IN THE SUPREME COURT OF THE STATE OF DELAWARE

PARAMOUNT COMMUNICATIONS INC., VIACOM INC., MARTIN S. DAVIS, GRACE J. FIPPINGER, IRVING R. FISCHER, BENJAMIN L. HOOKS, FRANZ J. LUTOLF, JAMES A. PATTISON, IRWIN SCHLOSS, SAMUEL J. SILBERMAN, LAWRENCE M. SMALL, and GEORGE WEISSMAN,	)	No. 427 and 428, 1993 (Consolidated)
Defendants Below-Appellants,	)	Court Below: Court of Chancery of the State of Delaware in and for New Castle County
v.	)	
QVC NETWORK INC.,	)	
Plaintiff Below-Appellee.	)	
IN RE PARAMOUNT COMMUNICATIONS INC. SHAREHOLDER LITIGATION	)	Civil Action No. 13208 (Consolidated)

ANSWERING BRIEF OF SHAREHOLDER PLAINTIFFS BELOW-APPELLEES

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NATURE OF THE PROCEEDINGS AND THE ORDER SOUGHT TO BE REVIEWED

This is the answering brief[1] of the shareholder plaintiffs below-appellees in opposition to an appeal by defendants Paramount Communications, Inc. ("Paramount"), its board of directors (collectively the "Paramount Defendants") and Viacom, Inc. ("Viacom") of the Opinion and Order of the Court of Chancery by Vice Chancellor Jack B. Jacobs preliminarily enjoining the Paramount Defendants from (a) redeeming Paramount's Shareholders' Rights Plan ("Rights Plan") in favor of defendant Viacom in violation of their fiduciary duties; and (b) exercising the Stock Option improperly granted to Viacom by Paramount. The Opinion and Order have protected Paramount's shareholders from Viacom's front end loaded coercive tender offer for 51% of the outstanding shares of Paramount which had a current market value of $1.3 billion less than QVC Network Inc.'s ("QVC") competing tender offer.

The Vice Chancellor granted the preliminary injunction in a November 24, 1993 Opinion and Order after expedited discovery, including post argument discovery, that concluded on November 21, 1993.

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[1] Citations herein to "JA___" refer to the Joint Appendix on this appeal. Citations to "PB ___" refer to Paramount's Opening Brief on this appeal.

RESPONSE TO SUMMARY OF THE ARGUMENT

A. Paramount

1. Denied. The Paramount board triggered Revlon duties by agreeing to sell majority voting control of Paramount. The mere inclusion of predominantly non-voting equity in the transaction does not avoid Revlon.

2. Denied. The Paramount board rejected QVC's facially superior offer without being sufficiently informed and without a reasoned basis, and improperly approved a lockup intended to deter other bidders without informing itself by conducting an auction or market check. The board could not render the Rights Plan inapplicable to the Viacom offer because it failed to inform itself about the relative values of the two offers.

3. Denied. The Stock Option impermissibly locked up the deal and was approved in an uninformed manner.

B. Viacom

I. Denied. Where a third party's contractual rights are derived from an impermissible breach of fiduciary duties, the injury to the shareholders outweighs the injury to the contracting party. The Stock Option would prevent Paramount's public shareholders from receiving the best available transaction.

II. Denied. See Paramount Points 1 and 2 above.

STATEMENT OF FACTS

A. The Chancery Court Correctly Found That The Paramount Board Triggered Revlon Duties By Agreeing To Sell Majority Voting Control Of Paramount

On September 12 the Paramount board "committed the company to a transaction that will shift majority voting control from Paramount's public shareholders to Mr. Redstone." JA7234. Paramount now has no controlling shareholder. JA5634, 5649; JA5145. But, Redstone demanded absolute voting control of the combined entity. JA5576; JA5264-5. Thus, after the Viacom merger Redstone would control the entity. JA5036-8; JA6238-9; JA5145; JA5635; JA5951.

Redstone's control of Viacom did not make his post-merger control inevitable. PB at 19. A Viacom merger could have given Redstone less than 50% of the votes or otherwise provided for public control. Redstone's insistence on control is not entitled to deference from this Court.

Paramount is not growing through a planned acquisition. Viacom, a privately-controlled company, is growing through acquisition of a publicly-held company, Paramount. This is not Paramount's strategic merger; it is Viacom's strategic merger. This is not Time-Warner. This is Revlon.

The Chancery Court recognized that if the Viacom merger closes it would be "the only opportunity that Paramount's shareholders will ever have to receive the highest available premium-conferring transaction." JA7238 (emphasis added). Even defendants admit that Paramount's shareholders are entitled to a control premium now. JA5635-6; JA5263-4; JA5471. The Chancery Court, therefore, correctly held

that the board was subject to Revlon duties to maximize shareholder value. JA7234.

B. **The Chancery Court Properly Enjoined The Stock Option**

The directors approved the stock option not only to induce Redstone to bid, but also for "the improper purpose of 'locking up' the deal for their favored suitor and to deter other potential bidders." JA7248. The directors acted without adequate information "as to whether the stock option would promote" maximization of shareholder value. Id. This was the basis of the Chancery Court's conclusion that the lockup was invalid from inception. That conclusion was not the product of circular reasoning as defendants imply. PB at 36. It proceeded directly from the September 12 facts found by the Chancery Court. JA7242-44, 7250.

One outside director admitted the stock option was "a question of protecting the deal". JA5042; JA7248. This testimony was consistent with the uniform testimony of each of the directors deposed that Paramount was not for sale and that it was never their intention to do anything but consummate the Viacom deal. See, e.g., JA6041-3; JA5145; JA5442. The board never intended to auction or maximize price but only to deliver Paramount to Redstone.

Further, the Chancery Court found that the absence of any cap on the value of the option and the presence of the junk note demonstrated the intent of the board and the effect of the option to deter competitive bids. JA7249. The junk note could poison the Paramount balance sheet for any higher bidder by "detrimentally affect[ing] the capital structure of Paramount" and creating "a company diluted of 20% of its equity, which held notes unlikely to

be convertible into cash." Id. No defendant has countered the affidavits of the shareholder plaintiffs' expert regarding the debilitating nature of the junk note or Redstone's control over its marketability. See JA3422-4; JA6293-6. The Chancery Court also noted that the $69 uncapped option exercise price had the foreseeable effect of increasing "the costs to a competing bidder" at the expense of the Paramount shareholders -- here $500 million. JA7249.

The Chancery Court further found that even if the board's motive to deter were not so clear, the option would be voided because the board "had no informed basis upon which to grant" it. JA7250. Most importantly, the board had no basis to conclude on September 12 that $69 was the best price. Id. The board conducted no market check, no auction, no canvas, no inquiry of any kind. JA7245. Paramount's contention that market rumors or merger announcements alone served the functions of formal canvases of interest and value availability is ludicrous and totally unsupported by the record. The board relied exclusively on Lazard. JA5472. Lazard was not even aware of QVC's interest. JA5492.

C. The Chancery Court Properly Found That The Paramount Board Did Not Meet Its Revlon Duties On November 15

The Chancery Court did not substitute its business judgment for that of the directors. On November 15 the directors formally rejected QVC's $90 offer in favor of Viacom's $85 offer. The purported bases for the board's action were that (i) the QVC offer was so conditional the board was contractually precluded from considering it, and (ii) Viacom offered greater long-term value to Paramount shareholders because of supposed synergistic benefits. JA7243. The

record shows that the board was not "sufficiently informed" and did not have a "reasoned basis" for its November 15 conclusions. Id. The board did not consider critical facts, including that QVC was 26 times more profitable than Viacom (compare JA7194 with JA7195); the Viacom deal would be twice as debt-laden as the QVC deal (JA6260-2); and, most crucially, the structure of QVC's $1.3 billion higher offer would, unlike Viacom's, still leave the public shareholders able to command a control premium for their shares.

1. The "Conditionality" Defense Is A Pretext

On November 15 the board "focused its attention on the contingencies of the QVC offer rather than the comparative economic merits of [the QVC and Viacom] offers." JA7216. See also JA6138. Based on management assertions that the QVC proposal was not bona fide because it lacked "irrevocable" financing commitments, the board accepted that the Viacom agreement prohibited consideration of the QVC bid. JA7216-7; JA6135-6; JA6190, 6205; JA6220-1, 6223-4, 6231. The Chancery Court, however, found that the "no shop" provision did not prevent an investigation of QVC's offer. Compare JA7202 with JA7242. Had the directors inquired about QVC's financing on November 15, an inquiry they recognized as their duty on October 11 (JA2741), they would have learned that the financing conditions would have been satisfied imminently. JA7243-4. "But meeting with QVC was the last thing management wanted to do, and by skillful advocacy, management persuaded the board that no exploration was required." JA7244.

