a-vis Forstmann Little. Again indisputably, there was no entrenchment motive. It is not disputed that the Board was fully informed and gave careful and conscientious consideration to the matters at issue. The directors were unanimous, and acted in conformity with unusually strong recommendations of investment bankers and counsel. By approving the Forstmann proposal, the directors secured an additional $100 million in value for the stockholders and Noteholders -- having previously brought the offering price for Revlon well up from the depths of inadequacy at which Pantry Pride had originally attempted to gain control of the company. Without granting the lock-up, the bidding process would have stopped at $56.25 without any protection for the value of the Notes.

Nonetheless, the Court below held that the directors' decision was not entitled to protection under the business judgment rule because the directors were supposedly motivated by self-interest in the form of a threat of litigation by disgruntled Noteholders. This conclusion cannot withstand scrutiny on the record and under controlling principles of Delaware law.

A. Pantry Pride has failed to meet its burden of proving primary or sole bad faith motivation.

The business judgment rule operates as "a presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company." Aronson v. Lewis, Del. Supr., 473 A.2d 805, 812 (1984) (emphasis added); see also Unocal Corp. v. Mesa Petroleum Co., Del. Supr., 493 A.2d 946, 954 (1985).

Each of these elements is presumed. To rebut the presumption, a plaintiff bears an unusually heavy burden. He must "tender evidence from which a factfinder might conclude that the [directors'] sole or primary motive" was to further the directors' self-interest. Johnson v. Trueblood, Inc., 629 F.2d 287, 293 (3d Cir. 1980), cert. denied, 450 U.S. 999 (1981) (emphasis added). It is not even sufficient that self-interest constituted "a" motive. Id.

That presumption is heightened where (as here) a majority of directors are independent or outside directors. Unocal, 493 A.2d at 955; Moran v. Household International Inc., Del. Ch., 490 A.2d 1059, 1075 (1985), appeal pending, Del. Supr., No. 37, 1985 (filed Jan. 31, 1985). Here, eight of Revlon's fourteen directors are outside, independent directors.*

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* The Court below, in a footnote, states that two of Revlon's outside directors are significant stockholders and "most" of the outside directors are or have been "associated" with entities which have done business with Revlon. Op. 4. The fact that outside directors own Revlon stock is a reason to give them greater deference -- especially here, where the Court apparently believed that stockholders' interests were sacrificed. See David J. Greene & Co. v. Dunhill International, Inc., Del. Ch., 249 A.2d 427, 432 (1968). And, the fact that certain of the outside directors are or have been

(footnote continued)

The Court below never explicitly referred to the sole or primary purpose test. Nonetheless, the Court proceeded as if such a finding of predominant wrongful motive had been made. The Court presumed that the directors' motive for accepting the Forstmann Little deal and ending the bidding process was a personal desire on the part of the directors to "rid themselves of a vexing and potentially damaging source of litigation," to wit, lawsuits by Revlon Noteholders, presumably for fraud in connection with the Exchange Offer. Op. 24. The Revlon Board -- which was "commended" for its role in achieving a major price increase from $42 to $57.25 (an increase in stockholder value made possible by the Exchange Offer, the Rights Plan and other measures) -- now supposedly sold out public stockholders in order to avoid the threat of personal liability to Noteholders.

In adopting Pantry Pride's eleventh-hour, reply brief "self-interest" theory, the Court below ignored several basic legal principles:

(footnote continued)

"associated" with entities that have had a commercial relationship with Revlon is insufficient, as a matter of law, to establish that these directors were motivated by personal financial concerns rather than their sound business judgment. See, e.g., Kaplan v. Wyatt, Del. Supr., No. 348, 1984 (Oct. 9, 1985), slip op. at 2-3, 9; Maldonado v. Flynn, 597 F.2d 789, 794 (2d Cir. 1979); Haber v. Bell, Del. Ch., 465 A.2d 353, 358 (1983). None of the outside directors is beholden to Revlon for his economic well-being -- an indisputable fact. This is a truly independent board.

