IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

IN AND FOR NEW CASTLE COUNTY

MACANDREWS & FORBES HOLDINGS, INC., a Delaware corporation,	)
Plaintiff,	)
v.	)
REVLON, INC., a Delaware corporation, MICHEL C. BERGERAC, SIMON ALDEWERELD, SANDER P. ALEXANDER, JAY I. BENNETT, IRVIING J. BOTTNER, JACOB BURNS, LEWIS L. GLUCKSMAN, JOHN LOUDON, AILEEN MEHLE, SAMUEL L. SIMMONS, IAN R. WILSON, PAUL P. WOOLARDL, 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.	)

BRIEF BY FORSTMANN LITTLE DEFENDANTS
IN OPPOSITION TO PLAINTIFF'S MOTION
FOR A PRELIMINARY INJUNCTION

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NATURE AND STAGE OF THE PROCEEDINGS

Defendants Forstmann Little & Co. and Forstmann Little & Co. subordinated Debt and Equity Management Buyout Partnership-II (hereinafter collectively referred to as "FLC") submit this brief in opposition to the motion by plaintiff, MacAndrews & Forbes Holdings, Inc. (hereinafter "MacAndrews & Forbes" or "Pantry Pride"), for a preliminary injunction.*

PRELIMINARY STATEMENT

In the face of an unsolicited tender offer that provided Revlon shareholders first with $47.50 per share and then with only $42 per share -- without the necessary financing to pay for the shares -- Revlon's independent board negotiated at arms length and unanimously approved a merger agreement with FLC at a firm $57.25 per share. Contrary to plaintiff's contention -- which cannot become true by repetition -- management is not a beneficiary of the FLC merger. Indeed, management and Revlon's directors stand to gain nothing more by the merger with FLC than they would if Pantry Pride or anyone else ultimately acquired Revlon. Shareholders, on the other hand, have already gained $450 million as a result of FLC's efforts. No court to our knowledge has ever enjoined a transaction in these circumstances.

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* The brief filed by Revlon, Inc. (hereinafter "Revlon") contains a more detailed statement of the nature and stage of the proceedings which is incorporated herein by reference.

The option and termination provisions of the merger, moreover, are customary features of such agreements and are supported by the overwhelming weight of authority concerning the fiduciary duty of target boards; it is understood in the financial and business communities that without such provisions, there would be no competitive bidding at all, leaving shareholders with the initial prices offered by the unsolicited bidder. Indeed, at some point in time, in the face of a hostile tender offer as in any other business context, a board of directors must determine, based on its assessment of all facts and circumstances existing at the time, that one business opportunity is more advantageous to shareholders and the corporation than another. Consistent with its fiduciary duty, the board may enter into a negotiated merger agreement that ensures that shareholders will be benefited. The business judgment rule protects these decisions, and if, as here, there is no possibility of self-dealing or self-benefit on the part of target management and directors, the courts cannot and will not interfere.

STATEMENT OF FACTS

FLC relies on the affidavit of Theodore J. Forstmann submitted herewith for a detailed recital of the facts with respect to the negotiation of the merger agreement and its subsequent revision, as well as the additional value these agreements have provided to the Revlon shareholders. In addition, FLC relies on the affidavit of Richard W. Herbst of Goldman Sachs & Co. which details the benefits provided to Revlon shareholders by the FLC merger agreement, and the valuations inherent in the FLC transaction. FLC also relies on the affidavits being submitted by Revlon which also chronicle the events leading up to the merger agreement and its revision. Finally, FLC relies upon the expert testimony submitted in the affidavits of five investment bankers specializing in mergers and acquisitions as to the critical importance of inducements such as asset options in obtaining the highest possible price for shareholders . As these affidavits show, without such inducements "white knights" will not enter the competition in the face of an unsolicited bid, so that shareholders are likely to be left with the original bid at the original price.

Succinctly put, the competitive process has undeniably worked here. It is undisputed that Pantry Pride's bid to . shareholders was $42 when FLC proposed its $56 merger and the price now available to shareholders is $57.25 -- an increase of $15.25 per share for each of the over 30 million shares Revlon outstanding.

POINT I

THE REVLON/FLC MERGER AND ITS INCIDENTAL OPTIONS AND TERMINATION PROVISIONS SHOULD BE SUSTAINED IN ALL RESPECTS

The Delaware Supreme Court has made it clear that where, as here, a corporation's board of directors determines to oppose takeover activity, and where, as here, that decision is made in good faith, after reasonable investigation, and for a proper corporate purpose, that decision and the measures adopted by the board to effectuate it are entitled to the protections of the business judgment rule. See, e.g., Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 954 (Del. 1985); Edelman v. Phillips Petroleum Co., (Del. Ch. No. 7899, Walsh, V.C. February 12, 1985); Lowenschuss v. The Option Clearing Corp., (Del. Ch. No. 7972, Brown, G.C. Mar. 27, 1985); Pogostin v. Rice, 480 A.2d 619, 627 (Del. 1984).* Moreover, as this court recently noted, "if a planned takeover defense strategy, whether general and prospective or specific and reactive was not primarily designed for entrenchment, it

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* When the action in question is approved by a board consisting of a majority of outside, independent directors -- as is the case here -- the presumption that the directors acted in accordance with these principles is heightened. Moran v. Household International, Inc., 490 A.2d 1059, 1074-75 (Del. Ch. 1985) (appeal pending); Unocal Corp. v. Mesa Petroleum Co., supra, 493 A.2d at 955.

continues to enjoy the presumption that it was the result of good faith managerial judgment." Edelman v. Philips Petroleum Co., Del. Ch. C.A. No. 7899, slip op. at 7, Walsh., V.C. (Feb. 12, 1985).