The directors entered the November 15 meeting armed with a three-page document prepared by Paramount's counsel, detailing only

the "Conditions and Uncertainties" of the QVC offer. JA7215; JA6221; JA6602-51. This document was intended to and did create a "negative impression" of the QVC offer even before the meeting began. JA7216, 7244; JA6220. At the meeting, Paramount's CEO, Martin Davis, following a prepared written script, "focused the board initially and primarily on the contingencies of the QVC offer." JA7216. See also JA6653-5. Lazard's own view, however, was that the QVC offer was financeable. JA7217.

The Chancery Court correctly found that "the 'conditionality' of QVC's offer was more a pretext than a problem, which management (and the board) have chosen to hide behind in order to avoid obtaining information that might induce them to take a second look." JA7244.

2. The Board Did Not Make An Informed Comparison Of The Offers

The directors conducted no inquiry into the comparative values of the Viacom and QVC offers. JA6227, 6232. Lazard was never asked to opine on the back-end of either transaction. JA6225, 6232; JA6181-2. The directors had no materials valuing or quantifying the long-term prospects of either of the QVC or Viacom combinations. JA6225, 6232. No board member requested any cash flow analysis of either resulting entity; none was provided by management, Lazard or Booz Allen. JA6858-9. Here, for the first time, defendants argue that information on the long-term prospects of the combined QVC/Paramount enterprise was unnecessary because 80%-90% of the

enterprise would be Paramount, with which the board was intimate.[2] But this is untrue; evaluation of synergies requires knowledge of both parts. All the board had to compare the two deals were the beliefs of Paramount's management and the discredited Booz Allen report.

Booz Allen had no access to any non-public QVC information for its self-described "first-cut" analysis of the potential long-term synergies of the offers. JA6185; JA6826-51. Its report was so immaterial it is not mentioned in Paramount's 14D-9 as a factor which the board considered. JA7212-3; JA6658-64. Booz Allen is not a financial analyst. JA7212-3. Lazard, the financial expert that was mentioned in the 14D-9, was compelled to disclose to the board numerous concerns regarding the Booz Allen report, including that "the market has valued the combination [of QVC and Paramount] more favorably than the Booz-Allen analysis would suggest." JA7219; JA6646-JA6648.

The board again failed to make any inquiry about steps to ensure the Paramount shareholders continued participation in the synergies that the board purportedly believed so important to the Viacom deal. JA6232-3. As the Chancery Court found:

> In this case the board did not obtain, or even bargain for, structural protections that would ensure the continuity of Paramount's current shareholders (or their successors) in any merged enterprise.

JA7238 (footnote omitted). The Chancery Court was properly concerned with structural protections because this uninformed board

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[2] This argument is improperly raised and should be disregarded.

was surrendering the shareholders' ability to obtain a control premium forever.

D. The Chancery Court Properly Enjoined Redemption Of The Rights Plan For Viacom

The defendants' only argument against the Chancery Court's injunction as to the Rights Plan is that it was premature. PB at 7-8. In fact, the board had already approved agreeing to lift the Rights Plan for Viacom unless a higher offer appeared. JA1647. The only other offer on the table was QVC's, and the board had already determined not to entertain it. JA6659. Further, the board had already authorized management to amend the Rights Plan for Viacom (JA1497) without further board action. Paramount's own counsel warned the Chancery Court on November 24 that "but for Your Honor's injunction" the offer would close at one minute after midnight. JA7159. It is absurd to pretend the Rights Plan was not about to be pulled for Viacom.

ARGUMENT

I. REVLON APPLIES TO THIS SALE OF MAJORITY VOTING CONTROL

A. Standard And Scope Of Review

The Chancery Court's decision to grant a preliminary injunction may be set aside only if it amounts to an "abuse of judicial discretion." Daniel D. Rappa, Inc. v. Hanson, Del. Supr., 209 A.2d 163, 166 (1965). This Court will accept findings of the Chancery Court if supported by the record and otherwise the product of orderly and logical reasoning process. Mills Acquisition Co. v. Macmillan, Inc., Del. Supr., 559 A.2d 1261, 1278 (1989). Only if the Chancery Court is clearly in error and justice so requires will this Court review the entire record and reach its own factual conclusions. Macmillan, 559 A.2d at 1278. Only rulings on pure questions of law are reviewed de novo. Kahn v. Household Acquisition Corp., Del. Supr., 591 A.2d 166, 175-176 (1991); Barkan v. Amsted Industries, Inc., Del. Supr., 567 A.2d 1279, 1284 (1989).

B. The Chancery Court Correctly Applied Revlon

In Barkan, this Court explained that:

> [T]he general principles announced in Revlon, in Unocal Corp. v. Mesa Petroleum Co., Del. Supr., 493 A.2d 946 (1985), and in Moran v. Household International, Inc., Del. Supr., 500 A.2d 1346 (1985) govern this case and every case in which a fundamental change of corporate control occurs or is contemplated.

Barkan, 567 A.2d at 1286 (emphasis added) (footnote omitted).

This Court's straightforward statement in Barkan forecloses Paramount's assertion that its directors were not subject to Revlon duties to maximize shareholder value from September 9, when the board authorized management to negotiate a sale of majority voting

control to Redstone. In Paramount Communications, Inc. v. Time Inc., Del. Supr., 571 A.2d 1140 (1990) ("Time-Warner"), this Court expressly affirmed the "fundamental change of corporate control" standard of Revlon:

> [T]he Chancellor found the original Time-Warner merger agreement not to constitute a "change of control" and concluded that the transaction did not trigger Revlon duties. The Chancellor's conclusion is premised on a finding that "[b]efore the merger agreement was signed, control of the corporation existed in a fluid aggregation of unaffiliated shareholders representing a voting majority -- in other words, in the market." The Chancellor's findings of fact are supported by the record and his conclusion is correct as a matter of law.

Time-Warner, 571 A.2d at 1150 (emphasis added). This Court further premised its finding in Time-Warner on the absence of other factors that might also have triggered Revlon duties, namely:

> the absence of any substantial evidence to conclude that Time's board, in negotiating with Warner, made the dissolution or break-up of the corporate entity inevitable, as was the case in Revlon.

Time-Warner, 571 A.2d at 1150. Thus, in ruling that Revlon duties did not apply in Time-Warner, this Court found no prospect of either a change of control or a break-up of Time.

The test articulated in Time-Warner does not restrict Revlon to a dissolution or liquidation. Gilbert v. El Paso Co., Del. Supr., 575 A.2d 1131, 1146 (1990) makes clear that the term "breakup" was not intended to be exclusive. This Court used the term "breakup" to include a change of control transaction absent any liquidation, dissolution or sale of assets. In Gilbert, Burlington made a hostile bid for majority voting control and had no plans for the back end or for any asset sales. Id. at 1135. Once it became apparent that Burlington would gain majority voting control, this

Court, citing Macmillan and Revlon, determined "that the breakup of the company was inevitable," and that therefore the El Paso board had to maximize shareholder value. Id. at 1146. Defendants' efforts to restrict Revlon to the dissolution or liquidation of the target is simply not supported by this Court's holdings.

C. The Chancery Court Properly Found The Board Failed To Comply With Its Revlon Duties

The Chancery Court correctly found that the board failed to get "the best price for the stockholders at a sale of the company", Revlon, 506 A.2d at 182, and failed to act "in a neutral manner to encourage the highest possible price for shareholders." Barkan, 567 A.2d at 1286 (citation omitted). See also Macmillan, 559 A.2d at 1285. Instead, the Chancery Court found that the board used every pretext to sell Paramount to Viacom and to Viacom only:

> [S]ince at least September 9, the mindset of the board has been patently unreceptive to gathering information by way of exploring or even discussing any alternative transaction deal. That predisposition is reflected in the board's approval of a lockup stock option of unprecedented magnitude ..., and of the "no shop" provision in the Merger Agreement that management (and the board) have chosen to interpret as forbidding them from even holding discussions with QVC to obtain information about its competitive bid.

JA7242.

In violation of its fiduciary obligations, the board on September 9 and 12 approved a change of control transaction and adopted a lockup designed to defeat any competing bid regardless of value. But, the law required the board to gather the information necessary to reach a considered decision that the Viacom offer presented the "best available alternative," even when the board was considering only a single offer. A "concern for fairness demands

a canvas of the market to determine if higher bids may be elicited." Barkan, 567 A.2d at 1287. See also In re Vitalink Communications Corp. Shareholders Litig., Del. Ch., C.A. No. 12085, Chandler, V.C., slip op. at 11-16 (Nov. 8, 1991); In re Fort Howard Corp. Shareholders Litig., Del. Ch., C.A. No. 9991, Allen, C., slip op. at 1-2 (Aug. 8, 1988). No such canvas or the equivalent occurred.

