IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

IN AND FOR NEW CASTLE COUNTY

MACANDREWS & FORBES HOLDINGS, INC., a Delaware corporation,

Plaintiff,

vs.

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

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Superior Courtroom No. 30
Public Building
Wilmington, Delaware
Friday, October 18, 1985
11:12 a.m.

- - -

BEFORE: JUSTICE JOSEPH T. WALSH

- - -

ARGUMENT ON PLAINTIFF'S MOTION FOR PRELIMINARY INJUNCTIC

CHANCERY COURT REPORTERS
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APPEARANCES:

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-and-
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for Defendant Revlon, Inc. and Individual Defendants

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ALSO PRESENT:

GROVER C. BROWN, ESQ.
Morris, James, Hitchens & Williams
-and-
DAVID M. BERNICK, ESQ., of the Illinois Bar
Kirkland & Ellis
for Adler & Shaykin

THE COURT: Is everybody one reasonably comfortable?

Mr. Stargatt.

MR. STARGATT: With deference to Your Honor, Justice Walsh, this Court has often said that it plays a small part in a larger stage in these takeover battles, and I have often thought of myself as pretty much of a bit player in cases of this sort. Not so here. It appears to me that we are all of us now at center stage.

The question here, as we see it, is whether the market will be allowed to operate or whether Revlon stockholders will be deprived of the right to tender or not tender into the pending Pantry Pride offer because of Revlon's defensive tactics. There has been a stack of paper inflicted on the Court, largely dealing with the facts. The facts as they have emerged cover a time span of from July to now, mostly from August 19 to now. And being somewhat of a fact lawyer, it seems to me that they are not complicated.

I propose to review them with some care and then to speak with respect to the legal arguments.

In July of 1985 Pantry Pride expressed interest in a negotiated transaction with Revlon. Revlon was not interested, encapsulating a lot of who struck John when I say that, but I think that is all that needs to be said. Until August Pantry Pride persisted. Revlon insisted on a stand-still agreement from Pantry Pride as a condition to negotiation. Pantry Pride refused to have its hands tied.

Pantry Pride continued to talk to Revlon, indicating that it intended to make a tender. During those conversations Pantry Pride tried to get negotiations going, and as events turned out, Revlon stalled.

That became apparent when on August 19 the Revlon board of directors adopted what has come to be called a poison pill rights plan, sort of a new innovation in the arsenal of weapons that potential targets, advised by counsel expert in these areas, seem to adopt. The essence of the plan was that if $65 a share was not offered to all Revlon stockholders by an offeror who got more than 20 percent of Revlon stock, the stockholders would have the right to turn in that stock for a $65 Revlon debt instrument. The $65 price was high, known to be high. It was doubtful that if liquidated Revlon could achieve that sort of a return.

The rights were redeemable for a dime apiece by the Revlon "independent" directors, the non-management directors, in their discretion in any transaction which they approved.

Confronted with, surprisingly, this device that Revlon had chosen to introduce under the guise of conversations, on August 23 Pantry Pride proceeded with what it had tried to avoid doing: A public tender offer for any and all of Revlon's shares at $47.50 a share, provided the rights were voided.

On August 29 Revlon again reacted, not by negotiating or discussing with Pantry Pride the possibility of its doing better on a negotiated basis but by tendering for a quarter of its stock, 10 million shares, in return for which it offered the exchange of notes with a face value of $57.50 apiece and a tenth of a share of a hundred-dollar preferred stock. The package was thought to be worth $57.50.

The notes and preferred stock were used as a vehicle to put in place another poison pill for the clear and express purpose of deterring Pantry Pride. The draft minutes declare that as the purpose. Unless waived by so-called independent directors, again, Revlon is, in effect, paralyzed. It is severely restricted from incurring debt. It can't sell more than 2 percent of its assets. It can't even increase its dividends.

If it is not clear from the minutes that this was pure and simple an anti-takeover devise, I call attention to the fact that again this was independent directors who were given these responsibilities, the independent directors being the ones who were supposedly impartial to possible takeover offers. These sorts of decisions ordinarily are left in the hands of the full board. Not so with the poison pill.

The effect of these poison pill restrictions is that only Revlon's current independent directors or their hand-picked successors can remove the strait jacket into which the restrictions put Revlon. If they resign, for example, if it became apparent that Pantry Pride was going to win the contest, this tender would proceed, there would be nobody to waive the restrictions, and

Pantry Pride and Revlon would be forever stuck with them. If they are replaced by stockholders at some later time with Pantry Pride no longer on the scene, the restrictions continue in place. It is only the current independent directors or the successors elected by them, nominated by them or chosen by them at a board meeting who can waive those restrictions.

There is a contention in the Skadden, Arps brief, first brief, that those restrictions are illegal per se, that they break the outer limit of corporate flexibility. I plan to say no more about them than what the brief itself says.

On September 13, after Revlon took down under its self-tender, Pantry Pride lowered its offer to $42 a share. And if Your Honor has waded through the briefs, you will note that much is made of that in our friend's brief. Pantry Pride made a 47.50 offer and then lowered it.

But the fact is undisputed, and it was recognized by Revlon, that the reduced offer was designed to take into account the effect of the exchange offer, which had inflicted debt on the company at a higher level and caused a dilution to occur.

Again, the $42 offer, which was the equivalent of the pre-exchange offer, the $47.50 offer, was cash any and all, but it had a floor of 90 percent, because it would not work unless 90 percent of the stock tendered, since the other 10 percent, if the rights had not been pulled, would have been entitled to convert. Pantry Pride said in the offer that if the poison pill was pulled, it would consider raising its offer.

After the September offer went out, Pantry Pride still tried to sit down with Revlon to strike a bargain. On September 27 Ronald Perelman of Pantry Pride wrote Michel Bergerac of Revlon, offering to do a merger with Revlon at $50 a share and offering to negotiate. On October 1 Perelman -- and at this point Pantry Pride was, in effect, bargaining against itself -- upped his merger offer to $53 a share.

This time there was a response, and it took the form of a press release. On October 2 Revlon announced a possible leveraged buy-out with management at $54 a share, but asked Pantry Pride to keep its $53 offer open. The next day another press release was issued. Apparently using Pantry Pride as a stalking horse, as our friends have put it in their brief, certainly as a benchmark, they announced that an LBO deal had been done at $56 per share.

As we learned later when the merger agreement with Forstmann Little was finally produced to us, the LBO had these features, among others: A price of $56 to shareholders when and if they approved the merger, management participation in the LBO to the extent of 25 percent of the equity, an agreement that management's severance contracts, its golden parachutes, would be triggered, even though the employee management people in many if not most cases would not move from their desks. They would continue to work for the continuing entity. The cost of the golden parachutes, the receipt to Mr. Bergerac and others, totaled $40 million, including $20 million to Mr. Bergerac, and the sale of Revlon's Beauty Division and the Revlon name to a firm called Adler & Shaykin for $900 million.

Now, mentioning Adler & Shaykin, let me digress for just a moment, because I do not plan to separately treat with the sale of asset points in the argument. And I mean to say no more about Adler & Shaykin than what I am going to say, unless I need to reply to something that is said by somebody else. We received very late yesterday afternoon an application on behalf of Adler & Shaykin to intervene in these proceedings, supposedly to protect their rights, with a grievance that they ought to have been made a party. It may be that they misunderstand or that maybe we misexpressed our point of view on that subject, but I shall try to do so so as to cut off later or perhaps reduce later argument on the point.

We have taken the position in the brief -- and I will not articulate during the course of the argument section -- that the Adler & Shaykin deal in combination with the $525 million lock-up that has been given to Forstmann is a sale of all or substantially all of Revlon's assets, which as such requires stockholder approval. If we are correct in that, we do not seek to enjoin the Adler & Shaykin transaction. And I haven't looked back over our papers in the rush of trying to get everything else done to see if there is anything on the subject. I don't think there is. We don't seek to enjoin the Adler & Shaykin transaction.