First, Pantry Pride adduced no evidence whatever to meet *its* burden of showing "sole" or "primary" wrongful motivation (or to rebut the showing affirmatively made by Revlon). *See* pp. 27-32, *supra*.

Second, the only "evidentiary basis" for finding a wrongful motive at all would be to *dis*believe paper deposition testimony and affidavits of directors. (Revlon's request to put on live testimony of director Rifkind was refused.) The law is well-settled that a fiduciary breach may *not* be found by disbelieving attestations. Indeed, even where there is a *conflicting* record, a preliminary injunction may not issue. *See*, *e.g.*, *Hemphill* v. *The Singer Co.*, Del. Ch., C.A. No. 818, Brown, C. (Jan. 16, 1984); *Melton* v. *Vessels*, Del. Ch., C.A. No. 1035, Brown, C. (Oct. 28, 1983); *Passwaters* v. *A & W Stables, Inc.*, Del. Ch., C.A. No. 5538, Hartnett, V.C. (Apr. 24, 1978); *Walter E. Heller & Co.* v. *Cox*, 379 F. Supp. 299, 301-02 (S.D.N.Y. 1974); *Gropper* v. *North Central Texas Oil Co.*, Del. Ch., 114 A.2d 231, 237 (1955); 11 C. Wright & A. Miller, *Federal Practice and Procedure* § 2949, at 474-75 (1973 ed.).

Third, in the specific context of a threat of personal litigation liability this Court has *already* ruled that the presumption afforded by the business judgment rule will *not* lightly be put aside. In *Aronson* v. *Lewis*, Del. Supr., 473 A.2d 805 (1984), the Court even went so far as to rule that a board may *directly* terminate litigation against itself absent a particularized showing of wrongful motive by the board: "[T]he mere threat of personal liability for approving a questioned transaction, standing alone, is insufficient to challenge either the independence or disinterestedness of directors." Id. at 815. See also Kaplan v. Wyatt, Del. Supr., No. 348, 1984 (Oct. 9, 1985), slip op. at 7-10 & n.1. It follows a fortiori that it cannot be presumed here that the Board was under a debilitating self-interest in approving a corporate transaction which -- even adopting plaintiff's analysis -- would at most have the indirect effect of terminating litigation that the Board was advised and believed was baseless.

Indeed, as Smith v. Van Gorkom, Del. Supr., 488 A.2d 858, 861 (1985), appears to recognize, it is the rule and not the exception that someone -- an offeror, stockholders, creditors or other interested parties -- will commence or at least threaten litigation as a result of actions or inactions of a target board. It cannot be the law that directors will be held to be motivated by self-interest merely because the directors are aware of the likelihood or existence of such lawsuits. Such awareness is a fact of life for all target directors, and does not constitute a disqualifying interest. See id. In this case, there was nothing more. The uncontradicted record establishes that the directors were advised and believed that the lawsuits were meritless. There is no basis for any finding -- even an inference -- that the "sole" or "primary" motivation of this Board was to avoid personal liability.

B. The Court below incorrectly found that the Revlon directors could not consider the interests of Noteholders in agreeing to the Forstmann deal.

The Court below found that in a competitive bidding situation the "primary responsibility" of the directors was "to bargain for the rights of the remaining equity holders" and that the rights of the Noteholders "had been fixed as a matter of contract." Op. 24. Under the business judgment rule, as formulated by this Court, however, there can be no question that the Court below was incorrect as a matter of law. The directors had every right to consider the rights of Noteholders and achieve a transaction which protected their interests as well as the interests of stockholders.

The starting point for this analysis is Unocal. That decision makes clear that a target board may properly consider the interests of "'constituencies' other than shareholders (i.e., creditors, customers, employees, and perhaps even the community generally)." Unocal, 493 A.2d at 955 (emphasis added).