When faced with a clearly superior offer, the board dug in and failed to undertake a process rationally designed to elicit the highest bids from all interested parties. See In re Holly Farms Corp. Shareholders Litig., Del. Ch., [1988-1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,181 (Dec. 30, 1988). Viewing the situation in toto, the Chancery Court criticized the actions of the board, both prior to September 12, 1993 and after November 12, 1993:

> Having chosen not to obtain such information [prior to November 12] by conducting an auction or a market check, and having determined [after November 12] not to meet with QVC to ascertain what its best and highest offer might be, the board put itself in a position where it had a heightened duty to obtain reliable information from other sources. That information was not obtained.

JA7245.

The Chancery Court's findings belie the defendants' assertion that the Chancery Court's opinion fully vindicated the Paramount board's information and processes up to November 12. PB at 5-6. Paramount disingenuously ignores the Chancery Court's unequivocal finding invalidating the lockup at inception because of the board's failure on September 12 to adequately inform itself. JA7250. Following September 12, up until November 12, the Chancery Court did find that any "arguable defects ... were immaterial." JA7242-3.

But, during that period, nothing on the face of QVC's bid indicated that it was superior to Viacom's except for a short period prior to October 11, when the directors found their fiduciary duties required them to enter into discussions with QVC. JA2741. On November 15, now presented with an offer $1.3 billion greater in value, the board failed to ask a single question or to authorize discussions designed to address the relative value of the two offers. See JA6138-9; JA7244-5. Instead, the board ignored its Revlon obligations and hid behind the "no shop" clause to justify its fiduciary breach.

D. The Mere Inclusion Of Equity In The Consideration Package Does Not Void Revlon's Requirements

Defendants do not dispute that Redstone will have majority voting control over the surviving entity. Paramount's shareholders will receive an equity stub, which is limited to an interest in the profits of the enterprise. Defendants claim that this "equity" voids any Revlon duties and puts them squarely within what they perceive to be the safe-harbor of a Time-Warner strategic plan. But the inclusion of an equity participation has never vitiated Revlon duties. See Barkan, 567 A.2d at 1286-7; Macmillan, 559 A.2d at 1285 (referring to restructuring enjoined in Robert M. Bass Group, Inc. v. Evans, Del. Ch., 552 A.2d 1227 (1988)); Holly Farms at 91,644. See also Rand v. Western Airlines, Inc., Del. Ch., C.A. No. 8632, Berger, V.C. (Sept. 11, 1989); In re J.P. Stevens & Co., Inc. Shareholders Litig., Del. Ch., 542 A.2d 770, 781-784 (1988). Thus, defendants' contention that Revlon duties are not triggered where a change of control is effected by means other than an all cash deal is wrong.

E. Paramount's Policy Argument Would Undermine Delaware's Protections For Shareholders

Paramount argues that the ruling of the Chancery Court extends Revlon in ways that will have "bizarre economic consequences". PB at 19. Defendants claim that because Revlon applies whenever an acquiror has a majority shareholder, acquisitions will be inhibited. Id. Defendants intentionally miss the point. The purpose of Delaware law is not to protect the rights of "entrepreneur-founded-and-controlled corporations [to] grow[] through strategic mergers." Id. As the Chancery Court found, Delaware law imposes upon directors the highest fiduciary duty to their shareholders, whose fundamental interest in corporate control the directors are charged to protect. JA7236.

The application of Revlon to acquisitions by privately controlled corporations is no perversion of Delaware law, nor is it a form of discrimination against controlling stockholders or closely-held companies. That argument is a red herring. Redstone could have granted a standstill agreement and structured this deal so that the Paramount public shareholders would have received sufficient Class A stock to reduce Redstone's voting control below 50%. Revlon might not have applied to such a transaction. See Ivanhoe Partners v. Newmont Mining Corp., Del. Supr., 535 A.2d 1334, 1344-5 (1987).

It is not the Chancery Court that is changing Delaware law here; it is defendants who urge a change. If the Time-Warner strategic merger doctrine is expanded as defendants urge, then all future change of control transactions will be accompanied by some

profit sharing paper to avoid the mandates of Revlon. If this were the law, the Courts of Delaware would constantly have to decide what amount and type of "equity" would be sufficient to invoke this new defense. Would 5% be enough? Would 10% be enough? Would preferred stock suffice?

F. The Chancery Court Properly Held That This Is Not A Time-Warner Situation

The holding of the Chancery Court is entirely consistent with the Time-Warner decision of this Court. Time-Warner did not involve a change in control. Time, in pursuit of its corporate strategy, was seeking to proceed with a merger agreement with Warner, another publicly-controlled company, in a manner that included specific protections to ensure the survival of Time's unique "corporate culture" and the long-term success of Time's strategic plan for the benefits of its shareholders. Here, unable to find a merger partner or acquisition target, Paramount abandoned its strategy and instead agreed to turn over control to Redstone. There are no long-range protections to ensure the Paramount shareholders' participation or voice in the method of achieving, or the benefits to flow from, Redstone's strategic plan. This deal represents the culmination of Redstone's strategic goals, not Paramount's.

II. THE CHANCERY COURT INJUNCTION WAS PROPER

A. Standard To Be Applied

See Section I.A. supra.

B. The Stock Option Was An Improper Lockup

This Court's precedents compelled invalidation of the stock option on these facts. Lockups that preclude further bidding and avoid a process to identify the best value maximizing transaction are invalid. Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., Del. Supr., 506 A.2d 173, 183 (1985). The lockup was not designed to nor did it confer any substantial benefit on Paramount's shareholders. See Macmillan, 559 A.2d at 1284. Nor was the adoption of the lockup informed. See Macmillan, 559 A.2d at 1284. See also Cede & Co. v. Technicolor, Inc., Del. Supr., Nos. 336 and 337, 1991, Horsey, J., slip op. at 68-9 (Nov. 1, 1993). The board adopted the stock option to protect the $69 Viacom deal. This purpose, with no information from which to conclude that $69 was the best transaction available, fails as a justification under Delaware law. See Revlon, 506 A.2d at 182-3; see also Macmillan, 559 A.2d at 1284-6. Viacom's contractual rights to the option arose from the directors' breach of fiduciary duties and thus, even assuming Viacom committed no wrongdoing, the overriding shareholder interests justify the injunction. MacAndrews & Forbes Holdings, Inc. v. Revlon, Inc., Del. Ch., 501 A.2d 1239, 1251 (1986), aff'd, Del. Supr., 506 A.2d at 185; Holly Farms at 91,644-5.

If the lockup were exercised now, "the cost to Paramount shareholders ... would be $500 million." JA7249. The shareholder plaintiffs find it unconscionable that the directors, charged with

protecting shareholder interests, instead come before this Court seeking to wrest back from Paramount's shareholders that $500 million.

C. The Chancery Court Properly Enjoined Redemption Of The Rights Plan For Viacom

The Chancery Court properly enjoined the board's planned redemption of the pill as to Viacom because the board had no reasonable basis for deciding that the Viacom offer maximized shareholder value. JA7246; Revlon, 506 A.2d at 183. The Chancery Court correctly found redemption of the pill would only have served to coerce the shareholders to tender into Viacom's earlier closing offer. JA7246. The record does not show the board met the heightened business judgment standard it was required to satisfy. JA7238-46. Indeed, on this record, even vanilla business judgment was not exercised. Smith v. Van Gorkom, Del. Supr., 488 A.2d 858 (1985).

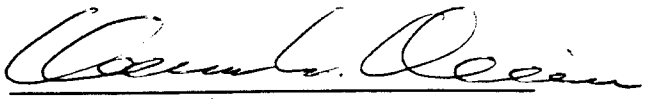
A rights plan is a powerful tool which a board must only exercise consistent with its fiduciary duties. Here these fiduciary standards required this board to ensure that the Paramount shareholders received the highest possible premium for relinquishing control. In breach of those duties, this board agreed to redeem the rights plan for Viacom on September 12. Even when QVC's offer exceeded Viacom's, the board used the rights plan as a sword against that higher offer, instead of as a shield to protect the shareholders. Redemption of the pill for Viacom's lower offer was imminent; grant of the injunction was necessary to prevent irreparable harm to the shareholders.