If the Adler & Shaykin transaction is subject to stockholder approval, two things can happen: It may be approved. The outside closing date is January 15, 1986. It may be approved, or it may be disapproved. If it is approved, then there is nothing to argue about. If it is disapproved, there is a provision in the Adler & Shaykin asset sale agreement which gives Adler & Shaykin a right to $20 million by way of what Mr. Bergerac in his deposition called liquidated damages for non-consummation of the transaction. But at this point, at least from our side, we see nothing to argue about with Adler & Shaykin.

THE COURT: Let me interrupt you. Are you saying that you recognize that in the event that Pantry Pride would be successful, the new owners would be contractually bound to at least the liquidated damages provision?

MR. STARGATT: We recognize that provision exists in the contract, and because we have been kept so much on the outside, we do not know whether there is a defense or, if there is one, whether we would wish to pursue it with respect to the liquidated damages aspect of the contract. But we do recognize that that was a contractual provision in the sale of asset agreement. And the reason we recognize it is, we read it there.

THE COURT: Well, if, as I recall in the brief, your argument is that there is an aggregate sale of assets if you combine the Adler & Shaykin provision with the sale of the Health Aide Division, and if that, in effect, invalidates the Forstmann Little arrangement, can I just turn my back on that part of it or do I have to sub silentio invalidate that, too, if I invalidate the Forstmann Little deal? In other words, can I leave it where it is on your terms or don't I necessarily have to face the effect of it under your aggregate argument?

MR. STARGATT: Well, the aggregate argument only would result in the requirement that the Forstmann Little and, per force, the Adler & Shaykin transactions be subjected to stockholder approval. Forstmann Little obviously doesn't want that. Adler & Shaykin doesn't either. But it doesn't operate to either validate or invalidate the Adler & Shaykin deal, unless I am missing the point of Your Honor's question.

THE COURT: Well, I guess what I am saying is if you can put the Adler & Shaykin deal on the shelf, why can't you put the other deal on the shelf, too?

MR. STARGATT: I didn't mean to say that we were putting it on the shelf. It is our contention that it requires stockholder approval because it needs to have added to it the lock-up transaction. So --

THE COURT: You don't mean for me to engraft the condition on both, the condition of shareholder approval?

MR. STARGATT: We wish you to say that the transactions are subject to shareholder approval, yes, and in a sense you could say that was engrafting a condition, yes, a condition which we think the law requires.

The $900 million sale, incidentally, was, it is clear, to help finance Forstmann's LBO. The Beauty Division would never have been sold but for the Forstmann entry into the picture. And it seems reasonable to infer that the $20 million amount in the Adler & Shaykin deal gave recognition to the possibility that the Forstmann deal might fall apart and somebody else might take the company over and be unwilling to proceed with the Adler & Shaykin deal. Forstmann did not have enough money to buy this company without that $900 million amount.

It also provided, this merger agreement of October 3, for the payment of $25 million to Forstmann Little if the deal was cancelled on top of all of Forstmann's expenses. It contained an agreement to elect three Forstmann nominees immediately before the merger to the Revlon board. They weren't named. Forstmann was given the absolute right to name them. And the purpose was to put new independent directors on. These directors were contracted to be elected by the present independent directors, so as to waive these debt covenants that I spoke of, independent directors electing more independent directors who can waive the debt covenants, and also provided as a condition to closing that the independent directors would give a certificate approving the debt to be incurred by Forstmann Little on the leverage of Revlon's assets.

The merger agreement declared that $56, the Forstmann Little price, was a fair price and agreed to redeem the poison pill for the Forstmann Little offer or, after a 10-day waiting period, to redeem the rights for any other offer, any and all cash of $56 or higher. In a sense the announcement of the Forstmann transaction was good news to Pantry Pride. Up to this point Pantry Pride had been trying to negotiate but had been rebuffed at every step. Now at least it had a competitor. And it proceeded to compete.

On October 7, four days after the press release about the LBO, it sweetened its tender price to $56.25 a share, again, any and all, again, all cash. It asked only that Revlon do for it what Revlon had done for the management-sponsored LBO: Redeem the poison pill rights, as it had promised, and provide relief from the covenants. It is candid to say that Pantry Pride was not optimistic about getting Revlon's agreement to level out the bidding field, if you will, based on past events. So it filed an amendment to its complaint here, attacking the rights and the covenants and asking for relief.

The 10-day window provided in the merger agreement for the redemption of the rights was due to expire Sunday, as we sat before the Court perhaps last week. Time is sort of escaping. This Sunday passed, and there was no redemption.

The Court during our hearing last week, if it was last week, did not wish to assume that the board would decline to redeem the rights in favor of Pantry Pride's offer, so the Court set a schedule envisioning the possibility that there would need to be no hearing but allowing for one if there had to be one. And that is why we are here today.

Meantime, Pantry Pride, we on our side of the table, tried to develop a record to make the case that it had to make in order to proceed before this Court as to facts relating to the merger agreement. With this Court's leave, expedited discovery was allowed. Extensive production was sought as to the background of the merger, how it came about, how it was to be financed, what the board's thinking was about it, what materials were before the board, the board minutes, the circumstances of management's participation, the golden parachutes. And what happened next was in keeping with everything that Revlon had done before. We got virtually nothing.

The discovery rules are largely self-administered. The Court doesn't like to get involved in discovery disputes and most typically doesn't have to. And most of the lawyers who practice before Your Honor and the other courts of this state do everything that can be done to avoid that occurring, knowing that the Court doesn't like it and themselves try to, and for other good reasons, work things out. There was no progress in that direction in this case.

We sought the deposition of Mr. Bergerac, another Pantry Pride director and Forstmann witnesses, so we would get both sides of the table. Meantime, Revlon requested that Mr. Perelman be deposed at the same time as Bergerac, and we agreed. Depositions were to have been last Friday, a week ago today.

During the course of Perelman's deposition Revlon's lawyer declared he was not getting proper answers, and he elected to terminate the Perelman deposition. He also called over to where I was deposing Bergerac and instructed that Bergerac leave that deposition -- it was maybe 20 minutes or a half an hour into it -- which he did. He refused to produce the other director, who had been noticed to be deposed last Saturday. Revlon's conduct is the subject of a motion for sanctions that we filed I think on Monday morning.

Meantime, we were to have taken the

Forstmann depositions Thursday and Friday of last week. The Court issued commissions to allow that to occur. There were arguments about whether it should occur or shouldn't occur, and the Court ruled and issued commissions.

As I sat Thursday afternoon in the deposition room waiting for the Forstmann people to show up, we were served with a motion to quash, filed by Forstmann in New York. That motion, as I am advised, could not be heard much less decided before the day before yesterday, under New York practice. And I was told that it is practically impossible to get a faster hearing on that issue in New York. So Forstmann ipse dixit quashed its own depositions, and we have had no discovery out of Forstmann in this case, not an iota, not a paper.

Late Sunday afternoon we knew almost nothing about the Forstmann transaction except we looked at the merger agreement, which either by then or maybe the next day had become a matter of public record. We knew only what the record showed. But we were prepared to proceed on that basis, and we did, as we were preparing our briefs.

Then in the midst of preparing those

briefs late Sunday afternoon, at 4:00 or 5:00 in the afternoon there came over the wires an announcement that the Revlon board of directors had met Saturday and approved a new transaction, which included a lock-up to Forstmann and other features to be discussed shortly.

When we got the announcement, we knew we would be here today anyway. The new transaction is of deep concern to us, and there were those who thought that it should immediately be the subject of papers filed before the Court and a more prompt hearing, but it was decided that since the transaction was executory, we ought to fit it into the papers that we were preparing, based only on the press release, because that is all we knew about the transaction at the time. And we did. We filed a supplement to our complaint attacking the new transaction Monday morning, and filed our briefs Monday afternoon, including the amended merger agreement, as best we could figure it out from the newspapers.

We had continuing production requests out to our opponents, production requests which requested continuing updating with respect to transactions with Forstmann, and that updating occurred not after the board meeting on Saturday or on Sunday or even early Monday morning but at the close of business Monday afternoon we got some papers, including the amendment to the merger agreement, an option agreement, which was the lock-up to Forstmann, and escrow agreements.