In addition, if directors decide that a tender offer or potential tender offer is not in the best interests of shareholders, it is their duty to act to oppose it. Panter v. Marshall Field & Co., 646 F.2d 271, 299 (7th Cir.) cert. denied, 454 U.S. 1092 (1981) (it is the directors' duty "to evaluate proposed business combinations on their merits and oppose those detrimental to the well-being of the corporation even if that is at the expense of the short term interests of individual shareholders").* See also Heit v. Baird, 567 F.2d 1157, 1161 (1st Cir. 1977); Northwest Industries, Inc. v. B.F. Goodrich Co., 301 F. Supp. 706, 712 (N.D. Ill. 1969).

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* The lower court in Panter expressed this basic principle as follows:

> Corporate directors have the duty to oppose a takeover offer which they have determined would be detrimental to the interests of the corporation and its shareholders.... Having so decided in good faith, with rational business purposes attributable to their decision, [directors have] not only the right "but the duty to resist by all lawful means persons whose attempt to win control of the corporation, if successful, would harm the corporate enterprise."

Panter v. Marshall Field & Co., 486 F. Supp. 1168, 1194-95 (N.D. Ill. 1980), aff'd, 646 F.2d 271 (7th Cir.), cert. denied, 454 U.S.1092 (1981) (emphasis added) (citations omitted).

Under these circumstances the business judgment rule provides that the good faith of directors in taking corporate action must be presumed (see, e.g., Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984); Johnson v. Trueblood, 629 F.2d 287, 292 (3d Cir. 1980), cert. denied, 450 U.S. 999 (1981); Treadway Cos. v. Care Corp., 638 F.2d 357, 381 (2d Cir. 1980); Crouse-Hinds Co. v. Internorth Inc., 634 F.2d 690, 702-703 (2d Cir. 1980)), and that the burden of demonstrating bad faith rests with the person attempting to overturn the decision of the board (see e.g., Warshaw v. Calhoun, 221 A.2d 487, 493 (Del. 1966)). Most recently, in Unocal Corporation v. Mesa Petroleum Co., 493 A.2d at 957, the Delaware Supreme Court reaffirmed the application of the business judgment rule as it was articulated in Johnson v. Trueblood, 629 F.2d at 292-3:

> The business judgment rule . . . achieves . . . [its] purpose by postulating that if actions are arguably taken for the benefit of the corporation, then the directors are presumed to have been exercising their sound business judgment rather than responding to any personal motivations. . . .
>
> . . . [U]nless the plaintiff can tender evidence from which a factfinder might conclude that the defendant's sole or primary motive was to retain control, the presumption of the rule remains. . . . In short, we believe that under Delaware law, at a minimum the plaintiff must make a showing that the sole or primary motive of the defendant was to retain control.

(emphasis added).

No such showing can possibly be made here. Revlon has an independent Board, and there is no self-interest even on the part of the management directors, who are not participating in the acquisition, and who have no assurances or understandings of any sort with respect to their employment positions. What is before the court is a major substantive business transaction, negotiated at arm's length between FLC and Revlon, and providing shareholders with hundreds of millions of dollars of premium payments for their shares. It is, we submit, inconceivable that such a transaction -- or any of the essential components required to bring it about -- should be enjoined by the court.

A. Revlon's Adoption of the Merger Agreement is Entitled to the Protection of the Business Judgment Rule

As a frustrated bidder, which had attempted to acquire Revlon for as little as $42 per share, Pantry Pride seeks to obtain by judicial fiat what it has lost in the marketplace. Indeed, if we look at just the facts -- stripped of hyperbole and innuendo -- the only conclusion possible is that Revlon's transaction with FLC should not be enjoined.

First and foremost, FLC's merger agreement provides Revlon's common shareholders, noteholders and preferred stockholders with far greater benefits than those provided by Pantry Pride's offer.

1. The FLC merger provides common shareholders with a higher price than Pantry Pride's tender offer. $57.25 remains higher than $56.25, and any slight discount that might possible be required for timing is more than offset by the fact that, at the time of the Revlon board's decision, FLC had a firm bid, with its financing in place, while Pantry Pride, after eight weeks, had still been unable to obtain the necessary financing to purchase the shares.*

2. FLC has provided a substantial dollar benefit to Revlon noteholders which Pantry Pride flatly refused to provide. Thus, FLC has agreed to make an exchange offer to Revlon noteholders of notes bearing substantially higher interest than the notes they presently hold. This solves a serious problem for Revlon, which had been faced with the complaints of noteholders that their notes had substantially declined in value. In stark contrast, Pantry Pride refused to provide anything that would similarly benefit Revlon noteholders.

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* See accompanying of Richard W. Herbst of Goldman, Sachs & Co. and the affidavit of Felix Rohatyn a general partner of Lazard Freres & Co.

3. The FLC merger agreement assumes and satisfies Revlon's obligations to its preferred shareholders.

Based on any one of these factors, Revlon's board would have properly exercised its business judgment in entering into the FLC transaction.* Taken together, we submit that the Board could have reached no other conclusion. Certainly, unless the business judgment rule is to be turned upside down, there can be no basis for the court to substitute its own judgment for that of the Revlon board. For this reason alone, the relief sought should be denied.

Indeed, no reason has been suggested why Revlon's Board -- comprised of a majority of independent directors of unquestioned standing and integrity -- would have entered into the FLC transaction other than out of a firm belief that it was in the best interests of the company and its shareholders. No possible entrenchment is involved: no directors are

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* The Board was also entitled to consider FLC's reputation in the business and financial communities as a company with a proven record of standing behind its commitments, completing transactions in which it determines to proceed, and raising substantial capital quickly from highly respected institutional investors. The Board was also entitled to compare this reputation with that of Pantry Pride, which has no similar record of achievement, had not been able to complete its financing in over two months, and which had been attempting to acquire Revlon at the lowest possible price, even to the extent of lowering its offer when this suited its purpose.

participating in the acquisition, and no one has any assurance of continued employment. The so-called "golden parachutes" are pre-existing obligations which would be binding on any acquiror, including Pantry Pride.* What we have here, in short, is not a "poison pill" or any other kind of transaction that can possibly be characterized as management self-dealing or as enhancing management power. Rather, we have an arm's length transaction entered into between two independent companies where the only sure beneficiaries are Revlon's shareholders and noteholders. If transactions of this nature are not permitted, shareholders of all target companies will be losers.