Here, the Notes had just been issued in the Exchange Offer to Revlon stockholders. As the Court below found, the Notes had been issued for the proper purpose of "provid[ing] increased value to the shareholders". Op. 24. The Notes had been structured to trade at par; the stockholders had been so advised. Shortly after the Notes were issued, the Board had been obliged to seek alternative transactions as a result of

Pantry Pride's new and inadequate $42 tender offer. The only alternatives turned out to be leveraged transactions in which a waiver of the Note covenants -- which would impair the creditworthiness and hence value (absent further modifications) of the Notes -- became inevitable.

In these circumstances, Revlon, its advisors and its directors legitimately believed that it was appropriate to take steps to maintain the value of the Notes. Indeed, it arguably would have been a breach of Revlon's contractual and good faith obligations _not_ to consider the Noteholders. _See_ _Gilbert_ v. _El Paso Co._, Del. Ch., 490 A.2d 1050, 1054-55 (1984).

The independent directors were expressly entrusted with contractual authority to waive the covenants. As a matter of the Note contract, which the Court below found to have fixed the Noteholders' rights, it was up to those directors acting reasonably and in good faith to consider the appropriate circumstances under which the covenants should be waived. Whether Revlon was _required_ to treat Noteholders fairly or not, it is inconceivable that the Board should be _forbidden as a matter of law_ to treat the Noteholders fairly. It is unthinkable that Delaware law would require the directors arbitrarily and irresponsibly to waive the protective covenants without proper arrangements protecting the value of the Notes -- Notes that stockholders had just received.

Moreover, putting aside whether the directors had the right or obligation to consider Noteholders' interests, in this case the directors' responsibilities were not in conflict. The Forstmann deal was, as an independent matter, better for the stockholders than Pantry Pride's then-existing offer in the business determination of the Revlon Board. That determination was classically a business judgment, turning, as it did, largely upon business judgments as to the relative value of competing offers and certainty of consummation. Had Forstmann Little's offer with its "lock-up" not been accepted, Pantry Pride could have acquired Revlon by default at $56.25 -- $1 per share less than Forstmann Little agreed to pay -- or even less, and the Noteholders would have been allowed to twist in the wind. There simply was no conflict between the best interests of the stockholders and the best interests of the Noteholders.*

C. The Revlon Board had a rational business purpose for entering into the transaction with Forstmann Little and ending the bidding process.

Once this case is rid of the improper finding by the Court below of bad faith motivation, the result is dictated by the business judgment rule. The directors here acted to secure $100 million in additional value and to avoid the risk

* In any event, the Noteholders are to a great extent the same people as the stockholders having received their Notes in the partial exchange of shares in the Exchange Offer. App. 1380-82, 1428, 1430-31, 1570-71.

of a reduction in Pantry Pride's lower tender offer that was further subject to less certain financing. As the Court reiterated in Unocal:

> A hallmark of the business judgment rule is that a court will not substitute its judgment for that of the board if the latter's decision can be "attributed to any rational business purpose."
>
> -- Unocal, 493 A.2d at 954, quoting Sinclair Oil Corp. v. Levien, Del. Supr., 280 A.2d 717, 720 (1971).

The record is absolutely clear that the Revlon Board's decision can be so "attributed to any rational business purpose." Indeed, a finding by the Court below itself supplies such a rational business purpose: "On Saturday, October 12, Revlon's directors met and concluded that Forstmann Little's latest offer was more favorable to Revlon's shareholders than Pantry Pride's tender offer at $56.25 because Forstmann Little's offer was [i] for a higher price, [ii] it protected the Noteholders, and [iii] its financing was firmly in place." Op. 12. Any one of these purposes standing alone would supply a rational business purpose and therefore foreclose Pantry Pride's effort to overturn the Board's judgment in an effort to serve its own interests.

Not only was the Revlon Board's "business purpose" here rational; it was correct. While the directors are entitled to business judgment rule protection here, even without the rule there can be no legitimate second-guessing of this Board. The evidence is overwhelming that the directors pursued the only rational course of action available. See pp. 18-26, 27-32, supra. Indeed, the irony is that any other decision would have raised the potential of real liability -- under Smith v. Van Gorkom, supra, for leaving stockholders exposed to a lower and less certain Pantry Pride bid in the face of the higher and more certain Forstmann Little proposal.