To our shock, the materials that we got provided for an escrow or lock-up of the stock which Forstmann was getting the option for and an escrow of the $25 million termination fee, in a palpable effort, Forstmann having resisted every effort at discovery and not voluntarily appearing in these proceedings, to put these matters beyond the reach of this Court. The escrow was supposed to occur not later than 10:30 Tuesday morning, so we filed a motion for a TRO, and Your Honor was kind enough to hear us at 9:30 Tuesday morning.

Revlon advised us just before the hearing and the Court at the hearing that the stock the day before, on Monday, had already been escrowed and said there is nothing to hear. It is a moot issue.

Forstmann also came to the hearing.

This time it appeared and was directly asked by the Court as to whether the stock was beyond the reach of the Court. Counsel first had trouble responding directly, and then as the question was about to be read back to him responded that the Court continued to have jurisdiction to do whatever it wished to do, whatever the law required that it do with respect to that stock. Nevertheless, the Court entered a TRO in the form submitted by plaintiff to be sure that the status quo would be preserved pending final adjudication.

The lock-up, the option, is of Revlon's Vision Care Group, Barnes-Hind and Coburn Optical, and of Revlon's Health Care Division for a total consideration of $525 million. I want to underscore here what I will be saying later, not in the hope that repetition will make it better but just to truly emphasize the point. The lock-up achieved by Forstmann if it is allowed to stand will give it an asset, the right to obtain an asset, at $75 million to $175 million less than Revlon's investment bankers believe to be the fair value of that asset.

If one were to compare that, to take the mid-point of those figures, the Lazard estimate of $675 million to $700 million versus the $525 million lock-up price, if one were to take Lazard's mid-point as modestly $125 million, actually, a little higher, it exceeds by a substantial margin Revlon's after-tax earnings for the entire fiscal year 1984, which earnings I think were in the range of $112 million for the whole year 1984.

The purpose of the lock-up was to stop the bidding, particularly to stop Pantry Pride from bidding. Part of the new deal called for Forstmann to cause the $47.50 notes which had been issued in the exchange offer to trade at par. And the reasons for this are somewhat whimsical.

When Revlon issued these exchange notes at $47.50 par, it did so, of course, with a prospectus, if that is the right word, which made disclosures which might have been designed to lead the holders to believe that the notes would really be worth $47.50. When Forstmann's LBO was approved on October 3, the leverage factor was so heavy that the market believed that the notes had become junk or junkier, and the price of the notes fell. The notes, some of the notes, many of the notes, were still in the hands of Revlon stockholders. Many were not.

There was a tremendous arbitrage market in Revlon stock. The notes didn't trade as heavily, but they were also trading in the Revlon notes. But whoever was holding the Revlon notes, whether people who never owned Revlon stock or Revlon stockholders, who thought they were getting a note for $100, were ending up after the LBO was announced with a note that the market valued at $87 or in that range.

The board of directors began to get squawks from people on Wall Street about what had occurred, and suit was threatened. In fact, suit has been filed by the noteholders.

THE COURT: Let me interrupt you. Was that because of the management participation in the equity arrangement or was it because of the waiver of the covenants?

MR. STARGATT: I can't candidly say that you could separate management participation in the LBO out from anything else. In other words, I could not tell Your Honor that it was because of management's participation that the price of the notes fell. It could be, but I haven't seen any direct evidence of that.

THE COURT: If that is the case, then the October 12 withdrawal by management of participation would neutralize that fact.

MR. STARGATT: Yes. But I don't believe that that was the reason. I believe that the evidence seems to strongly suggest that the reason was that when the LBO, with its heavy -- the LBO contemplated that Forstmann would be borrowing on Pantry Pride's assets, and the result of that additional leverage factor apparently made the market concerned enough to begin to devalue the quality of the notes, not because management did or did not participate but because of the transaction itself. And management got nervous. They hired independent counsel.

They had no duty -- the noteholders were creditors, and the covenants were, however they are portrayed now, not designed -- they were designed as an anti-takeover device. They were not designed for any other purpose. And management had waived the covenants, knowing when they entered into the Forstmann transaction that Forstmann would be borrowing on Pantry Pride's assets, although it may very well be and probably was that they didn't realize the furor that would result.

But in all events, faced with a great many unhappy noteholders and threatened with litigation, they struck a deal with Forstmann to, in effect, bring the notes, make the notes trade back up at par by raising the interest rate on the notes in accordance with some sort of formulation to take into account the increased risk that the noteholders had under the leveraged buy-out deal.

For our part, for Pantry Pride's part, after the October 3 merger agreement, continuing to try to bring Revlon to the point where it would discuss what Pantry Pride was willing to do for Revlon's stockholders, Pantry Pride was aware of the concern of the Revlon board and tried to accommodate it, indicated that it would be flexible, they themselves would be flexible in terms of dealing with the noteholders. And there was simply no effort by Revlon to bargain on the subject, and Pantry Pride has indicated that it will do for the noteholders what Forstmann has done for the noteholders: It will bring the notes up to par.

THE COURT: Well, on October 12 didn't Forstmann Little, in effect, say to Revlon, "The deal is on the table. You take it now or there is no deal"?

MR. STARGATT: It took that position, and it had taken -- the shape of the Forstmann deal was known on Friday, before the deal was put on the table. There had been negotiations on Friday which -- everything didn't magically come into existence on Saturday, when all the board members came together. The board was called together to consider and approve a deal which had been struck on Friday. There was ample time before that occurred for Revlon to have called Pantry Pride and said, "Look. We are about to consider a possible deal which has this shape. You started the bidding. You have always been willing to negotiate. What will you do for us?"

THE COURT: Well, that brings me to what I think is a crucial issue here. At what point must the Court say to management, "Walk away from the table because there is somebody else," even though the person who is at the table with you says, "The deal is accepted today or it is done"? Isn't that the real problem we have here, Mr. Stargatt? I am supposed to say that management is to hold them at the table, go out and deal with somebody else and then come back?

MR. STARGATT: I think that the issue is more -- I think that there is that to what you are saying, but I think that the issue is more expressable in legal terms. Does management have a continuing duty to seek the best price that it can possibly get for its stockholders? Does it have a right in an effort to fend off an unwanted, unliked, perhaps, suitor, who is pressing money on it by the vehicle of giving a lock-up at a huge discount from actual value? Does it have a right, having put into place a poison pill arsenal of weapons and having agreed at a lower price to lower those defenses for a friendly suitor, to continue to keep those defenses up and erect against an unfriendly suitor? In legal terms, that is how we view the issue, not whether, confronted with two offers that are close to the same, what it should do. I don't know that I am addressing --

THE COURT: Well, you made the comment earlier that Pantry Pride felt as though it were being used as a stalking horse. That is the exact argument that Forstmann Little is now making against reopening the bidding. They are saying, "Don't use us as a stalking horse. That is why we gave you an ultimatum, you accept the deal then or we walk away." Now, who is the stalking horse?

MR. STARGATT: I used the term because it had been employed in our adversary's brief and because it is my belief that if Forstmann had behaved as did we -- we, as I indicated to you, although our bid had been used to inspire a bid from Forstmann, that did not disturb us at all. We had some relief when Forstmann bid.

THE COURT: It brought your bid from $42 to $56.25 a share. I would say that is a considerable detriment.

MR. STARGATT: Well, yes, it would be, Your Honor. But we had, in fairness, bargained against ourselves by offering to bid $50 a share and then $53 a share before the Forstmann transaction came into place, while the tender offer was out there, offering to do a friendly transaction. It has to be true that the bidding process encourages a higher value, and it certainly is true that that is almost inevitable. But in this case the only bid that we had to bid against was the Forstmann bid, although we had continuously upped our proposal and offered to negotiate, and we stopped that until this present lock-up, which was designed to and has the effect of preventing us or I think anybody else from topping it.

THE COURT: So what you are saying, in effect, you want is the opportunity to further negotiate.

MR. STARGATT: Oh, no. No more. Our request for relief --

THE COURT: I say "further." Perhaps I am loading that question, because I think you have said there has already been arm's-length negotiation between Pantry Pride and Revlon.

MR. STARGATT: Our request is much more pointed than that. Our request is to invalidate the lock-up, to oblige Revlon to eliminate its restrictive covenants for us as it did for Forstmann, and then to allow the market to decide.