B. The Asset Options and Termination Provisions Are Proper in All Respects

It is a critical -- and undisputed -- fact that asset options and similar provisions are customarily required in order to induce "white knights", once there has been an unsolicited bid for a target company, to enter the arena and provide substantial additional consideration to shareholders. As the affidavits of representatives of Alex, Brown & Sons Inc., Gibbons Greene van Amerongen, Salomon Brothers Inc.,

* In making its own analysis of the transaction, Pantry Pride in fact included the payments under the severance agreements as a cost of doing the transaction.

Dillon, Reed & Co., Goldman, Sachs & Co., Smith, Barney, Harris, Upham & Co., Kidder, Peabody & Co. state:

1. The uncertainty inherent in the environment surrounding unsolicited offers makes it difficult for target companies to procure alternative transactions to enhance the consideration to shareholders.

2. Such alternative transactions are usually essential to shareholder realization of fair prices for their stock.

3. It is traditional in this context for third parties to demand option and termination fees before agreeing to undertake the expense, time and risks associated with takeover contests.

4. The elimination of these traditional inducements to third parties will substantially alter the market process by which competitive transactions take place to the substantial detriment of all shareholders.

5. Depriving a target board of the opportunities traditionally provided by the business judgment rule to obtain the best deal for shareholders will encourage original offerors to successfully acquire target companies at bargain basement prices, since they will be substantially insulated from effective competition.

It is well to note in this regard that the concept of an abstract auction for the target company, where bidding is unfettered by inducements or limitations, is one which, while seductive in theory, has no relation to the way in which these transactions are actually conducted. For if this were required, and inducements were somehow prohibited, the "auction" process would, in most cases, never start at all, and the original bidder would be the unchallenged winner at its original price.

The present case provides a compelling demonstration of this principle. Pantry Pride opened the bidding at $47.50. It then reduced its offer to $42.00. For over six weeks, no competition appeared. Although Pantry Pride suggested -- without the financing to back it up -- a possible bid of $53.00, it made no offer above $42.00 to the shareholders until FLC entered the bidding. FLC's initial offer of $56.00 thus increased the actual consideration being offered to shareholders by $14.00 per share. In response, Pantry Pride raised its offer to $56.25 -- a mere 25 cents per share. FLC then went to $57.25, along with substantial additional benefits to noteholders and preferred shareholders. The net result was benefits to shareholders of hundreds of millions of dollars. This is precisely how the process should take place, and it would never have even started if inducements such as termination fees and asset options had not been available.*

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* Plaintiff's selective citation from Note, Lock-Up Options: Toward A State Law Standard, 96 Harv.L. Rev. 1068 (1983) merits completion.

> Reasonably formulated lock-up arrangements, however, can be beneficial to the shareholders of target corporations. The principal virtue of a lock-up is its function in inducing an otherwise reluctant bidder

Footnote Continued

It is little wonder that transactions of this nature have uniformly been upheld. For example, in Treadway Companies v. Care Corp., 638 F.2d 357 (2d Cir. 1980), the court upheld, as a reasonable exercise of business judgment, the decision of a target company's board to enter into a stock sale with a white knight as a necessary and proper step toward avoiding a hostile takeover and implementing a merger with the white knight. 638 F.2d at 380-84. The court reached its conclusion after reviewing the history of the transaction. As here, the target's

> board was simply not acting to maintain its own control over the corporation. Rather,

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* Footnote Continued From Previous Page

> to enter the fray as a white knight and thus raise the stakes in the contest for corporate control. Because of the considerable risk involved in competing with a tenacious and cash-laden raider, a prospective white knight may be hesitant to enter a bidding war. Any bidder is certain to incur extremely high litigation costs. In today's political climate, participation in a tender offer contest may also harm a company's public image. Finally, entry into a tender offer contest may make the white knight itself vulnerable to a takeover attempt. In short, a prospective white knight faces unavoidable expenses, substantial risk, and uncertain prospects for a profitable return on its investment of corporate resources. A lock-up option gives the white knight a running start--which enhances its probability of ultimate success--and simultaneously serves as insurance against failure. When a white knight is drawn into a fight it would otherwise have avoided, the target's shareholders are the primary beneficiaries.

Id. at 1078.

> in approving the stock sale, they were moving [the target] Treadway toward a business combination with Fair Lanes. Fair Lanes had made the stock sale a precondition to further merger talks. From all that appears, Fair Lanes and Treadway had every intention of carrying through with that merger.

638 F.2d at 383. The court also emphasized that -- as here -- the Treadway board had retained investment bankers to negotiate and evaluate the proposed merger, that arm's-length negotiations were conducted, and that the Treadway board insisted upon obtaining an opinion from the investment bankers that the merger would be fair to Treadway shareholders. Id. at 384.*

Similarly in Whittaker Corp. v. Edgar, 535 F. Supp. 933 (N.D. Ill. 1982) a white knight secured for itself an agreement to purchase the crown jewel asset of the target in the event that its competing tender offer failed. In upholding the application of the business judgment rule to the white knight transaction the court held:

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* The court further noted that:

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

638 F.2d at 382 n.47.

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

<u>Id</u>. at 951 (citations omitted) (emphasis added).

In <u>Buffalo Forge Co. v. Ogden Corp.</u>, 717 F.2d 757 (2d Cir.), <u>cert.</u> <u>denied</u>, 464 U.S. 1018 (1983), a successful offeror sought rescission of the target corporation's sale to an unsuccessful white knight of a 425,000 share block of the target's treasury stock in the face of the hostile tender offer and the grant of an option insisted upon by the white knight to purchase 143,400 additional treasury shares. 717 F.2d at 759. Rejecting the raider's claim that the target's board had breached its fiduciary duties by approving the sale and option,* the Second Circuit affirmed the district court's finding that the board had acted within the scope of its business judgment. "Under the circumstances, it would have

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* The claimed breach of fiduciary duty was rejected in spite of the fact that the option was given at a price below the optionee's offering price.

been a mistake for the district court to substitute its judgment for the business judgment of the directors. . . ." Id. The court of appeals found that the district court had properly concluded that the sale and option constituted a valid exercise of the board's business judgment because, as here, the transaction had been negotiated at arm's length and the directors had properly relied on the advice of their financial advisors and attorneys. Id.