CONCLUSION

For the foregoing reasons, the shareholder plaintiffs below-appellees respectfully request that this Court affirm the decision of the Court of Chancery granting injunctive relief.

Dated: December 4, 1993

MORRIS AND MORRIS



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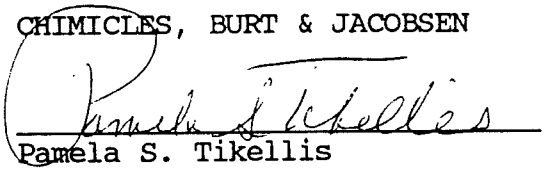

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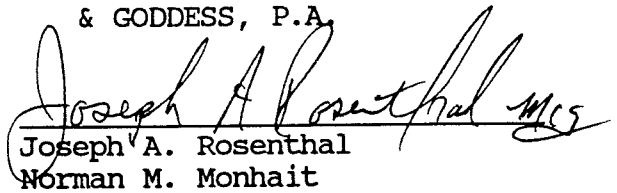

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Exhibit A

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

IN AND FOR NEW CASTLE COUNTY

IN RE FORT HOWARD CORPORATION SHAREHOLDERS LITIGATION	)	CONSOLIDATED Civil Action No. 9991

MEMORANDUM OPINION

Date Submitted: August 4, 1988
Date Decided: August 8, 1988

Irving Morris, Esquire, and Kevin Gross, Esquire, of MORRIS, ROSENTHAL, MONHAIT & GROSS, P.A., Wilmington, Delaware, and Victor F. Battaglia, Esquire, of BIGGS & BATTAGLIA, Wilmington, Delaware, and Pamela Tikellis, Esquire, of GREENFIELD & CHIMICLES, Wilmington, Delaware, and Sidney B. Silverman, Esquire, of SILVERMAN & HARNES, New York, New York, and Stanley Nemser, Esquire, of WOLF, POPPER, ROSS, WOLF & JONES, New York, New York, and Ralph Ellis, Esquire, of ABBEY & ELLIS, New York, New York, and Lowell E. Sachnoff, Esquire, of SACHNOFF, WEAVER & RUBENSTEIN, Chicago, Illinois, Attorneys for Plaintiffs.

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Bruce M. Stargatt, Esquire, and Richard H. Morse, Esquire, of YOUNG, CONAWAY, STARGATT & TAYLOR, Wilmington, Delaware, Attorneys for Fort Howard Corporation.

Charles F. Richards, Jr., Esquire, and Thomas A. Beck, Esquire, of RICHARDS, LAYTON & FINGER, Wilmington, Delaware, and Arthur F. Golden, Esquire, and Julie O'Sullivan, Esquire, of DAVIS, POLK & WARDELL, New York, New York, Attorneys for Defendants Morgan Stanley Leveraged Equity Fund II, L.P., Morgan Stanley Group Inc., FH Acquisition Corp., Paul J. Schierl, Donald H. DeMeuse and Kathleen J. Hempel.

ALLEN, Chancellor

Pending is a motion to preliminarily enjoin the closing of a public tender offer for up to all of the currently outstanding shares of Fort Howard Corporation at $53 cash per share. The offer has been made by FH Acquisition Corp., an entity organized by Morgan Stanley Group, Inc., a Delaware Corporation, through the Morgan Stanley Leveraged Equity Fund II, L.P., a Delaware limited partnership (together, "Morgan Stanley"). The offer was extended on July 1, 1988. Pursuant to its original terms, which are still in effect, it may close no sooner than midnight August 8, 1988.

The tender offer represents the planned first stage in a two step leveraged buyout transaction. The CEO and other senior management of Fort Howard have affiliated themselves with Morgan Stanley in extending the offer. The transaction is a large one. Morgan Stanley and those affiliated with it will contribute $400 million and the balance of the required $3.7 billion purchase price will be borrowed, largely from banks.

Plaintiffs claim that the process followed by the directors of Fort Howard in negotiating the agreement pursuant to which the offer was made, and their conduct since, constitutes a violation of a duty arising when a sale of the company is being considered. That duty is said to require the directors to search, in good faith and advisedly, for the best available

alternative and to remain perfectly neutral as between competing potential buyers. Plaintiffs claim that a realistic assessment of what occurred here shows the board, acting through a special committee, favored the management-affiliated prospective buyer from the beginning of the process; did all it could to push the transaction in its direction and to discourage the development of an active and effective auction for the Company.

Plaintiffs also claim that the Morgan Stanley Offer to Purchase omits material information and thus violates a duty of candor owed by the management directors and, in this case, shared by their co-venturer, Morgan Stanley.

The relief plaintiffs seek is delay in the closing of the tender offer in order to permit (that is, to require) a supplemental disclosure. They also seek an order requiring First Boston Corporation, the financial advisor to the Special Committee, to render a new opinion on the fairness of the $53 price after it has had access to certain financial information that it has heretofore neither seen nor sought to see.

Plaintiffs have not seriously attacked the $53 cash price as unfairly low. They have, for example, put in no expert affidavit to that effect. They do claim that it is an undependable price because the market has not been effectively explored and, putting disclosure points to one side, the

correctness of that factual assertion is at the core of the matter presented by this motion.

It is essential for valid director action that it be taken on an informed basis. Indeed, it is essential of any rational human choice that alternatives to the proposed action be considered. The more significant the subject matter of the decision, obviously, the greater will be the need to probe and consider alternatives. When the decision is to sell the company, or to engage in a recapitalization that will change control of the firm, the gravity of the transaction places a special burden upon the directors to make sure that they have a basis for an informed view. Here the Special Committee did not conduct an auction of any kind before signing an agreement of merger with Morgan Stanley. It did, however, negotiate provisions purportedly intended to permit an effective check of the market before the Morgan Stanley offer could close. For purposes of this motion, I have concluded that this approach was adopted in good faith and was effective to give the board an informed, dependable basis for the view that the Morgan Stanley offer is the best available transaction from the point of view of the Fort Howard shareholders. (See Part IV, infra) So concluding, I may not issue a preliminary injunction predicated upon plaintiffs' Revlon theory. See

Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., Del. Supr., 506 A.2d 173 (1986).

As to the disclosure claims, I have considered them in the light cast by Rosenblatt v. Getty Oil Co., Del. Supr., 493 A.2d 929, 944 (1985). I cannot conclude now that the matters raised by plaintiffs would likely be of actual significance to shareholders. The reasons for this view are set forth below. (See Parts V and VI, infra).

Thus, finding at this time that plaintiffs have not established a reasonable probability of ultimate success, I will for the reasons more fully set forth below decline to issue the remedy sought.

I.

Fort Howard is a Delaware Corporation with its principal executive offices in Green Bay, Wisconsin. It is a manufacturer and marketer of diversified lines of paper products, including tissues. In fiscal year 1987 Fort Howard had net sales of $1.75 billion, net income of $158 million and balance sheet assets of $2.19 billion. Its stock price has not recovered from the market break of October 19, 1987 to the extent that the market generally has recovered, nor to the extent others in the paper products industry have. In late May, 1988, just prior to the emergence of the Morgan Stanley

interest, its stock traded in the mid 30's. It had traded in the high 50's within the prior year.

Fearing that a temporarily depressed stock price might render the Company particularly vulnerable to an unfairly low and perhaps coercive takeover attempt, the Company's management on March 30, 1988, met with representatives of Morgan Stanley at Morgan Stanley's New York office and sought its advice concerning possible steps to protect Fort Howard shareholders from the perceived threat. Morgan Stanley had been engaged on a number of occasions in recent years to give investment banking advice or services to the Company. Defendant Paul Schierl, the CEO of Fort Howard and defendant Kathleen J. Hempel, its first Vice President and CFO, met with Donald Brennan, and others from Morgan Stanley. Mr. Schierl asked about a wide range of possible types of transactions that the Company might consider engaging in order to elevate its stock price. He mentioned recapitalizations, spin-offs, acquisitions and other structural transactions. Mr. Brennan apparently gave a description of the structure and mechanics of types of recapitalizations, commented on other possibilities and indicated that a possible alternative to recapitalization would be a leveraged buyout of the Company's shareholders with Morgan Stanley acting as a principal and

management participating in such a transaction. No decisions were made at the March 30 meeting.