THE COURT: So let me understand this. You don't want the opportunity to further negotiate. You want the deck cleared so your $56.25 offer can play in the market.

MR. STARGATT: Revlon can't negotiate with us anymore. The amendment -- and I am really not only trying to answer Your Honor's question but really trying to grope with what may be in Your Honor's mind, hoping that I am doing it.

Revlon cannot negotiate with us anymore. Part of the Forstmann transaction contained a provision that Revlon can't negotiate with any other bidder. So Revlon is contractually forbidden at this stage -- as of last Saturday, when they had this board meeting and signed this amendment, they are out of the box so far as negotiations are concerned.

THE COURT: Aren't you asking to have the no-shop provision invalidated

MR. STARGATT: I don't think we are asking to have it invalidated.

THE COURT: So you want the same --

MR. STARGATT: If Your Honor is asking whether we would like to negotiate with Revlon, we would be thrilled to. We always wanted to, from our side. But I don't think it, unless I am mistaken, proper to be asking this Court to enter an order -- this isn't the National Labor Relations Board where you can get a good-faith bargaining order. I would be presumptuous if I tried to get the

Court to move in that direction.

THE COURT: Well, you are asking for relief, and apart from the theory of getting the relief, the Court has to ask itself the question, what will that relief do for you and what will it do to other players on the scene. If the answer is all we want you to do is give us the opportunity to have our tender offer, which I understand closes on October 21 --

MR. STARGATT: I think it is Monday, yes, sir.

THE COURT: To have that go forward free of the restrictions, free of the rights plan, free of the covenants and so on, free of the notes, if that is what you want, I have some concern about that for other reasons, but taking the cue from counsel, the concern of the board's plenary negotiating rule and my concern at that time that the board has got to keep that negotiating opportunity open to everybody, your request would close it, would it not? There would be no further negotiation.

MR. STARGATT: Our request, I think, would close it, because I expect we would get the stock that --

THE COURT: Wouldn't it be a better result in the interests of all the shareholders to have the negotiations resume, because you may be required to come up with more money, and that is to the interest of all the other shareholders?

MR. STARGATT: As matters now stand, unless Your Honor strikes down the amendment, our adversaries -- "adversaries" I say at least in the legal sense -- are unable to bargain with us. And our offer -- I hardly know how to --

THE COURT: Well, the difference is very simply this: It is one thing to ask the Court to open negotiations. It is another thing to ask the Court to make a new deal for the parties. And it is that latter course that I have trouble with, because I don't think courts should be making deals for parties. And under the business judgment rule I don't think we generally do.

MR. STARGATT: If I can take a step back for a second, Your Honor, looking at it pragmatically, as the Court does, who gets hurt if Your Honor enjoins the lock-up, cancels it, and makes Revlon do the same for us as it did for Forstmann? Forstmann gets hurt if it ultimately cannot establish its right to the lock-up, because we will have acquired those divisions. If the payment of the termination fee is enjoined, Forstmann will have to sue us instead of us suing Forstmann to get it back. The noteholders, there is a commitment that the noteholders will get their money at par.

THE COURT: Where is that commitment?

MR. STARGATT: It is in the Perelman affidavit.

THE COURT: I read that to state that if requested, he would make some arrangement. That is not the same as Forstmann Little's obligation to bouy the price.

MR. STARGATT: If Mr. Mitchell might speak to that.

MR. MITCHELL: Your Honor, we are obligating ourselves to do one of two things with regard to the notes: Either to make an exchange offer on the same terms as the Forstmann Little proposal or to tender for those notes at par. In either instance, Your Honor, the noteholders will be in the same position as they are under the Forstmann Little proposal. That was thrust of Mr. Perelman's affidavit. If it is not clear, Your Honor, I am making that representation to you in open court.

The noteholders will be in no worse position than they are under the Forstmann Little proposal.

THE COURT: So you, in effect, are matching the Forstmann Little proposal.

MR. MITCHELL: Absolutely, Your Honor. So what Mr. Stargatt was saying, if an order was entered, the noteholders are certainly not going to be heard.

And as to your question about negotiating, Your Honor, if you do enter this relief, we would be delighted to negotiate with Revlon. I don't think you can reasonably expect that if an order is entered, that nothing is going to happen between the parties. We have always wanted to negotiate with the Revlon representatives, and we will negotiate with the Revlon representatives. The problem we face is, they wouldn't talk to us and won't talk to us.

A decision by you granting this relief is not going to turn this situation into a one-sided one. We are not going to have some great advantage, Your Honor. All we are saying is, temporarily enjoin this lock-up pending a trial on the merits. Maybe eventually Forstmann is going to win. But at least let us have our offer out to shareholders. That is what we can't do at this point because of this lock-up. And that is all we are asking Your Honor.

We are not asking you to give us victory, because I understand courts don't like to do that. You don't want to take one side and say, "Look, shareholders, you are going to have to take Pantry Pride's offer." But we can't be out there at this point because of this lock-up.

THE COURT: What about the no-shop agreement? Can they talk to you?

MR. MITCHELL: I think, Your Honor, if you enjoin the lock-up temporarily pending a trial on the merits, I would think that the Revlon representatives would know at that point they have a duty to their shareholders, an overriding duty, to talk to us. And certainly from our perspective, I can represent to you that we would talk to them, as we have always tried to do in the past.

THE COURT: Well, look at Page 16 of

the minutes of the October 12 meeting. There is advice given by Mr. Brownstein concerning that. And I quote, "A director inquired as to the consequences of the proposed agreement for other possible offers, such as an offer at $60 a share. He asked whether the board would be precluded from making the deal. Mr. Brownstein stated that the no-shop provision in the merger agreement would prevent the company from soliciting or negotiating any other deal."

MR. MITCHELL: Your Honor, I say at that point, then, if that is really true and if Revlon can't come to an accommodation with Forstmann so that the interests of all shareholders are served, there is nothing I can do from Pantry Pride's perspective. I would like to negotiate with them. I have made that representation. Mr. Perelman has, Mr. Gittis has and Mr. Drapkin has. But they are then putting me in a box, Your Honor, by saying because we have contractually bound ourselves, then don't give me an injunction.

We haven't created this situation, Your Honor. They are the ones who created the situation. And it is in Your Honor's hands. You are the central player in this situation, because unless this injunction is entered, our offer cannot go forward because of the lock-up, which, you know, Mr. Stargatt is describing to you.

Maybe what we should do is amend -- you know, Mr. Stargatt can amend his complaint orally before Your Honor to restrain the operation of the no-shop provision. But what I am saying to Your Honor is, I think two things are going to happen, much more realistically.

One is Revlon's board, knowing its obligations to its shareholders, is going to do something about it and sit down and talk to us.

Second, Your Honor, most important, if they can't because of this agreement, that shouldn't be the reason why Your Honor denies relief to us when we are willing to sit and talk to them, as we always have been.

And again, Your Honor, on the lock-up, on the asset lock-up, we are just asking that it be restrained pending a trial on the merits. And given the fact that the noteholders are going to be in the same position, Your Honor, given the fact that \$56.25 next week is the same as \$57.25 six or seven weeks from now, no one is going to get hurt other than the temporary delay to Forstmann.

But again I emphasize to Your Honor, if we can negotiate, we would love to negotiate.

THE COURT: I know I am taking up some time here, but I think it is important to try to get to the nub of this problem.

MR. STARGATT: I agree, and from our side, we much appreciate the Court's questions. It is disquieting to make an argument not knowing what is in the Court's mind.

The record should show that the last speaker was Mike Mitchell, who is a partner in Skadden, Arps and generally counsel to Pantry Pride in this matter.

I feel as though the remaining comments that I was to make about the facts are somewhat anticlimactical in light of the responses to Your Honor's question, and I will pass them and also deal just in the briefest way with the legal points that I wish to stress, of which there are only two: First, that the lock up is illegal, illegal plain and simple. And toward that point I make these comments.

First off, there are not a very

large number of lock-up cases, because the device has only been in place for the past six or seven years. I stand to be corrected on this, but I believe that the first reported decision on the subject was the Marathon vs. Mobil Oil decision.