Likewise, in GM Sub Corp. v. Liggett Group, Inc., Del. Ch., C.A. No. 6155, Brown, V.C. (April 25, 1980), the target, Liggett, responded to a hostile tender offer by entering into a contract to sell its prize subsidiary to a third party. The court found that it was "realistic to assume that it was contemplated by Liggett that the practical effect of the sale of its sought-after asset might be to cause the hostile offeror, GM Sub, to lose interest in its tender offer." Slip op. at 3. Nevertheless, the court refused to enjoin the sale.

In Thompson v. Enstar Corp., Del. Ch., C.A. Nos. 7641, 7643, Hartnett, C. (August 16, 1984), the court similarly applied the business judgment rule to sustain Enstar's asset option agreement with an offeror. The agreement was challenged because subsequent to it, a possible higher offer materialized. The court held that

> The test of whether the Enstar board acted reasonably on May 22nd, however, is not whether something happened on June 12th which, in hindsight, may show that the

> directors of Enstar should have delayed. The judgment of the directors must be measured on the facts as they existed on [the date the board made its decision].

Slip op. at 9-10.

In Enstar the court further recognized that, where time is of the essence, corporate directors may enter into a transaction that is reasonable in light of the time pressures and uncertainties involved.

> While reasonable men may differ as to whether the offer was the best which might ever materialize, the plaintiffs have not met their burden of showing that it was unreasonable for the directors to conclude that, in their judgment, the offer of Unimar was the best which could be obtained under the circumstances and that it was possible it might be soon withdrawn, thus leaving the shareholders of Enstar to face the prospect of liquidation for a much lesser price and at some time in the distant future. The adoption of the lock-up provisions was a necessary prerequisite to Unimar making its tender offer and therefore it is probable that it was reasonable for the directors to accede to Unimar's demand under the unusual circumstances present. (emphasis added).

Slip op. at 13.*

In the case at bar, the asset option and termination provisions are essential incidents to a merger agreement that ensures Revlon's shareholders the highest premium available for

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* Plaintiff's attempt to find support for its position in Enstar is thoroughly misguided. Here there was a more expansive and exhaustive bidding process than that which the Court approved in Enstar.

their shares. Moreover, it bears emphasis that Pantry Pride has not been prevented from competing on the merits with FLC and has had ample opportunity to present its best price to shareholders -- indeed, when FLC entered the bidding Pantry Pride's price was only $42 per share.

Here, as in Enstar and Treadway, the board had time constraints imposed upon it by forces outside of its control. Here, as in those cases, the target retained investment bankers to evaluate the competing offers, arm's-length negotiations were conducted and once FLC's offer emerged as the more beneficial to shareholders, an agreement was executed. And, as in those cases, the agreement reached was clearly an appropriate exercise of business judgment, which should not be disturbed by the courts.*

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* The instant case bears no relation to the situations presented in either DMG, Inc. v. Aegis Corp., Del. Ch., No. 7619, Brown, C. (June 29, 1984) or Data Probe, Inc. v. CRC Information Systems, Sup. Ct. N.Y., N.Y.L.J. at 7, Col. 2 (December 28, 1984). In DMG County an unsuccessful white knight brought an action to specifically enforce an option to purchase 51% of the stock of a subsidiary of the target and sought preliminary injunctive relief to restrain the new directors of the target from taking action to amend the subsidiary's by-laws and charter in a manner that would adversely impact the value of the option. In seeking the injunction, the optionee relied upon the body of cases which hold that "in a tender offer situation defensive maneuvers by a target company, including a sale of assets or subsidiaries to a third party, are not open to attack on the basis of a breach of fiduciary duty or a waste of assets when they are undertaken based upon the informed business judgment of the board of directors acting in what

Footnote Continued

C. The Board's Solicitation and Implementation of an Advantageous Competing Bid and Negotiated Merger Agreement Are Consistent <u>with its Fiduciary Duties</u>

A logical corollary to the board's duty to oppose a takeover bid which it finds to be inadequate or detrimental to the well-being of the corporation and shareholders, is the board's right and responsibility to pursue, select and commit to a competing bid and proposed merger which, based on its assessment of all facts and circumstances existing at the time, it finds would be advantageous to the shareholders and the corporation. The business judgment rule sets the standards for judicial review of these efforts by management to optimize shareholder benefits. In the absence of fraud or self dealing -- which cannot even be claimed here, much less

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* Footnote Continued From Previous Page

it believes to be the best interests of the shareholders." (Slip. Op. at 8). The Chancellor recognized that "the cases relied upon by [the optionee] are good as far as they go," but denied preliminary injunctive relief because of doubt that the business judgment rule could be used as an offensive weapon by the optionee "for the purpose of establishing a right to a preliminary injunction against internal corporate action" (<u>id.</u> at 9), particularly where the option did not purport to prevent the corporation from taking the contemplated action. (<u>Id.</u> at 11).

In <u>Data Probe</u>, the court specifically found that the target's directors were self-interested as a result of their agreements for continued employment with the favored acquiror and as a result of their acceptance of loans at interest rates below market. Such self-interest is clearly not present in this case.

proven -- a negotiated merger agreement cannot be set aside even if a subsequent proposal is made at a higher price.

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

> [T]o permit a board of directors to decide that a proposed merger transaction is in the best interests of its shareholders at a given point in time, and to agree to refrain from entering into competing contracts until the shareholders consider the proposal, does not conflict in any way with the board's fiduciary obligation. . .