On May 3 management did ask Morgan Stanley to evaluate the various alternatives open to the Company. Morgan Stanley responded with a written report at a May 24 meeting with Messrs. Schierl and Donald DeMeuse, President of the Company and Ms. Hempel. According to Mr. Brennan, "all the possibilities were gone through, with the objective of what alternative would produce the highest value." (Brennan Dep. at 71). The session was "an analytical presentation;" the financial feasibility of each alternative was not discussed. Mr. Brennan reported that in Morgan Stanley's view, a leveraged buyout would generate greater value for shareholders than would a recapitalization transaction, a share repurchase or a spin-off. He stated that, in Morgan Stanley's view, a leverage buyout in the $48-50 range was feasible and the preferred alternative. It was again stated that Morgan Stanley would be interested in participating with senior management in such a transaction. Management did not commit to participate in such a transaction at that time, but rather took the matter under advisement.

On May 31 Mr. Schierl informed Mr. Brennan that he and others of the senior management of the Company were interested in pursuing such a transaction, but only if the Fort Howard

board gave prior approval to their effort to structure a transaction and agreed to receive such a proposal.

That same day, Mr. Schierl met with director Thomas L. Shaffer at the Roanoke, Virginia Airport to advise him that senior management had decided to pursue a possible leveraged buyout of the Company in partnership with Morgan Stanley. Schierl informed Shaffer that a Special Committee of the board would have to be formed to consider the buyout proposal and that Schierl wanted Shaffer to serve as its chairman. They discussed other possible members of a Special Committee and agreed that directors Ziemer and Cuene were best suited for the job.

Mr. Shaffer, who was a law school classmate of Mr. Schierl's, has been on the Fort Howard board longer than any other outside director. He is a professor of law specializing in ethics. Mr. Cuene has been on the board for ten years; he owns a new car dealership in Green Bay. Mr. Ziemer has been on the board about one year; he is the retired chairman of a Wisconsin gas and electric utility company.

Over the next several days, Mr. Schierl flew to Florida to talk with Dr. Cofrin, a director and large shareholder, and spoke as well with Mr. Ziemer, Mr. Cuene and director Diane Rees, who had recently been named to the Fort Howard board. Mr. Schierl invited Dr. Cofrin to participate in the

transaction. Cofrin asked that his children be given the opportunity to participate. Mr. Schierl declined that request.

The June 7 Board Meeting

Fort Howard's ten member board was scheduled to meet on June 7, 1988 to consider the adoption of a Shareholders Rights Plan as a defensive measure against hostile takeovers. Such a plan, however, was never considered by the board. Instead Mr. Schierl and Mr. Brennan presented the board with a "proposal to make a proposal". (Brennan Dep. at 138). Mr. Schierl discussed the results of the Morgan Stanley analysis and informed the board that Morgan Stanley and the three management directors, and possibly Dr. Cofrin were interested in exploring a leverage buyout of Fort Howard. In addition, the board was told that director Koerber's law firm might serve as counsel to the management directors in any such transaction. Mr. Schierl stated that if the board were willing to entertain a proposal, he would "seek to make one" but there was "no commitment that it could be done because we [are] collectively ignorant of the ability to get appropriate bank financing." (Brennan Dep. at 123).

The three management directors then left the meeting and (judging from the draft minutes of the meeting) outside legal counsel then guided the remaining directors through adopting

the necessary resolutions to appoint a Special Committee and to select outside legal counsel, began the process of selecting a financial advisor and acted affirmatively on the request to indicate an interest in receiving a proposal.

The Special Committee was comprised the three outside directors discussed by Mr. Schierl and Mr. Shaffer. Shaffer was designated Chairman. The Special Committee made a determination at the June 7 meeting to keep these developments confidential. Outside legal counsel advised that disclosure was not legally required at that time. In the absence of advice that there was a legal obligation to do so, the Special Committee elected secrecy. As its chairman testified:

> It was very important to keep this matter confidential, until they [the buyout group] were in a position to present their proposal and we could listen to it.
>
> The reason for that was that it might be a good deal and if we introduce prematurely some sort of bidding war, we would lose it and we might lose in the bidding war as well; that all we would have done then is to invite a hostile takeover, and it had been our concern for two years to avoid a hostile takeover.
>
> So for that reason we determined among ourselves, talked about it a good deal, confidentiality until we had a proposal. (Shaffer Dep. p. 95).

The Special Committee acknowledged that the management group was served by this decision:

> They didn't want to be in the middle of a bidding war . . . their concern from the beginning was that there not be any third party offers. (Shaffer Dep. at 101).

The Special Committee retains First Boston and prepares to receive a proposal.

On June 9, 1988, the Special Committee met and retained First Boston Corporation as its independent financial advisor. On June 10, Morgan Stanley entered into a confidentiality and standstill agreement with Fort Howard pursuant to which Morgan Stanley agreed not to purchase (without the board's consent) any shares in furtherance of any acquisition of the Company for a period of one year. Over the next few weeks, Morgan Stanley received confidential information concerning the Company, including management's financial projection not earlier disclosed to shareholders or the market. First Boston was provided with the same information. Promptly following the June 7 meeting, Morgan Stanley started contacting sources of financing to arrange the more than $3 billion that, in addition to its own $400 million equity investment, would be needed to close a transaction.

The Special Committee met again on June 17. At that time, First Boston distributed a preliminary written analysis of the Company and of possible transactions. While apparently no specific range of fair values was mentioned at that meeting, defendant Shaffer drew the inference from it that First

Boston and Morgan Stanley might be very far apart with respect to opinions on that subject. The Special Committee then requested First Boston and Morgan Stanley to meet "to insure that everybody was dealing with the same factual information" (Brennan Dep. at 164-65; Koch Aff. at ¶ 14). Plaintiffs in this action contend that views about fair value were expressed at this meeting and, as a result, First Boston brought its estimates down to the neighborhood that Morgan Stanley was thinking about. The record developed to date, however, does not support that assertion. Rather, it now appears that the matters discussed were general valuation issues and the types of information being used by the two firms in their work. After the meeting, First Boston informed the Special Committee that both firms were using generally the same financial information and factual data.

On June 21, 1988 the Special Committee held a 7-hour meeting at which First Boston delivered and reviewed a second written report to the committee. Draft stock option and merger agreements, prepared by counsel for Morgan Stanley, were distributed. First Boston was not yet prepared to opine on a range of fair values for Fort Howard. Under questioning, however, it did opine that there were a number of factors that suggested that this might be a good time to sell the Company. The Special Committee also discussed at this meeting the need

to test any acquisition proposal in the market. It was suggested that the need for such a test would, in part, be a function of the adequacy of the price proposed.

Towards the end of this meeting, a report came in that there had been remarkably high trading volume that day in the Company's stock. There was, of course, concern that there had been a leak of information concerning the prospect of a buyout. The Special Committee chairman reports that this gave rise to concern:

> If there was going to be some profit-taking on it, we felt that it was more important to give the old time shareholders an opportunity to take their profits and not to leave it all to the speculators. That led us to the conclusion that perhaps we ought to issue a press release. Mr. Atkins drafted one.
>
> In the process of these discussions, we also got in touch with Mr. Schierl, who was in New York at Morgan with people there, and there were a few phone calls back and forth about that and the two groups negotiated a bit over it with speaker phones. They were very reluctant to have any press release at all . . .
>
> * * *
>
> We did not concede that we would not issue the press release in any case . . . [but concluded to reconsider the matter the following day].

The next day, there was a telephone inquiry to the Company reporting on a rumor that there was a management LBO in the works. Promptly thereafter, Fort Howard did issue a

press release stating, in part, that "members of [Fort Howard's] management intend to seek a proposal with third parties to acquire the Company in a leveraged buyout."

The June 23 Special Committee Meeting

The Special Committee next met on June 23, augmented by independent directors Rees and Schoshinski. At that meeting, the directors received a presentation from First Boston reflecting its analysis of Fort Howard and several potential alternative transactions. A First Boston representative stated its opinion that it was not an inappropriate time to consider selling the Company. The Special Committee was told that, in First Boston's view, a recapitalization would not result in greater value to stockholders than a leveraged buyout, in part because the value of the resulting stub share would be highly speculative. First Boston recommended that if the board accepted a leveraged buyout proposal, that it provide for a test of any such proposal in the market to determine whether another acquiror would make a better offer.

The Special Committee then reviewed the terms of the draft merger agreement and a proposed stock option agreement calling for the creation of rights to acquire 18½% of the Company's shares. These had been prepared by Morgan Stanley. The committee found the option and several other provisions unacceptable. Among the provisions rejected were provisions

calling for unspecified "break-up fees"; unlimited expense reimbursement; a broad prohibition against shopping the Company; and a provision acknowledging Morgan Stanley's right to commence and complete any tender offer within twenty days from the announcement of its agreement.