In none of the cases in which lock-ups were approved has there been a situation in which the value of the asset locked up was grotesquely disproportionate to the option price. The typical, the most typical lock-up sort of option relates to the stock in the target. What usually happens and happens in some of the panoply of reported cases is that the new bidder, in order to come into the picture, wants an option to acquire stock at a price higher than the only bid that is on the table, figuring that if it starts a bidding contest, at least he wants to get some profit out of his option, even if the other bidder takes over. That is the most typical situation.

In other cases --

THE COURT: Wait a minute. Did you say an option to acquire stock at a price higher?

MR. STARGATT: No. An option to acquire stock at a price which is higher than the offer on the table.

For example, in the Marathon case itself Mobil had an offer on the table for Marathon at $85 a share. Marathon wanted to generate some bidding interest, so it wanted to get and did get U. S. Steel to enter the fray. U. S. Steel was given in order to persuade it to bid an option to buy 40 million Marathon shares at $90 a share, which was higher than the offer that was on the table. And it proceeded, I think, to make an offer itself at I believe $125 a share. But it was assured that if its offer got topped, it would at least make a profit on the difference between $90 a share for those 40 million shares and whatever the final offer was, and nobody got hurt because the offer was above the bid price. In Marathon there was also given the option to U. S. Steel to buy Marathon's Yates Oil Field for $2.8 billion.

And Marathon is a case relied upon by our opponents, so I believe it is sort of illustrative of where I believe they are going astray. But the $2.8 billion price was not a low price. It was a high price. Marathon's investment banker had put the value of the oil field at 2.5 to

2.7 billion. So there was a lock-up in a sense. U. S. Steel was getting a favorable price on the option stock if the bidding continued and it was getting a price which both it and the target felt were fair for a valuable asset.

I believe there is no case in which a lock-up has ever been approved, the six or eight cases in which they have been dealt with since the Marathon case, at a price below what the target deems to be fair value. That is the way we read all of the cases. And certainly in no case has a lock-up ever been done for the purpose of shutting out a competitive bidder, and that is the stated purpose of this lock-up. It is in the competitive bidding process to bring that process to an end is the purpose of this lock up. So in our view the lock-up contravenes accepted authority.

On the point of the rights, the legal points of this are set forth in our brief, but to concentrate a little bit again on the facts, there was an agreement by Revlon to redeem the rights and to relieve the restrictive covenants to Forstmann at a $56 level and anybody else at the same level.

THE COURT: Well, isn't the rights

issue really moot here? It is rather unequivocal that Revlon said, they have indicated specifically to Pantry Pride in the October 12 agreement that the rights will be lifted, the covenants relaxed in favor of any deal which is in favor of the Forstmann deal.

MR. STARGATT: Yes. But the October 12 agreement obliges us to raise our bid in order to get the rights lifted to a price above the Forstmann postponed price.

THE COURT: Well, you are contending, when you discount the Forstmann Little deal, you claim your $56.25 is worth more.

MR. STARGATT: Oh, yes.

THE COURT: But the rights plan it seems to me is rather academic here.

MR. STARGATT: Well, it isn't, because unless we are granted relief from the rights plan, we can't buy, because we run the risk of buying, having the rights triggered, having the rights traded, having the interest of third parties intervene and being obligated to those parties to buy at $65 a share when Revlon has been unwilling to redeem the rights in favor of our offer, although they said they were going to do it when the offer for $56 was made.

THE COURT: Well, my point is that this isn't the type of poison pill that we have seen in other cases where management has put it in place to deter an acquiror in the sense that there are people out there they simply don't want in the board room. They are saying, in effect, that if this person goes in the board room with a deal better than Forstmann Little, we will withdraw the rights.

MR. STARGATT: I think not, Your Honor, with due deference. They want a deal with Forstmann Little, and they have used the rights for that purpose. And the best evidence of it is that when Forstmann offered 56, they agreed to redeem the rights at 56, and they agreed to redeem it to anybody else who offered more than 56. And even though the Forstmann offer was not worth $56 -- and it wasn't -- to cut the matter off and, we hope, end the competition, we tendered cash, any and all, immediate, at $56.25 a share and asked them to do what they said they were going to do: Pull the rights. And they didn't.

So it is not an academic matter,

although, in our view, our offer is better on a cash basis than the Forstmann offer. But it is not academic, because we cannot afford to proceed under the cloud of the rights.

Unless Your Honor has further questions, if my argument has been somewhat disjointed, I apologize, but we have tried to spend more time perhaps in responding to the Court.

THE COURT: Thank you. Gentlemen, how are we going to divide the rest of the time? I know we have several participants.

MR. WACHTELL: If Your Honor please, on the assumption that Your Honor has only an hour for us, which is what has been indicated, I was going to try to keep myself down to 45 minutes, in order to leave time for Mr. Cherno. If Your Honor has a little more latitude, I could probably well use a little more, depending on questions.

THE COURT: Well, it is going to get us into a long afternoon.

The matter is really very well briefed, gentlemen, in the short period of time that you had to do it. I have done all that can be humanly done here, and I think you all understand the problems. I think another hour.

MR. SPARKS: For the record, before we begin, I would like to introduce Herman Wachtell of the New York Bar and move his admission for the purpose of this case. He will make the argument on behalf of the Revlon defendants.

THE COURT: Good morning, Mr. Wachtell.

MR. WACHTELL: Good morning, Your Honor. Good to be before you.

If Your Honor please, I think the sole issue before this Court is whether the board of directors of Revlon was entitled last Saturday to enter into the merger agreement with Forstmann Little on the terms that were being required by Forstmann Little, which terms included the grant of a conditional option to Forstmann Little to purchase Revlon's Vision Care and National Health Laboratories divisions, what we have referred to as a lock-up.

As Your Honor noted, the Revlon board last Saturday was faced with two alternatives. They had this Forstmann Little proposal. It would enter into a merger whereby all of the shareholders of Revlon would receive $57.25 in cash for all of their shares. Additionally, Forstmann Little would take action to bring the notes that had just been issued to the Revlon shareholders upon the exchange offer up to par, a proposal that the record shows would add approximately 60 to 65 million dollars in value to those notes and which the record shows was still largely held by the shareholders of Revlon themselves. They had just been issued. They were still going out in the mail, as a matter of fact.

That was approximately another, on top of the 57.25, the value of those notes, the record shows, was another approximately $2 to $2.25 value per share.

Forstmann's financing was firmly in place. It was prepared to go forward on an expedited basis. But Forstmann Little, was, indeed, imposing conditions. It would require a decision from the Revlon board at the conclusion of the meeting. It would insist upon a no-shop, no-negotiate covenant, and it would insist upon the option to purchase the two divisions for $525 million.

From Forstmann Little's perspective -- and Mr. Cherno is here. I am sure he will tell Your Honor more -- but even the board felt, as the record shows, that from Forstmann Little's perspective, there were good and cogent reasons why it was being adamant in its insistence upon these provisions.

As Your Honor noted, in its previous merger bid it had taken a quantum leap in price from the Pantry Pride $42 a share to $56, and I heard Mr. Stargatt say, well, that isn't really so because Pantry Pride was "bidding against itself. It bid $50. It bid $53." But the record shows that that $50 and $53 on the eve of the Forstmann Little $56 was because of pre-knowledge of what was coming, and they were trying to jam it in. After having been adamant down there at 42, knowing a higher bid was coming, they were trying to say, "Well, here we are, too, here we are, too." And, indeed, even then the record shows that the prospective bid was being used by Forstmann as a stalking horse by Pantry Pride.

So apparently Forstmann had taken the quantum leap of getting the price of this company from the basement, the 42 where Pantry Pride was trying to acquire the company, up in the realm at least of fairness, $56.

The record shows that Forstmann had

wanted lock-up and no-shop protection at that time and had come in insisting it had to have it in order to make the $56 bid. Revlon had refused to accede in the negotiations and ultimately Forstmann had given way on the point, because Revlon essentially had said, "We are getting a put." That is the way the Revlon board had viewed the $56 transaction. "We are entering into a merger agreement. There is no lock-up. There is no provision that says we can't continue to negotiate or shop the company."