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

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

Id.

> the information available at that moment. . The pursuit of competitive advantage has never been recognized at law as a sufficient reason to render void or voidable, an otherwise valid contract. . . .

Id. at 1563-1564 (emphasis added).

Similarly, in Thompson v. Enstar, Del. Ch., C.A. Nos. 7641, 7643, Hartnett, C. (August 16, 1984), the court held that the target's board had properly chosen to accept an offer from one bidder notwithstanding that subsequently, a new potential bidder appeared which might have agreed to effect the transaction on more favorable terms. Moreover, the board did not merely approve the earlier offer, but also had actively courted the bidder and facilitated the proposed transaction. In fact, in deference to the offeror's wishes, the Enstar board entered into a voting trust agreement with the offeror, thereby giving the offeror indefeasible voting control over Enstar's "single most valuable asset." This asset was ceded to the suitor for no consideration other than the signing of the agreement. It was not a situation like the present where the white knight was given an option to purchase the asset at a reasonable price. The court nevertheless held that the board had acted reasonably.

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

The Revlon board's actions in furtherance of the merger agreement similarly constitute a valid exercise of management's right to protect shareholders by facilitating an advantageous offer. The board dutifully has taken steps to secure the highest possible premium for its shareholders. There are no agreements to perpetuate either board or management control. All shareholders are ensured equal treatment. The exercise price for the asset options was reached after arm's length negotiation and is clearly within the range of the probable value of these assets.* The termination agreement is reasonable in light of the size of the transaction, the benefit to shareholders and the risk and expense undertaken by FLC.** In sum, this is a case in which

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* As the accompanying affidavits show, the option price for the assets is within the range of valuation estimates of both Goldman, Sachs, FLC's investment banker, and of Pantry Pride and its investment banker.

** In any event, the extraordinary remedy of injunctive relief would clearly be improper with respect to FLC's termination fee, since this is plainly a subject as to which there is

Footnote Continued

the business judgment rule is, without further inquiry, clearly controlling.

D. Plaintiff's Frustration as a Bidder Does Not Rob Revlon of the Protection of the Business Judgment Rule

A central theme of plaintiff's presentation is that the board of Revlon breached its fiduciary duties to the corporation by failing to negotiate with plaintiff in a manner acceptable to the plaintiff. Aside from the obvious sophistry of an unsolicited bidder arguing that a target should be compelled to negotiate with the bidder pursuant to the bidder's ground rules, plaintiff's argument runs afoul of the business judgment rule. As demonstrated above, application of this rule to the business decision by Revlon's disinterested board is mandated since plaintiff has not and cannot present any evidence whatsoever of self-dealing or personal interest in the challenged transaction.

Plaintiff's attempt as a bidder to wear the mantle of the derivative plaintiff and argue that a bidder, such as itself, has been treated unfairly has been considered and

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an adequate remedy at law. See e.g., Bayard v. Martin, 101 A.2d 329, 335 (1953), cert. denied, 347 U.S. 944 (Del. Supr. 1954) ("courts of equity will not deal in matters readily measurable in dollars" where there has been no showing that a defendant is unable to respond in damages).

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rejected under similar circumstances. Simkins Industries, Inc. v. Fibreboard Corporation, Del. Ch., C.A. No. 5369, Marvel, C. (July 25, 1977). In the Simkins case plaintiffs, who were shareholders of Fibreboard, sued individually and derivatively to require Fibreboard "to deal fairly with plaintiffs in regard to their efforts to buy one or more of the plants and equipment of the defendant which the latter proposes to sell." Plaintiffs argued, as does Pantry Pride here, that the board had not dealt fairly with plaintiffs, had refused to give them certain information and was not seeking to obtain the best bid for the assets. The Chancellor characterized this effort as follows:

> Plaintiffs, in seeking injunctive relief, have asked that defendant be required by this Court to conduct its proposed sales of its carton producing assets as if defendant were a government agency, namely on the basis of sealed bids or by Court regulated competitive bidding and ask that defendant be enjoined "*** from selling its carton group at less than the best available prices."

Slip op at 2.

He flatly refused to grant such relief, noting that in the area of the sale of corporate assets:

> the courts of this State have in general paid respect to the business judgment of corporate directors, refusing to disturb such judgment in the absence of a showing of fraud, gross unfairness of price Mitchell v. Highland-Western Glass Co., Del. Ch., 167 A. 831 (1933), or unwarranted

> personal interest in the form of a sharing in the proceeds of such a sale. Robinson v. Pittsburgh Oil Refining Corporation, Del. Ch., 126 A. 46 (1924).

Id.

The Chancellor quoted Robinson v. Pittsburgh Oil Refining Co., Del. Ch., 126 A. 46 (1924), also cited by Pantry Pride here, for the proposition that the defendant board was entitled to a presumption that it acted with "a bona fide regard for the interests of the corporation whose affairs the stockholders have committed to their charge. This being so, the sale in question must be examined with the presumption in its favor that they were securing terms and conditions which were expedient and for the corporation's best interest." Despite the Chancellor's findings that the board had committed to one group "not to disclose to other interested parties the terms of its offer" and that there was a "persisting bad feeling" between the litigants arising out of plaintiffs' successful effort to prevent the adoption of an option plan for key members of the defendant board, he found that the board had exercised its business judgment and denied the injunctive relief requested.

Chancellor Marvel, in Simkens, specifically distinguished his earlier decision in Thomas v. Kempner, Del. Ch., C.A. No. 4138, Marvel, C. (March 22, 1973) (Exhibit I), as being a "unique case which was decided on a record which indicated that corporate directors failed to give any consideration to a higher cash bid for corporate assets." Indeed, in Thomas, the higher bid which the board ignored was in fact received prior to the acceptance of the lower bid.*

Similarly, the Revlon board is entitled to a presumption that it is acting for the benefit of the stockholders who elected it. Plaintiff has raised no facts evidencing any self-dealing motive on the part of the directors not to achieve the highest price. On the contrary, the board has been successful in raising the Pantry Pride bid from $42.00 to $56.25 per share and the FLC bid to $57.25 per share. This court should not be called upon to second guess the successful judgment of the board or to suggest that it could have done its job better. The directors were elected by the shareholders to protect their interests and that is exactly what they have done.