Whether the business decision on October 12 was correct or not, however, the business judgment rule is applicable and the law under that rule overwhelmingly supports the rationality of decisions such as that of the Revlon Board. See, e.g., Crouse-Hinds Co. v. InterNorth, Inc., 634 F.2d 690, 703-04 (2d Cir. 1980); Whittaker Corp. v. Edgar, 535 F. Supp. 933, 951 (N.D. Ill. 1982), aff'd, Dkt. Nos. 82-1305, 82-1307 (7th Cir. March 5, 1982).

The Court below's finding of lack of reasonableness (and indeed its entire decision) was built upon the factually erroneous -- and, under the business judgment rule, legally improper -- premise advanced by Pantry Pride that the directors' judgment that the Forstmann Little deal was superior in terms of the stockholder interests alone "seems highly questionable" as a business matter. Op. 20. With all due deference, it was just not the Court's province to make that judgment. The directors' business judgment is what counts, and as director Glucksman testified, the directors' business judgment concerning the Forstmann proposal was unequivocal: this "was a very advantageous offer." App. 1456.*

The Board's decision was clearly rational. The business judgment of the Board is, as a matter of law, unassailable.

D. The business judgment rule applies fully to decisions to agree to so-called "lock-up" provisions.

Like any other business judgment, in the takeover context or otherwise, a board's business decision to agree to a "lock-up" provision is fully subject to the protections

* Notably, the Court below came to its conclusion that Noteholders' interests were the "perhaps dispositive" reason for the directors' acceptance of the Forstmann proposal only as an inference from its disagreement with the directors' judgment that the Forstmann proposal was most advantageous in terms of stockholder interests -- a business judgment that the Court termed "highly questionable." See Op. 20-22. The Court below, on the basis of its judgment that the directors made a questionable business decision on October 12, then inferred that the Board's motivation must have been protection of the Noteholders. The Court then held that such a motivation is inimical to the business judgment rule. In seemingly circular reasoning, the Court thus came to conclude that the business judgment rule was inapplicable by first violating the rule by substituting its business judgment for that of the directors.

Moreover, the critical determination of the Court below that (contrary to the directors' judgment) the Forstmann proposal was not better financed was based on indisputably erroneous factual premises: (i) that $400 million of financing had been lost by Forstmann via management's exit from the deal (Op. 22), whereas in fact, management's withdrawal removed their intended contribution of only $18 million which the Board was told would be otherwise available; and (ii) that Pantry Pride's Drexel Burnham claimed to have commitments for the $700 million to complete its offer (id.), whereas in fact Drexel never so claimed and Pantry Pride was still $350 million short. See pp. 5-6, supra.

-- and the obligations -- of the business judgment rule. This is true even though the grant of a "lock-up" may deter other bids or end the bidding entirely. A board's judgment as to how best to run negotiations, and when to end the bidding, in order to obtain the highest bid is manifestly no less a matter of business judgment than any of the other judgments directors make in the takeover context. There are no special rules.

All the case law supports this application of the business judgment rule, and "lock-ups" and like provisions have been upheld repeatedly thereunder. See, e.g., Thompson v. Enstar Corp., Del. Ch., C.A. No. 7641, Hartnett, V.C. (June 20, 1984, revised Aug. 16, 1984); GM Sub Corp. v. Liggett Group, Inc., Del. Ch., C.A. No. 6155, Brown, V.C. (Apr. 25, 1980); Whittaker Corp. v. Edgar, 535 F. Supp. 933 (N.D. Ill.), aff'd, Dkt. Nos. 82-1305, 82-1307 (7th Cir. March 5, 1982) (Delaware law); Buffalo Forge Co. v. Ogden Corp., 555 F. Supp. 892 (W.D.N.Y.), aff'd, 717 F.2d 757 (2d Cir.), cert. denied, 464 U.S. 1018 (1983) (New York law); Jewel Cos. v. Pay Less Drug Stores Northwest, Inc., 741 F.2d 1555, 1563 (9th Cir. 1984) (California law); Crouse-Hinds Co. v. InterNorth, Inc., 634 F.2d 690, 701-04 (2d Cir. 1980) (New York law).*