So the board reasoned at the board meeting, as the minutes show, "We are wide open. If anyone wants to come in higher than 56, we can promote an auction here and see if there is still a better price to be had over and above the Forstmann Little." And Forstmann Little had bought that the first time around, bought it very, very reluctantly, but nonetheless had bought it. But now from Forstmann's perspective the situation had become intolerable.

Pantry Pride had come back with a mammoth raise. Where Forstmann had gone from 42 to 56, Pantry Pride had said, "I will raise you a quarter. You are at 56. I am at 56.25."

And the record shows that in subsequent conversations that took place that week -- and there were a lot of negotiations that week, as the record shows -- nobody had slammed the door on Pantry Pride. Everybody was talking to Pantry Pride that week. Forstmann had extensive discussions with them. The record shows that my partner, Mr. Lipton, was having extensive discussions with Mr. Drapkin of Skadden. You have an affidavit from Mr. Drapkin that concedes that that, in fact, was the case. Nobody saying we won't talk to you. People were talking all over the place.

And the record shows that one of the things Pantry Pride said in those conversations is, "We have a very, very great respect for Forstmann Little's expertise. We are using them as our investment banker. Anything they bid, if they are prepared to do it, well, we will be prepared to go up another nickel, dime or a quarter." And that situation was totally intolerable to Forstmann Little that in what was essentially a $3 billion transaction that they should put all the financing in place, get all the commitments, incur all the expenses and just be out there for someone else to come along, be it

Pantry Pride or anyone else and say, "Up you a quarter."

But whatever Forstmann Little's rationale may have been, this was its proposal. It was clear it had been pushed as far as it could go. There had been a lot of negotiation the previous day. There had been negotiation about the lock-up. Forstmann Little had wanted the lock-up to be unconditional, exercisable immediately. Revlon's advisors had absolutely refused to agree to that, and eventually Forstmann had given way, so that the lock-up became a conditional option, where it only becomes exercisable if somebody else acquired 40 percent of the stock of the company. In other words, if somebody else, Pantry Pride, for example, would acquire 40 percent and be in a position to block the merger that Forstmann Little was negotiating for, then Forstmann Little says essentially, as sorry money or whatever you want to call it, "We get these two divisions for $525 million."

THE COURT: Well, it has the same effect, though, doesn't it?

MR. WACHTELL: Excuse me, Your Honor?

THE COURT: It has the same effect

with that trigger or not. If the effect is deterring further Pantry Pride activities, it had that effect.

MR. WACHTELL: No. Theoretically, the shareholders could turn down the merger, and the option is not operative. It is not the same. It is very much not the same, if Your Honor please. This merger does not become operative just because the merger, for example, is turned down. It only becomes operative if somebody such as Pantry Pride gets 40 percent of the stock of the company. That triggers the merger. That is a very significant difference.

So I think frankly, to be perfectly -- from a legal point of view, from a reasonable business judgment point of view, the board would have been perfectly entitled to take an unconditional option, but the point is, they had, indeed, negotiated here for this conditional option. They had pushed Forstmann Little just as far as Forstmann Little was prepared to go, and now the board was at the moment of decision. Those were the Forstmann Little terms, and the Revlon board last Saturday had to decide were they going to take it or were they going to leave it and what were their alternatives.

The record shows, Your Honor, that

the decision received the most careful analysis and scrutiny from the Revlon board at a meeting that lasted some two and a half hours, nor, as Your Honor, of course, knows, was this a board that was suddenly coming on this problem anew or afresh. This board for over two months had incessantly, repeatedly, intimately, been dealing with the entire panoply of problems that had been thrust upon it in this takeover situation. It had carefully, only nine days before, had had a previous meeting at which it had thoroughly, in detail, discussed values, analyzed, considered and approved the Forstmann Little $56 merger agreement.

The board, as Your Honor knows, consisted of a majority of independent outside directors, including people with the highest degree of sophistication and integrity in financial, securities and corporate matters.

THE COURT: You get the impression from reading the October 12 minutes that there were certain directors who had their own counsel there and perhaps with a feeling that the flak from the market reaction to the noteholders' predicament -- aren't you getting close to an interested board in that situation?

MR. WACHTELL: I don't think so at all, Your Honor. I plan to address in about two moments the situation with the notes. But the record is quite to the contrary on that.

For example, you have Mr. Glucksman's testimony -- and he is the person who was the originator of the idea of having his own counsel there, the Cleary firm, as he had said had represented him for 20 years in any significant decision that he was called upon to make.

THE COURT: Well, why was his counsel there on the 12th and not there on the 3rd?

MR. WACHTELL: Because, Your Honor, when you are dealing with a question of a lock-up, Mr. Glucksman and everybody else recognized the fact that there was going to be a close call that the board was going to have to make, that there undoubtedly would be a litigation challenging it, and Mr. Glucksman testified that he felt more comfortable having -- it was totally unrelated to any question of liability on the notes, the record shows. There is no linkage there whatsoever.

In fact, Mr. Glucksman's testimony

was that from 35 years experience -- he was there, I am also told -- I was not aware. He was also there at the October 3 meeting. I am mistaken. Mr. Glucksman had his counsel there at the October 3 meeting as well. I had forgotten that. And I am just reminded by a note, Your Honor.

It had nothing to do with any liability on the notes. Mr. Glucksman testified, indeed, that from 35 years experience in the securities business, he knows that anytime you put out a security and it immediately trades lower, there are going to be a bunch of lawsuits, but that in this situation he had taken a hard look and he was absolutely certain there was no conceivable liability whatsoever, and, indeed, that was the case, as I will be talking about in two moments.

THE COURT: But in any event, they did buoy the price of the notes.

MR. WACHTELL: Yes, Your Honor, indeed. But Glucksman was there. He does have 35 years experience. He was the former chief executive officer and chairman of Lehman Brothers.

I am not talking about people who are names as distinguished people. I am talking about people who are very, very heavyweight directors. Ezra Zilkha, a very, very successful investor in his own right. Mr. Alderwereld, former partner of Lazard; Simon Rifkind, former judge, who was probably one of the most revered and esteemed wise men of the New York Bar. I don't like to say that about a competitor, but I have to be honest about the matter.

He was also -- there is no animus here, Your Honor. Judge Rifkind was very close to Pantry Pride.

THE COURT: Let me ask you this: What happened between October 3 and October 12 except the adverse reaction of the market to the notes?

MR. WACHTELL: They came in with an amended tender offer. I mean, they came in with an amended tender offer. They announced that even though they didn't have their financing in place, that it was their legal position that they could buy immediately and snap up the company, and the board basically -- we went into the federal court and we got an agreement from them that they would not buy without 24 hours advance notice and we would have the opportunity to get a temporary restraining order, because we thought the amended offer was illegal, and we maintained the status quo so that the board would have turnaround time. And the week was spent in intensive negotiations to see if a better deal would be arranged for the shareholders, either with them or with Forstmann Little.

The precipitating event was not the fallen price in the notes, Your Honor. That was something that the board then, indeed, felt that it had a responsibility to do something about to those noteholders, as I will point out in a moment. But the precipitating event for the flurry of activity was their coming in and saying, "Raise you a quarter and we think we can buy the company immediately and snap it out from under before the board has an opportunity to make a better deal with anybody else." That is what caused the flurry of activity.

THE COURT: Well, was that difference sufficient to bring about the new terms that were --

MR. WACHTELL: Sure, sure. If left undeterred, if there is no better deal on the table, people will take a quarter more rather than a quarter less, absolutely. And there was, indeed, as has accurately been pointed out, though it has been wildly over stated, there also is a time difference of money.

Basically, the Forstmann people were saying that they could do the merger on an expedited basis. They anticipated it would take approximately 35 days. Everybody recognized there could be a few days slippage on that. Maybe it would take 45 days or the like.

As Mr. Glucksman's testimony shows, when you calculate the time value of money here, you are talking about 58 cents a month. But that is what it really comes down to on a discount rate of getting $56.25 now as against $56 maybe 45 days from now.

So their offer at $56.25 was in an economic sense to an arbitrageur worth a little bit more than a 25-cent spread.