This court has repeatedly determined that the business judgment rule is especially applicable to cases such as the present matters of valuation are involved. "When the

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* Plaintiff's reliance on Thomas v. Kempner, Del. Ch., C.A. No. 4138, Marvel C. (March 22, 1983) and Pennsylvania Co. v. Wilmington Trust Co., 186 A.2d 751 (Del. Ch. 1962) is utterly misplaced. In both of those cases a competing offer was made before the trust or the corporation executed an agreement at a lower price. Here, FLC's offer is higher than Pantry Pride's and provides substantial benefits to the noteholders and preferred shareholders which Pantry Pride's does not.

question is asked whether in a given case the price is adequate, it is readily seen that room is afforded for honest difference of opinion." Allied Chemical & Dye Corp. v. Steel & Tube Co. of America, Del. Ch., 120 A. 486, 494 (1923). Thus, "a wide discretion in the matter of valuation, as in other matters, is confided to directors". Cole v. National Cash Credit Ass'n., Del. Ch., 156 A. 183, 188 (1931). Consequently, a "mere inadequacy of price will not suffice to condemn the transaction as fraudulent, unless the inadequacy is so gross as to display itself as a badge of fraud". Mitchell v. Highland-Western Glass Co., Del. Ch., 167 A. 831, 833 (1933). The established rule, as stated in Cole v. National Cash Credit Ass'n., supra, is that:

> "[t]he overvaluation or undervaluation as the case may be must be such as to show a conscious abuse of discretion before fraud in law can be made out.
>
> * * *
>
> "[M]ere inadequacy of price will not reveal fraud. The inadequacy must be so gross as to lead the court to conclude that it was due not to an honest error of judgment but rather to bad faith, or to a reckless indifference to the rights of others interested.

156 A. at 187, 188.

In the present suit the Revlon board evaluated the Pantry Pride bids with the advice and counsel of experts and acted according to its view of their merits. When FLC made its merger proposal the board did not foreclose Pantry Pride but instead induced a still higher offer from Pantry Pride and then induced FLC to make the present, highest, merger proposal.

Even if there were some question as to the relative value of the two proposals,* this would hardly limit the applicability of the business judgment rule. For when a board is faced with "something more than the simple process of deciding between two flat offers of two sums of money tendered by rival bidders for the same identical thing...." Robinson v. Pittsburgh Oil Refining Co., Del. Ch., 126 A. 46, 49 (1924), the rule that a court should defer to the judgment of the directors "remains as appropriate now as when written over 50 years ago." Simkins Industries v. Fibreboard Corporation, supra, at page 5.

Thus, Pantry Pride's failure as a bidder has not and cannot be shown to be attributable to any bad faith or self-interest on the part of Revlon's board. Under these circumstances, courts time and again have refused to substitute their judgment for the rational judgment of directors, and there is no basis whatever to do so.

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* There certainly can be no question insofar as the total value to security holders -- including noteholders as well as stockholders - - is concerned.

II

THE OPTION AGREEMENTS DO NOT AMOUNT TO A SALE OF SUBSTANTIALLY ALL OF THE ASSETS OF REVLON

Plaintiff's contention that Revlon's agreements to sell certain of its assets pursuant to contracts with Adler & Shaykin and FLC constitute sales of "substantially all" of Revlon's assets and, therefore, require shareholder approval pursuant to 8 Del. Code § 271, is without merit. First, the agreements with Adler & Shaykin and FLC are separate transactions which can operate independently and must be considered as such in determining whether § 271 requires that they be subject to shareholder approval. Second, if the options are exercised, the assets which will be sold to FLC do not represent, in quantitative or qualitative terms, "substantially all" of the assets of Revlon. Third, even if the sales to Adler & Shaykin and the option to FLC are analyzed together they do not represent, in quantitative or qualitative terms, "substantially all" of the assets of Revlon. Indeed, Revlon is retaining approximately 55% of its total assets,*

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* Plaintiff's contention that Revlon is selling 60% of its assets is totally disengenuous. As indicated by Pantry Pride's Goldstein affidavit, that figure is based on <u>operating</u> assets. However, the authorities make it clear that § 271 speaks in terms of <u>total</u> assets -- that is, operating and corporate assets combined.

including several of its most profitable divisions. Accordingly, § 271 is plainly inapplicable here.

A. The Contracts with FLC and Adler & Shaykin Are Separate Transactions

Plaintiff's theory that the sales to Adler & Shaykin and FLC can be lumped together to reach some imaginary threshold which would trigger the application of § 271 simply does not hold water.* There is no evidence nor could there be that at the time Revlon contracted with Adler & Shaykin it intended to dispose of any other assets independent of the merger agreement. In fact, at the time that the October 3 merger agreement and the Adler & Shaykin sale were negotiated, FLC asked Revlon for an option to purchase the very assets which later became the subject of the option agreement and, at that time, Revlon refused to grant such an option.

Each sale can operate independently from the other. For example, if the Adler & Shaykin sale does not go forward and there is no Revlon-FLC merger but Pantry Pride or some other third party acquires 40% of Revlon, then the option agreement will be triggered in the absence of the Adler &

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* Since plaintiff characterizes the Adler & Shaykin contracts as "at the least, not certain" elsewhere in its brief, it is difficult for this reason alone to understand why the Adler & Shaykin sale should be regarded as part and parcel of the Revlon-FLC option agreement. <u>See</u>, plaintiff's opening brief at 24.