After about six hours, the Special Committee recessed to reconvene at 8 p.m. at which time the management directors and Morgan Stanley were invited to address the committee. Morgan Stanley then presented a proposal to purchase all outstanding Fort Howard stock at $50.00 per share in cash pursuant to the merger agreement. First Boston, in private, shared its view with the Special Committee that that price was below the low end of the range of fair values and stated that it could not opine that the price proposed was fair.

At about 9:35 p.m. the Special Committee announced that its members had "unanimously determined that they were disappointed with the price offered . . . and the group's financing arrangement." The Special Committee also told the buyout group that the limitation upon its ability to shop the transaction were "unacceptable, that we were not going to go forward at any price without a market test and depending on what the price was, that market test was going to have to be pretty broad . . . ." (Shaffer Dep. I at 113, 157; Ziemer Dep. at 106). The Special Committee named no price that it

would consider fair. The Special Committee stated that it would enter into negotiations only if there was a substantial improvement in the price offered and that, if any price improvement was at the low end of the range of fairness, the committee would require more time to test the market and fewer restrictions on its ability to do so. (Shaffer Dep. at 173). The committee also said that it would not accept a provision precluding it from furnishing third parties with the same information provided to Morgan Stanley.

The June 24 Special Committee Meeting and the $53.00 Offer

The Special Committee reconvened at 7:30 a.m. on June 24. A further revised draft merger agreement was distributed and discussed. At 9:20 a.m., Mr. Brennan and the management directors joined the Special Committee. Mr. Brennan put forward a revised "final" proposal. The price was $53.00 per share cash for all shares. The tender offer would begin five business days after the public announcement of the transaction and remain open for twenty-five business days. Thus, the tender offer transaction was designed to be publicly known for a period of thirty business days after announcement (forty-three calendar days). During that period, the Special Committee would be free to negotiate with, and provide information to, any potential acquiror who contacted the Company or First Boston. This would be expressly disclosed in any press

release announcing the transaction. If a competing party outbid the buyout group, the "final" proposal provided that the buyout group would be entitled to be paid up to $1.00 per share, including actual expenses (i.e., up to $67.8 million).

After receipt of the revised buyout proposal and after consulting with its counsel, the Special Committee informed Morgan Stanley, before making any decision with respect to that proposal, that, in the committee's view, it would be necessary for the Company to issue a press release which the Special Committee and its counsel had prepared. The Company then issued the following press release:

> Fort Howard Corporation (NYSE:NHP) announced today that it is engaged in negotiations with a group comprised of members of its senior management and an affiliate of Morgan Stanley Group, Inc. for the acquisition of the Company in a leveraged buyout. There can be no assurance that any transaction will be agreed upon or consummated.

After this press release was issued, the Special Committee and its advisers considered the further proposal. First Boston advised the Special Committee that the $53.00 per share was clearly within the range of acceptable prices for the Company and that the revised ability to check the existence of other opportunities — that is, the contemplation of a public announcement that the Company was willing to entertain third party interests and the extension of the tender offer to

include a thirty business day period from the date of the announcement — would, even considering the size of the transaction, provide a reasonable opportunity for third party interests to present themselves. First Boston also advised the Special Committee that the buyout group would be able to finance the transaction, but $53.00 per share was the most it could finance. After a three-hour discussion, Mr. Shaffer announced that at $53.00 per share cash, the Special Committee was prepared to go forward with negotiating other aspects of the transaction.

The June 25th Meeting

The Special Committee reconvened at 8:30 on Saturday, June 25. Counsel reviewed with the directors the most recent draft of the merger agreement page by page. First Boston delivered a written opinion that $53.00 per share was fair from a financial point of view. At approximately 2:30 that afternoon, the Special Committee determined to approve the merger agreement (the proposed topping fee and expense reimbursement provision having been reduced to $67 million in the interim) and recommend that the entire board adopt the agreement. Immediately thereafter, the full board met (with Dr. Cofrin absent) and unanimously approved the execution of the merger agreement, with Mr. Koerber abstaining.

The Market Test

The Company and Morgan Stanley prepared a joint press release for release first thing Monday morning, June 27. In delaying public announcement while the markets in the U.S. were closed, the parties, in effect, extended slightly the time during which an alternative transaction might present itself. While the merger agreement permitted the Company to receive and consider alternative transactions, it did not permit the Company to shop the Company actively by soliciting offers. The Special Committee had, however, negotiated a provision to make clear in the initial press releases that the Company has the right and would entertain alternative proposals and would cooperate with any such person in the development of a competing bid. The press release that was issued provided, in part, as follows:

> The transaction was unanimously recommended by a Special Committee of Fort Howard's outside directors, which was advised by the First Boston Corporation. Notwithstanding its recommendation, and consistent with the terms of the merger agreement, the Special Committee directed the Company's management and the First Boston Corporation to be available to receive inquires from any other parties interested in the possible acquisition of the Company and, as appropriate, to provide information and, in First Boston's case in conjunction with the Special Committee, enter into discussions and negotiations with such parties in connection with any such indicated interest.

(Koch Aff. at ¶23).

This press release and the news accounts that it stimulated received widespread attention. The record shows that the story was reported prominently in the business section of The New York Times, The Wall Street Journal, The Los Angeles Times and in other publications. Within days, eight inquiries were received.

The Special Committee instructed First Boston to screen these inquiries initially to filter out any that could not be considered serious possibilities in a transaction of this size. The next day, it reported back that all eight inquiries came from persons or entities that seemed worthy of further attention. The Committee then authorized First Boston to deliver to each all of the materials that had been given to Morgan Stanley and to First Boston including management's financial projections. These materials were those that were later filed pursuant to Section 13E-3 of the Securities Exchange Act by Morgan Stanley. The Special Committee instructed First Boston that further particular information, facility inspections or discussions with management would only be available if an inquirer was willing to sign a confidentiality and standstill agreement.

Only two of the eight entities that received the 13E-3 materials sought further access to information, to facilities and to management. The first of these did so promptly. It

was a financial entity. It signed a confidentiality and standstill agreement similar to that signed by Morgan Stanley. It has not proposed a transaction.

After some delay the other of these two entities sought further information. This firm was a competitor of Fort Howard. On July 22, approximately three weeks after receiving the information Morgan Stanley had had, an investment banker, representing such entity, asked First Boston whether, if his client signed a confidentiality/standstill agreement, it could see specific types of information. This party was interested in certain financial data on a plant by plant basis; financial data broken down by broad product group and business segments; cost data for fiber by grade and site; capability of mills; total labor cost and headcount per site and other data of a kind that would be of interest to a competitor. See Shaffer Dep. at 279 and Exh. DX1 thereto.

At a meeting on July 22, the Special Committee discussed this second request from the competitor that had only been identified as "Company A" in this litigation. Company A is said to be a substantial competitor of Fort Howard in the tissue business. At the July 22 meeting, it was noted that much of the information sought could be provided, but that Company A would have significant antitrust problems in acquiring Fort Howard and, perhaps, would have some financing

problems, as well. The Special Committee wanted to find out how Company A proposed to deal with the antitrust problems that its acquisition of Fort Howard would occasion. The Committee's outside legal counsel was instructed to propose to Company A discussion between its antitrust lawyers and the Committee's advisors and between the investment bankers for the two firms.

The Special Committee met by telephone on July 25 and its lawyer reported no agreement on the suggestion for direct discussion among advisors. Company A took the position that it was willing to "bear the antitrust risk" and that a merger agreement could so provide. Therefore, conversations as to how it might address the antitrust problem were said to be unnecessary. Such an approach would mean, however, that the provisions that would have such an effect would have to be agreed upon before the confidential materials were furnished.

The Special Committee reports that it was concerned to explore this potential opportunity but concerned as well to protect against risks to the Morgan Stanley deal that announcement of this interest might pose, especially if the antitrust or financing problems were not solvable. The concern for confidentiality of competitive information, while noted, is somewhat underplayed.

The Committee thus says that, acting through its counsel, it attempted to negotiate an agreement that balanced these concerns. Its counsel prepared a draft form of confidentiality/standstill agreement that had several unusual features designed, it is claimed, to deal with these special problems. Those special features, not included in the confidentiality agreement that Morgan Stanley had signed or that the earlier post-agreement potential bidder had signed, included the astonishing proposal that in order to see further information about the Company, Company A would have to agree to be liable to Fort Howard in the amount of $67.8 million if Company A (1) was provided with access to the information sought, (2) made no bid, (3) the Management Group's tender offer did not close, and (4) a substitute for it did not eventuate. Not surprisingly, Company A refused to put $67 million subject to risks it could not control simply to get a look at more detailed information.