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* See also Simkins Industries, Inc. v. Fibreboard Corp., Del. Ch., C.A. No. 5369, Marvel, C. (July 28, 1977), slip op. at 2-3 (denying injunction which sought to facilitate competitive bidding and rejecting proposition that it is a court's function to impose a particular bidding process; the business judgment rule requires deference to a board's manner of sale "in the absence of fraud, gross unfairness of price . . . or unwarranted personal interest in the form of a sharing in the proceeds of such a sale").

That bidding may end as a result of a target board's business judgment is by no means an evil -- certainly not where (as here) the bidding process had run its course anyway and there would be no higher bids <u>but for</u> the "lock-up" option. The apparent view of the Court below that "lock-ups" should only be used where there is only one bidder ignores that in the <u>absence</u> of such "lock-up" and bid, the bidding could have (and here would have) ended at a <u>lower</u> price. Lock-ups are used typically and most justifiably to induce a competing bid at a higher price. That is precisely what happened here.

Moreover, whatever the relative business merits of "lock-ups," the determinative fact is that the judiciary has no authority to and is not competent to decide what the best bidding strategy should be for a target company. That is a business judgment within the province of the directors. Repeated bids and counterbids where one side "nickels and dimes" the other may result in a lower price. It may result in a higher price. It may even result in <u>no</u> price, if the winning bidder is then unable to finance the transaction and the losing bidder loses interest.

The determinative consideration here is that the business merits of a particular bidding strategy should be decided in the boardroom and not in the courtroom. This case is proof of the pudding. Before Forstmann Little entered the picture, the price Pantry Pride was offering was $42 per share.

its subsequent proposals all came after it learned that it had competition. The strategy pursued by Revlon and its directors not only was reasonable -- it worked, and there is a sublime irony now in branding these persons of good faith and wise judgment as faithless fiduciaries.

POINT II

THE COURT ERRED BY ENJOINING THE RIGHTS PLAN AND COVENANTS.

The Court below expressly held that Revlon's Rights Plan was not void *ab initio* and that the Plan's adoption "falls within the business judgment rule as a prospective device calculated to strengthen the board's bargaining position." Op. 16. The Court, further, rejected the attacks on Revlon's Exchange Offer and the Note covenants. Op. 17-18.

Nevertheless, without any finding of wrongdoing in connection with the Rights Plan or covenants, the Court granted injunctive relief with respect to both. *See* Op. 27. This ruling was entirely unnecessary; Revlon had already effectively redeemed the Rights and agreed to waive the covenants in connection with offers that provided certain levels of consideration for securityholders; there was no conceivable threat of irreparable injury to Pantry Pride. Pantry Pride's outstanding bid promises to meet those levels and would be unimpaired -- even without any preliminary injunction -- by the Rights plan and covenants. The request for an injunction on these points was moot and should not have been granted.

The Court below also appears to have been influenced by the existence of these devices in denying Revlon's directors the protections of the business judgment rule. Op. 25-26. It is respectfully submitted that this reasoning is erroneous. The Rights Plan did not stop Pantry Pride; nor did the covenants. They assisted the Board in obtaining a far better deal than Pantry Pride originally offered. To say that having taken those steps, the Board was thereafter stripped of the right to exercise its business judgment simply does not make sense.

CONCLUSION

When this takeover situation commenced, the Revlon Board sought to protect and maximize stockholder values. It did just that by securing a bid far in excess of the bargain basement price at which Pantry Pride would otherwise have been able to acquire the company. The Board acted properly. The decision below should be reversed.

Respectfully submitted,

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