Shaykin sale. If the Adler & Shaykin sale does go forward and there is no Revlon-FLC merger but Pantry Pride or some other third party acquires 40% of Revlon, then the option agreement will be triggered together with the Adler & Shaykin sale. If the Adler & Shaykin sale goes forward and the merger is accomplished, then the option agreement will not be triggered despite the consummation of the Adler & Shakin sale. Clearly, the sale to Adler & Shaykin and the options to FLC are independent transactions and must be regarded as such.

Instructive in this respect is the court's refusal in <u>Bacine v. Scharffenberger</u>, Del. Ch., C.A. Nos. 7862, 7866, Brown, C., (Dec. 11, 1984) -- the most recent Delaware decision under § 271 -- to enjoin the consummation of a $1.25 billion asset sale. In that case, plaintiffs alleged that the asset sale was part of a plan of liquidation approved by the board one month later and, therefore, was subject to stockholder approval pursuant to 8 Del. Code § 275. The court rejected this argument* and further held that the assets in question,

* There is absolutely no authority for integrating separate agreements reached at different times by different parties under § 271. Plaintiff's reliance on <u>In re Associated Gas & Electric Co.</u>, 149 F.2d 996 (2d Cir. 1945), for such a proposition is clearly misplaced. <u>Associated Gas</u> had nothing to do with § 271; indeed, it had nothing to do with any analogous statute. Rather, it was a bankruptcy proceeding determining whether successive asset transfers by a subsidiary company were proscribed by a restrictive covenant contained in debentures held by the parent company.

which for the prior three years had provided a maximum of 29% of the corporation's consolidated revenues, 35% of its operating income and 13% of its asset base, were not "substantially all" of its assets.

B. The Assets Under Option to FLC Do Not Constitute Substantially All the Assets Under § 271

Shareholder approval is not required for the sale of Vision Care and NHL simply because they are healthy parts of Revlon's business. Section 271 requires shareholder approval for the sale of "all or substantially all" of the assets of a Delaware corporation. The assets that might be sold by Revlon to FLC pursuant to the option agreement constitute only 8.7% of Revlon's total assets for the fiscal year ending December 31, 1984 (hereinafter "fiscal '84").* Clearly, "all or substantially all" does not encompass 8.7% of a company's assets.

Justice Moore of the Delaware Supreme Court has written (while in private practice) that dispositions of less than 50% of a corporation's assets are clearly not within the ambit of § 271 and are _per se_ legal. _See_, A. Moore, The Sale of All or Substantially All Corporate Assets Under Section 271

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* Unless otherwise indicated, all figures herein are taken from the affidavit of William R. Loomis, Jr. submitted in support of Revlon's Brief in Opposition to Plaintiff's Motion for a Preliminary Injunction.

of the Delaware Code, 1 Del. J. Corp. L. 56, 58 (1976). When higher percentages are involved, according to Justice Moore, a transaction is only subject to § 271 if (1) the assets sold are quantitatively vital to the operation of the corporation; (2) the transaction is out of the ordinary; and (3) the transaction substantially affects the very existence and purpose of the corporation. Id. at 59. It is inconceivable that the present transactions meet this test.

Justice Moore's view is consistent with that set forth in the leading case of Gimbel v. Signal Corporations, Inc., 316 A.2d 599 (Del. Ch. 1974). The Gimbel court noted: "A sale of less than all or substantially all assets is not covered by negative implication from the statute." Gimbel v. Signal Companies, Inc., 316 A.2d 599, 605 (Del. Ch. 1974) citing, Folk, The Delaware General Corporation Law, Section 271, p. 400, n.3. The Gimbel court explicitly rejected a rule which would require shareholder approval "simply because an independent, important branch of a corporate business is being sold." 316 A.2d at 605.

While no specific numerical threshold is set forth in § 271, courts interpreting that section have uniformly held sales of assets which comprise much greater percentages of a corporation's business than is at issue here not to require shareholder approval. For example, the Gimbel court denied plaintiff's motion to enjoin, pursuant to § 271, the sale of a wholly-owned subsidiary of defendant Signal. As here, the sale had been authorized by the board and was to be consummated without shareholders' vote. The subsidiary in question represented 26% of Signal's total assets* and 41% of its total net worth. The _Gimbel_ court held that, from a strictly quantitative approach, the sale of these assets would not constitute a sale of "all or substantially all of Signal's assets." 316 A.2d at 607.**

The _Gimbel_ court announced a "qualitative," not merely "quantitative," test for determining whether shareholder approval is required under § 271.

> While it is true that a transaction in the ordinary course of business does not require shareholder approval, the converse is not true. Every transaction out of normal routine does not necessarily require shareholder approval. The unusual nature of the _transaction must strike at the heart of the corporate existence and purpose_.

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* As stated above, it was the percentage of a company's _total_ assets not operating assets which the _Gimbel_ court looked to.

** Sales of significantly larger assets than those at issue in the instant case or in _Gimbel_ have also been held not to trigger the requirement of shareholder approval. In _Whittaker Corp. v. Edgar_, 535 F. Supp. 933 (N.D. Ill. 1982), the court cited _Gimbel_ as authority for the proposition that the sale of an asset which represented at least 26% (the percentage in _Gimbel_) and possibly as much as 50% of a corporation's total assets was not a sale of substantially all of the corporation's assets within the meaning of § 271. 535 F. Supp. at 951.

316 A.2d at 606 (emphasis added).

Accordingly, the Gimbel court looked to the character of the transaction at issue and, noting that Signal was a conglomerate engaged in many businesses in addition to those being sold, concluded that the sale in question need not be subject to shareholder approval pursuant to § 271. The court distinguished the sale of certain operations by a multi-business corporation like Signal from a single business corporation's sale, by one transaction, of its entire means of operation. Id. at 608. The same factors are obviously present here as well.