Plaintiffs point to this most recent development as the most dramatic confirmation of their contention that the "market check" period purportedly negotiated for the purpose of providing to the Special Committee a technique to assure itself that the Management Group's offer was the most beneficial one available — was a sham. No one could believe that a potential bidder would take on the risk the Special Committee

proposed. The proposal in fact was designed, it is said, to deter active interests from a logical source that First Boston has admitted could likely do the deal.

The Special Committee answers this charge by referring to further negotiations that did occur which removed the $67.8 risk and offered in substitution another approach that would have required Company A to make an offer, if any, by August 5th. Under that approach, the market would know with certainty on August 8th, the date of the scheduled closing of the Morgan Stanley offer, whether Company A intended to make an offer. Other special provisions treating the antitrust problems that Company A raised were also further negotiated. Before these matters reached conclusion, the CEO of Company A spoke to Mr. Shaffer, the Chairman of the Special Committee, informing him that Company A was suspending its activities with Mr. Howard.

II.

The pending motion is for a preliminary injunction. Such a remedy is discretionary in the sense that, in determining to issue such an order, a number of competing factors, whose weight is not scientifically ascertainable, must be evaluated. The factors themselves are not controversial. They include first, a preliminary determination of the likelihood that plaintiff will be able to prove his claims at trial. To issue

the provisional remedy, the court must be satisfied that a reasonable probability of such success has been shown. Secondly, plaintiff must show that he is threatened with irreparable injury before final relief may be afforded to him. Should the court determine that both of these elements appear, it is necessary to consider what sort of injury, if any, may be visited upon defendant by the improvident granting of the remedy, how great might that injury be in relation to the injury with which plaintiff is faced, and whether a bond may offer adequate protection against that risk or whether it might be avoided by the shaping of relief. Lastly, the court must be alert to the legitimate interests of the public or innocent third parties whose property rights or other legitimate interests might be affected by the issuance of the remedy. All of this, of course, is perfectly well settled.

III.

To simplify, plaintiffs assert that the facts set forth above constitute at least four distinct legal or equitable wrongs accomplished by the management directors and the other directors working in sympathetic coordination with them. Morgan Stanley is, of course, seen as a co-venturer and an active participant in these wrongs which is jointly liable for resulting injury to the class of Fort Howard shareholders.

The first theory of liability is predicated upon plaintiffs' reading of Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., Del. Supr., 506 A.2d 173 (1986). It asserts that the independent committee engaged in a course of conduct that has had the effect of never shopping the Company; that the board never took steps that any prudent person seeking to locate the best available transaction would have taken and that, indeed, its actions throughout — from the secrecy designed to permit the management group to make its offer in a nonbidding context, to its direction to First Boston to meet with Morgan before a price was put forward and to the chilly reception it gave Company A — are consistent only with an inappropriate motive. That motive, of course, is the accommodation of management and its financial partners' desire to buy the enterprise in a highly leveraged transaction. This course of conduct is said to offend the central teaching of Revlon, that once a corporation is for sale, it is the board's duty to show no preference, but to seek the best transaction available.

The next proposed theory of liability relates to the disclosures contained in the July 1, 1988 Offering Circular. These are called grossly inadequate because they are said to fail to disclose the centrally important fact concerning Fort Howard — that, because it possesses a proprietary process, a

deinking process, that permits it to use cheaper paper in the manufacture of tissues than do any of its competitors, it is the "superstar" of its industry. Plaintiffs contrast the lack of any description of the special nature of the Company with the descriptive material supplied by Bankers Trust to a prospective investor. Those materials, plaintiffs say, emphasized the special character of the Company's advantage. The details of this argument are treated below.

The third theory of liability involves a claim that First Boston's opinion as to the fairness of the $53 price is based upon inadequate information and the Special Committee's role in restricting First Boston's access to relevant information constitutes a breach of a duty of fair dealing. The specifics can be summarized: First Boston did not have access to Company data relating to the deinking process — either the technical information or the cost accounting information relating to the process. First Boston did not seek such information, however, stating now that it is irrelevant to the financial analysis of stock price that it was engaged to perform. Plaintiffs then join issue with First Boston on the question of what information is necessary to render a fairness opinion for a company such as Fort Howard and join issue with the Special Committee on the question whether one could, in good faith and competently, rely upon an opinion by First Boston, knowing that

First Boston did not have and did not want access to such information in rendering its opinion.

The fourth theory of liability has two aspects. It relates to the attempt by defendants to keep confidential or secret such contacts, action and prospects relating to a possible management affiliated leveraged buyout as occurred prior to the announcement of the signed merger agreement. From June 7, 1988 forward, it is contended that the defendants had an obligation to disclose to the market an evolving transaction of enormous importance to existing stockholders. Silence violated that duty, it is contended. The two press releases that were issued were misleadingly vague and compounded the wrong. During the period, many stockholders sold their stock for very much less than the defendants knew or should have realized would be available in a premium commanding LBO transaction. Indeed, it is asserted that many sold on the market to Morgan Stanley during this period.

This is said both to constitute a violation of a state law imposed fiduciary duty (compare Bershad v. Curtiss-Wright Corp., Del. Supr., 535 A.2d 840 (1987)) and, equally importantly, to be reflective of the lack of good faith that is necessarily intertwined with plaintiff's Revlon argument. The pending motion for preliminary injunction with respect to the Morgan Stanley tender offer, however, presents no occasion to

express any preliminary view with respect to the questions raised by this theory insofar as it attempts to supply an independent basis for recovery. If class members were disadvantaged in a way that is legally compensable and if defendants or some of them are accountable in damages for some or all of the injury suffered, a money judgment can be made available. But the closing of the current offer has, as I see it, no current impact upon persons who have sold their stock prior to this time. Thus, I see no reason to further address this theory directly on this application.

IV.

I turn first to plaintiffs' argument built on their understanding of the Revlon case. On June 7, the Fort Howard Special Committee faced two important questions. The first of course was whether the board of directors would receive and consider a proposal by the management affiliated leveraged buyout group to acquire all of the stock of the Company. The other question was whether, in evaluating any such offer from management as it did receive, it would be necessary or prudent to shop the Company, that is, to explore whether others might be interested in such a transaction and on what terms. The board, or rather its Special Committee, decided that it was unnecessary to announce an interest in selling the Company and that prudence in the circumstances dictated that it not do so.

Two related critical issues that this motion presents are thus raised: first, whether that decision was legally permissible in light of the holding of Revlon, and second, whether, if legally permissible, it was made in a good faith effort to promote or protect the interests of the corporation and its shareholders.

The former issue is a legal one and is susceptible of resolution now. For the reasons that follow, I am of the view that — even assuming that the board action of June 7 was the equivalent of a board decision that the Company was for sale — Revlon does not so constrain the functioning of a board acting without a conflicting interest as to preclude the approach that was here followed when undertaken competently and in good faith. The second issue is essentially factual and may not be finally resolved now. Nevertheless, it is at the heart of the matter and decision of the pending motion does require a preliminary judgment concerning the bona fides of the board's action on June 7th and throughout the following period. I will discuss it first.

A.

Having read much of the testimony taken in the matter, reviewed all of the briefs and affidavits and inspected relevant documents, I am unable to conclude provisionally that the Special Committee was not motivated throughout to achieve

a transaction, if there was to be one, that offered the assurance of being the best available transaction from the point of view of the shareholders.

In so concluding, I note that one's view concerning bona fides, will, in settings such as this, almost always rest upon inferences that can be drawn from decisions made or courses of actions pursued by the board (or a Special Committee). Rarely will direct evidence of bad faith — admissions or evidence of conspiracy — be available. Moreover, due regard for the protective nature of the stockholders' class action, requires the court, in these cases, to be suspicious, to exercise such powers as it may possess to look imaginatively beneath the surface of events, which, in most instances, will itself be well-crafted and unobjectionable. Here, there are aspects that supply a suspicious mind with fuel to feed its flame.

It cannot, for example, be the best practice to have the interested CEO in effect handpick the members of the Special Committee as was, I am satisfied, done here. Nor can it be the best procedure for him to, in effect, choose special counsel for the committee as it appears was done here. It is obvious that no role is more critical with respect to protection of shareholder interests in these matters than that of the expert lawyers who guide sometimes inexperienced directors through the process. A suspicious mind is made uneasy

contemplating the possibilities when the interested CEO is so active in choosing his adversary. The June 7 decision to keep the management interest secret, in a sense, represents a decision to sell the Company to management if it would pay a fair price, but not to inquire whether another would pay a fair price if management would not do so. It implies a bias that, while as explained below, I accept as valid for purposes of this motion, nevertheless is a source of concern to a suspicious mind. Similarly, the requested meeting between First Boston and Morgan Stanley. For present purposes, I cannot conclude that plaintiffs' reading of that affair will be shown to be correct. But it is still odd for the Special Committee to risk infecting the independence of the valuation upon which it would necessarily place such weight, by requiring its expert to talk directly with Morgan Stanley. And that risk is run for what can only be seen as a minor benefit to the convenience of the individuals involved. So there is ground for suspicion with respect to the good faith of the Special Committee, but, on balance, not such that seem at this stage persuasive.