So the answer is, yes, if nothing had happened, if the board had not been able to promote a better deal and get higher values for the shareholders and the noteholders, they would have taken the company at the lower price, absolutely.

THE COURT: But wasn't there also a

market reaction to the involvement of the management directors in the deal?

MR. WACHTELL: No, Your Honor. But the problem that occurred -- let me get away from this and go right to that. It is clear we had an informed board. We had a careful board. We had all the advisors there, and this is the most informed, careful analysis, as Your Honor has read the minutes. I don't think I have to belabor the point.

Let me get right to the question of the price on the notes.

THE COURT: Okay. The question arises, though, why did the management directors, who on October 3 were a part of the directors, within a period of 10 days, nine days, not become a part of the deal.

MR. WACHTELL: I think there were two reasons, Your Honor. The first is that there, indeed, was adverse publicity. And even though it is typical in an LBO situation to have management continue on the scene, for some reason this particular situation generated a huge amount of adverse, cynical publicity about the matter. That is one reason.

But the second reason, which I think is much more cogent, is that what the board was being asked to do on October 12 was different than what the board was being asked to do on October 3 and, indeed, did present a conflict of interest.

On October 3 essentially, as I pointed out, Revlon was only getting -- it wasn't giving anything. It was getting a commitment from Forstmann Little to pay $56 a share, but Revlon really wasn't committing itself to do anything. It could continue to negotiate for a higher price with somebody else. It could continue to shop, actually go out and affirmatively seek to get a higher bid. So Revlon wasn't tying its hands at all. Essentially, it had an option to sell the company for $56 a share to Forstmann Little and management.

THE COURT: What about the cancellation fee?

MR. WACHTELL: It gave that.

THE COURT: $25 million?

MR. WACHTELL: Yes. It gave that. When you are talking about a transaction of $3 billion -- I know $20 million is very, very important to me. I know it is very, very big money to most people in this courtroom. It is very big money to Your Honor. Believe me, it is very big money to me.

But on a scale of a $3 billion transaction, it is not very big money. And in these contexts we are talking about big numbers. And when you are talking about proportion of the cancellation fee to the size of the transaction, it isn't very large.

When you come down to October 12, you are dealing with a different situation. Here now Forstmann Little is saying, "We want a lock-up. We want something from" -- I mean, lock-up is too strong a word, but we all use it and I am going to use it. And the testimony shows that it isn't really a lock-up. It does not preclude another deal. It does not preclude anybody including Pantry Pride from going forward if they want to.

But let's use the term lock-up.

THE COURT: Wait a minute. You have lost me. It doesn't preclude Pantry Pride from acquiring 40 percent of the shares?

MR. WACHTELL: Of course not. All they have is $525 million in the bank rather than two divisions when they take over the company.

THE COURT: And the other deal is gone, the $900 million.

MR. WACHTELL: Sure. They can take over the company. Anybody can take over the company. They may not like -- they may think that they would have liked to have gotten a better price for these two divisions, and that is why we call it a lock-up, because it is, indeed, a favorable price to Forstmann Little. But as Mr. Glucksman testified, any major player would come along and take over the company anyway.

THE COURT: The thing that strikes me about everything that I have seen in this transaction, the one given is that Revlon is going to be broken up.

MR. WACHTELL: That's correct

THE COURT: Don't you agree?

MR. WACHTELL: That's correct. And Judge Rifkind testified -- and I think his affidavit says this was a very, very bittersweet thing. He said this company had been there. It had been performing a social service for many, many, many, many years. He had been on the board for many years. And he said, "I think we are getting a spectacular result for the stockholders. I think we are getting the stockholders a spectacular price for this company, but I must say it is sad that this great company is being broken up." And that was the problem with the notes, Your Honor.

THE COURT: So you don't have that overriding need on the part of the directors to maintain the corporation qua corporation as it previously existed. Everybody is assuming that it is going to be broken up whether Forstmann Little gets it, Pantry Pride gets it or a third party gets its.

MR. WACHTELL: Well, it depends what third party. That was the problem. If the board had been successful in enlisting a Phillip Morris or a Unilever to come forward with all the funds in the world to take over the company, then the company would not have been broken up. That effort failed. That effort was undertaken, the record shows -- when they came along and were trying to get the company at bargain basement prices, the board went out and tried to sell the company as an entity. They failed. They then turned to Forstmann Little, and that, Your Honor, is where the to notes problem arose.

THE COURT: All right. Let me just

pick up here one minute. Refer to Page 28 of the October 12 minutes.

MR. WACHTELL: Let me find it, Your Honor.

THE COURT: At the bottom of the page.

MR. WACHTELL: Which page, Your Honor? I am sorry.

THE COURT: Page 28. There is a reference there to another party coming into the picture. Mr. Lipton received a call from Mr. Wasserstein of First Boston saying that he had a client who was interested in Revlon. Mr. Lipton stated he had invited the client to bid for the company at $60 a share.

MR. WACHTELL: Right.

THE COURT: Now, what happened to that?

MR. WACHTELL: Well, it says right on the next page, Your Honor. It turned out that they weren't interested in the whole company. All they were interested in was a piece.

THE COURT: Wasn't everybody else interested in a piece?

MR. WACHTELL: No. Everybody else is interested in taking the whole company and they are going to do the breaking up.

THE COURT: It is a question of whether you do it before or after.

MR. WACHTELL: That's correct. There is a big difference. One way the stockholders get their money and the buyer is at risk. The other way the company was liquidating.

That was the other alternative that the minutes showed was carefully considered by the board: Do we have the latitude here to do a self-liquidation. And Lazard told them, "Yes, we think if you have the time, if you can spin this out over a year, we can possibly get you from $60 to $62 a share if we liquidate the company, but it isn't real. We can't do it, because Pantry Pride is breathing down our neck, and they are going to take over the company at 56.25."

THE COURT: You have already got Adler & Shaykin with a payment of $905 million. You have got Forstmann Little at $525 on the health division.

MR. WACHTELL: Oh, no. They are not

in that, Your Honor, at all. They are not willing to buy that -- do you mean if the merger went away?

THE COURT: Yes.

MR. WACHTELL: I don't think Forstmann Little was really saying, "We want to come in and buy these two divisions at $525 million." That wasn't the deal they wanted. That is a consolation deal. They wanted the company.

THE COURT: In other words, they really don't want the $525 million deal?

MR. WACHTELL: Of course not.

THE COURT: They are just using it as a method to deter Pantry Pride.

MR. WACHTELL: Exactly, exactly.

THE COURT: Isn't that a straightforward type of lock-up?

MR. WACHTELL: It is a lock-up, Your Honor, and there is absolutely nothing wrong with it. It is essential in order to get the real value for the shareholders of what is essentially $59.25 here, the 57.25 on the shares and the other $2 to $2.25 on the notes. I mean, that is the price. The board would have preferred not to have paid that price. The board would have preferred not to have to give an option which would say these people can get these two divisions at what the board was told is a favorable price to them. Everybody knew that. The board did it with its eyes wide open. It is a favorable price to them.

THE COURT: But doesn't that get you right back into the interested problem? Now, you have got the directors coming in and trying to pick up another $2 for the noteholders who received their notes as a result of the exchange offer which management originally put together to deter Pantry Pride.

MR. WACHTELL: Well, they did not put it together to deter Pantry Pride as well as to make sure that the stockholders got at least for 25 percent of their shares, 10 million shares, $57.50 a share in value, Your Honor. In other words, what the board was saying is, let's at least make sure that for as much as we can manage, as much as we have the financial flexibility, let's make sure our stockholders are not going to get -- I don't want to use the vernacular. Are not going to get hurt. Let's at least give them -- what we can do now for them is we can take 10 million shares and give our stockholders $57.50 per share, which ultimately turned out to be a very, very realistic price.

But the point I am making, Your Honor, if I can talk about the notes for a moment, because Your Honor has asked questions about them -- the situation on the notes was this: They had just gone out. They had gone out in good faith not to strangers but to the shareholders of Revlon. The board had said to them in absolute good faith, they are designed to trade at par. They are an investment-grade security, and everybody thinks they will trade at par.