Indeed, the only case in which a Delaware court has found that a sale of less than all of a corporation's assets requires prior shareholder approval under § 271 is Katz v. Bregman, 431 A.2d 1274 (Del. Ch. 1981). In that case, however, the court found that substantially all the assets had been sold because the corporation did not have a single profitable asset remaining -- a fact which plaintiff here, in its discussion of the case, has neglected to mention. Thus, the sale in Katz fell clearly within the Gimbel court's category of sales affecting the very existence of the corporation.*

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* The qualitative test set forth in Gimbel has been adopted by other courts. For example, in Mobil Corp. v. Marathon Oil Co., 1981-82 Fed. Sec. L. Rep. ¶ 98,375, (S.D. Ohio 1981), the court rejected Mobil's argument that the option

Footnote Continued

Like the corporation in Gimbel, Revlon is engaged in a multitude of operations. Indeed, in fiscal '84, the businesses being retained by Revlon had assets of more than $1.27 billion, sales of more than $935 million and operating profits of more than $111 million. In sharp contrast, NHL and Vision Care -- the assets under option to FLC -- accounted for 2.8% and 5.9%, respectively, of Revlon's total assets; and each has historically accounted for less than 10% of the company's sales and less than 14% of its operating profit. Viewed in the context of Revlon's overall business operations, as it must be, the option to FLC of Vision Care and NHL cannot be said to constitute a transaction which strikes at the heart of Revlon's existence and purpose.

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* Footnote Continued From Previous Page

by Marathon of its most important oil field required the prior approval of Marathon's shareholders under a provision of Ohio law analogous to § 271. In light of testimony as to Marathon's other significant assets, the court stated that it could not "help but conclude that Mobil has failed to make any showing that the . . . option, if exercised, would result in the transfer of all the effective operating assets of Marathon, in substantially affecting the existence and purpose of Marathon as a corporate entity." (Citations omitted.) Thus, the court concluded that the Gimbel qualitative test was not satisfied. Id. at 92,283.

C. The Assets Under Option to FLC Together With Those Sold to Adler & Shaykin Do Not Constitute Substantially All the Assets Under § 271

Even if all of the assets which Revlon has recently contracted to sell or option are viewed as a single transaction, they do not possibly constitute a sale of substantially all of Revlon's assets. Revlon is retaining significantly profitable divisions. During fiscal '84, the retained divisions constituted 55% of Revlon's total assets and accounted for 39% of its sales and 43.2% of its operating profits. Indeed, Revlon's operating profit in Ethicals, which manufactures and distributes worldwide various pharmaceuticals sold by prescription -- a business generating over $400 million a year in sales -- increased 18% over its 1983 operating profit. See, Revlon's 10-K for fiscal year ending December 31, 1984, p. 4 (attached as Exhibit A to affidavit of Lisa Klein ("Klein aff.") submitted herewith.)

Similarly, Northcliff Thayer, which generates over $200 million a year and engages in the manufacture and distribution of such well known products as TUMS antacid tablets, the OXY line of benzoyl peroxide acne treatment products (e.g., OXY-5 and OXY-10), NATURE'S REMEDY (a natural laxative), NOSALT (a table salt alternative), and ESOTERICA fade cream, is being retained by Revlon. During fiscal '84 both the OXY line, which include the largest selling benzoyl peroxide acne product line in the United States and TUMS, the second largest selling antacid tablet in the United States, have increased their market shares. Id. at p. 6.

And, Revlon is also retaining Technicon, which is primarily engaged in the development, production, marketing and servicing, worldwide, of automated medical diagnostic systems for the analysis of blood and other body fluids and is the leader in the worldwide market for large automated clinical diagnostic equipment. Technicon has manufactured approximately 25% of all such analyzers in use, accounting for 45% of the estimated $5 billion annual clinical chemistries conducted worldwide. See, Revlon 1984 Annual Report, p. 6 (attached as Exhibit B to Klein aff.) With Revlon retaining divisions of this nature, it is simply fatuous to suggest the these transactions substantially affect "the very existence and purpose of the corporation."

In sharp contrast to the highly profitable divisions being retained by Revlon, the Beauty Group being sold to Adler and Shaykin suffered a 10% decline in its operating profit for fiscal 1984. See, Revlon 10-K for fiscal year ending December 31, 1984, Exhibit A to Klein aff., at p. 9. Assuming, arguendo, that the profit and sales figures provided by plaintiff are accepted at face value -- a questionable proposition at best since nowhere in the public materials purportedly relied upon are these figures available* -- plaintiff is still far short of the mark. Indeed, had the legislature intended such percentages to require shareholder approval of asset sales, it would have said "a majority," not "substantially all.".

Plaintiff claims that business accounting for 61% of Revlon's total divisional revenues and 56% of its operating profit are being sold. These figures, even if presumed accurate, can hardly be said to trigger § 271. First, the statute speaks to assets and not revenues; only 45% of Revlon's total assets are being sold or optioned. Moreover, as Justice Moore has explained:

> While the phrase "all or substantially all" of the company's assets is not subject to mathematical certainty, it clearly appears that the word "or" is conjunctive rather than disjunctive, and <u>the phrase "substantially all" does not create an additional prohibited area of sales outside the purview of the word "all"</u>.

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* Indeed, the annual reports, which among the public documents purportedly relied upon by Pantry Pride give the only divisional breakdowns on Revlon, group under the category of "Diagnostic" both Technicon and NHL. Since Technicon is being retained by Revlon and NHL sold to FLC, plaintiff's figures as to the operating profit of the businesses being retained are simply woven from whole cloth. To the extent that plaintiff has relied upon other non-public information for these figures, such information has not been made available to defendants.

1 Del. J. Corp. L. at 58-59 (emphasis added). Justice Moore further noted with approval the suggestion by another commentator that the phrase "substantially all" was merely designed "to prevent avoidance of the statute by retention of some minimal residue of the original assets." Id.

In sum, the qualitative test set forth in Gimbel is determinative here. In order for a sale of assets to fall within the Statute, it "must strike at the heart of the corporate existence and purpose." Gimbel, 316 A.2d at 606. It is inconceivable that that test has been met here.

CONCLUSION

For the foregoing reasons, plaintiff's motion for a preliminary injunction should be denied.

Respectfully submitted,

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