There was then a very, very quick turnabout in events. Pantry Pride came back with an offer that was still lower, $42 a share. And the board then had to see what it could do to come up with values.

It came up with the Forstmann -- it was clear when it struck out with the big players, like Phillip Morris or -- I am not using those as specifics. I am using it as generic. When it was unable to get a white knight who had the overall financing to take over the company without leveraging the company's assets themselves, it went to Forstmann

Little for a leveraged buy-out. You essentially have two competing leveraged buy-outs here: The Forstmann Little leveraged buy-out and the Pantry Pride leveraged buy-out, because Pantry Pride has borrowed 100 percent of the money necessary for this deal, will be borrowing, if they ever go forward, a hundred percent. They don't have a dollar. Every single dollar is bore rode, and they have conceded that every single dollar has to be serviced from the assets and income of Revlon.

So on either deal what happened after these notes went out is, the market turned around and said, we have two competing leveraged buy-outs. The board has said in order to achieve the values of price on the stock, we are going to have to waive the covenants. Everybody was breathing down the board's neck to waive the covenants. Forstmann Little was demanding it. Pantry Pride was demanding it. And what the market was saying was, if either of these deals now go forward, this is wonderful. The stockholders are going to get $56 or $57 or whatever it is on the stock, but we are being left stranded. We are now going to have a highly leveraged company without the protection of covenants. The notes went down to $86 or $87, as the record shows.

The board did not feel it had a legal liability in the matter, but the board did feel that it had both a moral and a fiduciary responsibility. The noteholders were overwhelmingly the same people as the shareholders. This wasn't a bunch of strangers. The notes had just been issued to them for 25 percent of their stock pro rated across.

Moreover, the board had a responsibility to act responsibly with respect to waiving the covenants. That had been entrusted to the independent directors of the board. And the independent directors did not want to be in a position -- that is why they didn't waive the covenants on October 3. They did not want to be in a position where they would waive the covenants, leave those noteholders, stockholders out there stranded with notes that were not worth what everybody had promised the people they would be worth. And that was why the directors went not just to Forstmann Little but to Pantry Pride and said, "Look, we want these notes to be made whole."

Now, this was referred to as a

whimsical problem. There is nothing whimsical about it. The representatives of Revlon were talking about some $65 million of value that they were asking for, additional value, of Forstmann Little and of Pantry Pride.

And the record shows, it is now conceded -- you have an affidavit before you from Mr. Drapkin that was put in this morning in which Mr. Drapkin concedes that on Thursday, the 10th, my partner, Mr. Lipton, said to him, "If you want to compete here, you have to do something about the notes. You have to take action to bring them up to par."

Mr. Drapkin says -- here is his affidavit -- "I understood the directors' concern on that subject." That was on Thursday.

Now, Mr. Mitchell got up in court here and said, "We have offered to take care of the notes. We have offered to do whatever Forstmann Little does." Was that their response at the time, Your Honor? On Thursday, October 10 Mr. Lipton says to Mr. Drapkin, "You must take care of this problem with the notes. Mr. Drapkin says, "I understand the directors' concern." And he gives them a couple tentative things. Maybe we will be willing to do this, maybe we will be willing to do that.

THE COURT: Weren't you still negotiating with Forstmann Little on that very subject then?

MR. WACHTELL: That's correct, Your Honor. But what does Pantry Pride come back with the next day as their formal response to the board? They also had a letter from Lazard Freres which expressly said to them, "Tell us what you are prepared to do about refinancing the notes." And on October 11, Friday, they come back with their answer, and here is their answer: "We will do nothing."

"Pantry Pride understands the obligations under Revlon's outstanding debt including the 11.75 percent notes, and after it obtains control of Revlon it intends to cause the required interest payments to be made on such debt and the principal to be paid when do at maturity." In other words, they would do nothing. They would not tender for the notes. They would not raise the coupon on the notes. That was their formal response.

This is what was before the board when the board met on Saturday. And here is Mr.

Glucksman's note.

THE COURT: Would it not have been fairer to say that "We now have a deal with Forstmann Little in which they have agreed to support the notes at par. Can you match that?"

MR. WACHTELL: Your Honor, there is a negotiating process that goes on. Mr. Lipton, the record shows, said to Mr. Drapkin, "Will you get back to us and tell me what you are prepared to do."

How many times do you have to go back to people? He said, "We want to have the notes brought up to par." Mr. Drapkin said, "Let me think about it. We might be prepared to do this." It is right in his affidavit. It is in Mr. Lipton's. It is in the board minutes. We might be prepared to maybe raise it 1 percent interest rate, we might be prepared to do the other thing. And then they come back the next day, not three weeks before the board meeting; the day before the board meeting, and they say, "We are prepared to do nothing."

How many times do you go back to people when they slam the door in your face? I mean, there is a reasonable process of negotiation that goes on between business men, and you just don't keep on running in and out of corridor doors, Your Honor. Besides, the door was left open.

The record shows that he was invited to call. He was invited to call Mr. Rohatyn. Mr. Loomis returned his calls, and they couldn't reach him to see if he had anything further to say on the matter.

And then the board meets. And what is the board supposed to do; say let's not deal with Forstmann Little because maybe after they said they are not going to do anything they will change their mind?

When Mr. Mitchell comes into Court, Your Honor, and says we are now prepared -- and when you are told that you should be the central player in this drama, you are being told precisely to ignore the law, which says it is not for the Court to exercise its reasonable business judgment. It is not for the Court to usurp the province of the board of directors. The board of directors decides what is reasonable for the company. And that is the sole issue here, Your Honor.

When they come in after the fact, just as happened in the ENSTAR case and say, "Well, now we are prepared to do something, so why don't you invalidate what the board did, even though we refused to do it previously -- Chancellor Hartnett rejected that out of hand in the ENSTAR case. He said we have to deal with the facts as the facts were before the board when the board dealt. And somebody coming in after the fact and saying, "Now I am prepared to do something more," that doesn't invalidate retrospectively the conduct that took place of the board.

Moreover, what is it -- the irony is, usually, Your Honor, when people come in after the fact and say, "Oh, well, here I am. I am really prepared to do more if only board had left the auction open," this is always rejected by the courts, which say the board is entitled to deal. But usually, Your Honor, it is rejected in the context where the disappointed suitor comes in and says, "Look, here I am. I am willing to do better, if only they had left the auction open."

What do we have in court this morning? They come in and say even now, "We are willing to do worse." They say Forstmann Little is giving the stockholders 57.25 plus the notes. We will give them 56.25 plus the notes."

Even Mr. Mitchell cannot bring himself to say that it is a better deal. He got up and said, in his view, it was the same. Well, it isn't the same. The record shows it isn't as good, because this deal on the merger will take place in a shorter time frame than one dollar.

But suppose it was the same. This is their proposal: "Let's all go back to the negotiating table, because we are not prepared to top the Forstmann Little deal."

I mean, it is essentially, putting aside legalities -- and the legalities are that a board makes a reasonable business judgment. There is no question this board did it. But just looking at this in a hard, practical sense, without any law whatsoever or any equity whatsoever, the disappointed person is coming in after the fact and saying, "Would you please reopen the auction by judicial fiat so I can bid lower than the winning bid." That is what we are hearing in the courtroom this morning, Your Honor. It is totally absurd.

If I can get back to what I think controls here, which is business judgment, what the board was faced with on Saturday night was a comparison of a bird in the hand against what they might have out there in the bush, and what they had in the hand was a deal which essentially was giving 59.25, pay up to 56.25, a dollar on the share and $2 to 2.25 on the notes, which were also held by the shareholders.

They also had certainty. Different factors weigh differently with different directors, as is always the case when you get a group of men and women together in a room to exercise their business judgment, but the evidence shows that the factor of certainty weighed very, very heavily with any number of the directors.

Mr. Gluckman testified that he walked into the room and he was given the letter that was written by Mr. Gittis, the vice chairman of Pantry Pride, the previous day, with respect to where they stood on their financing, and he looked at this and he was disturbed. And here is his contemporaneous piece of paper. This is Mr. Gluckman writing in the margin, his own comment when he read the letter, "Not a commitment." And Mr. Gluckman testified to this.