Here, I draw no inference of bad faith on the part of the Special Committee from its course of conduct in part because I

am persuaded that the alternative course pursued[1] was reasonably calculated to (and did) effectively probe the market for alternative possible transactions. The alternative "market check" that was achieved was not so hobbled by lock-ups, termination fees or topping fees; so constrained in time or so administered (with respect to access to pertinent information or manner of announcing "window shopping" rights) as to permit the inference that this alternative was a sham designed from the outset to be ineffective or minimally effective. I am particularly impressed with the announcement in the financial press and with the rapid and full-hearted response to the eight inquiries received. Very full information was provided very promptly. The later developments with Company A have been explained to my satisfaction for purposes of this motion.

Moreover, the rationale for adopting this approach — for permitting the negotiations with the management affiliated buyout group to be completed before turning to the market in any respect — makes sense (and thus, cannot alone justify an inference of bad faith). Management had proposed to make an all cash bid for all shares if and only if the board endorsed it. The rest of the world was not bound by any of these three

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[1]That is alternative to announcing an auction on June 7.

important qualifications. To start a bidding contest before it was known that an all cash bid for all shares could and would be made, would increase the risk of a possible takeover attempt at less than a "fair" price or for less than all shares. Accordingly, even if the approach adopted could be said to favor the management affiliated group — in the sense that it negotiated its deal without the imposition of time constraints and in a setting in which no other bidders were present — it does not do so in a way that would support the inference that the decision to do so was not made in the good faith pursuit of the interests of the stockholders.

B.

While plaintiffs contend that the Special Committee acted in bad faith, they also argue that without regard to that fact, the members of the Special Committee violated duties recognized by Revlon. The argument is as follows. The Company was for sale as of June 7 when the board indicated it would receive Morgan Stanley's offer, appointed a Special Committee, hired special counsel, etc. This, it is said, "established Revlon duties. From that point on, the Special Committee was required to maintain a neutral stance towards management and any competitor bidder in order to obtain the best possible transaction for the shareholders." (Reply Br. p. 13). Three specific examples are cited of favoritism, two

of which (the claim that the Special Committee "implored First Boston to adjust its valuation in order to achieve a management buyout" and that the treatment of Company A was designed to discourage its interest) do not appear to be factual at this stage. But the basic decision on June 7 to keep the process secret was, or so its seems to me, not a wholly neutral step as between potential bidders.

For the reasons set forth above, that decision may plainly be thought to serve stockholder interests, and, as stated above, I have concluded, for present purposes, that it was a decision made in good faith. Thus, the question does arise whether Revlon establishes rules that came into play whenever the Company is for sale, such as once the Company is for sale, the board must, in all events, be neutral as between offerors or, what is the same thing, the board must maintain a "level playing field" or the board must not interfere with the free workings of an auction market. If so, and if plaintiffs have identified such a rule with its claim to neutrality, then I would think such a duty was breached here. As the recent case of In Re J.P. Stevens & Co., Inc. Stockholder Litigation, Del. Ch., C.A. No. 9634, Allen, C. (April 8, 1988) makes clear, however, that is not my understanding of the thrust of Revlon. I understand that case as essentially a breach of loyalty case in which the board was not seen as acting in the

good faith pursuit of the shareholders' interests. Revlon explicitly recognized that a disinterested board acting in good faith and in an informed manner may enter into lock-up agreements if the effect was to promote, not impede, shareholder interests. (That can only mean if the intended effect is such, for the validity of the agreement itself cannot be made to turn upon how accurately the board did foresee the future).

More generally, a board need not be passive even in an auction setting. It may never appropriately favor one buyer over another for a selfish or inappropriate reason, such as occurred in Revlon, but it may favor one over another if in good faith and advisedly it believes shareholder interests would be thereby advanced. Even in the auction context, if one deal is all cash and more likely to close and sooner, a disinterested board might prefer it to a deal that may be thought to represent a somewhat higher price, but is not all cash and not capable of closing as quickly. See Citron v. Fairchild Industries, Inc., Del. Ch., C.A. No. 6085, Allen, C. (May 19, 1988). The need to exercise judgment is inescapably put on the board at points in an auction process and the validity of the exercise of that judgment is appropriately subjected to a business judgment form of judicial review. In J.P. Stevens, supra, the board did favor one bidder by

granting it a substantial topping fee. While some aspects of the case made the question of good faith or not a quite close one, once one found good faith, it was clear that granting that fee could (and as things worked out, did) benefit shareholders.

Accordingly, I cannot share plaintiffs' view that Revlon duties were violated by the procedure adopted here, which I am persuaded, for present purposes, was followed in good faith and was sufficient to inform the exercise of judgment that the board made in entering the merger agreement, and, in a sense, continues to make while it awaits the close of the offer or the announcement of another bidder.

V.

With respect to plaintiffs' claim concerning First Boston's role in this process, I conclude that they have not established a probability of success on the merits of their claim that the withholding of information relating to Fort Howard's proprietary manufacturing process from First Boston constitutes a breach of fiduciary duty to the shareholders or renders the First Boston opinion unreliable.

The argument runs like this. Fort Howard's secret nonpatented process for deinking waste paper and making it into tissue paper which the Chairman of the Special Committee Shaffer estimated to be worth over a billion dollars (Shaffer

Dep. I at 113) makes the Company the "superstar" of the industry. While its competitors have to use expensive virgin wood pulp, Fort Howard's secret technology enables it to enjoy a much higher profit margin by substituting cheaper waste paper for the wood pulp. The competitive advantage to Fort Howard is said to be so great that its competitors have concentrated expansion of their businesses abroad instead of in the United States, where Fort Howard operates.

It is argued that disclosure to First Boston of information relating to the specific cost accounting aspects or implications of this secret process was absolutely critical to the rendering of a dependable estimate of fair value of Fort Howard stock. Plaintiffs do not, of course, mean that an engineer's or scientist's description of the technical details of how the process works should have been disclosed. Rather, they insist that a "meaningful evaluation" of the Company would require knowledge of the financial implications of the Company's most valuable trade secret. Thus, for example, management allegedly should have disclosed what grades of waste paper may be used to manufacture tissue paper when the secret process is employed; what are present prices and pricing trends for waste paper of those kinds; what are the objectives and the progress of research aimed at improving the secret technology. There is however, nothing in the record

that suggests that a material change or improvement in the process has been developed which has not yet had an opportunity to be reflected in the Company's financial performance.

The conclusion that emerges from the record developed at this stage does not, in my opinion, show the withholding of critical information. Rather, it shows that First Boston, an investment banker of acknowledged expertise, did not ask for the information plaintiffs claim was withheld. In fact, First Boston states that it received all of the information it requested which was all that it needed in its expert judgment to conduct a financial analysis of Fort Howard. (See generally Koch Aff. at 18-22). Since the financial experts decided that they did not need specific information regarding Fort Howard's secret technology, it is difficult to conclude that it is likely that at trial it will be established that not providing this information constituted a breach of directorial fiduciary duty or rendered the Special Committee's reliance upon First Boston inappropriate.

VI.

With respect to the claim concerning the allegedly flawed disclosure contained in the Offer to Purchase, I also conclude that plaintiffs have failed to establish a probability of success on their claim.

I assume for present purposes that having entered upon a co-venture with the management directors relating to the Company, that Morgan Stanley (and its affiliates involved in this transaction) must operate under the same rules that apply to those fiduciaries. Thus, those defendants extending the offer bear the duty to make full and complete disclosure of all material facts within their knowledge relating to the proposed tender offer. The scope of that duty is defined realistically to catch material omissions or misstatements. Our Supreme Court has carefully defined just what "material" means in this context:

> A showing of a substantial likelihood that, under all of the circumstances, the omitted fact would have assumed actual significance in the deliberations of a reasonable shareholder. Put another way, there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the "total mix of information available".

Rosenblatt v. Getty Oil Co., Del. Supr., 493 A.2d 929, 944-45 (1985), quoting TSC Industries, Inc. v. Northway, Inc., 426 U.S. 438 (1978). (emphasis supplied). See also In Re Anderson Clayton Shareholders' Litigation, Del. Ch., 519 A.2d 680, 690 (1986); Weinberger v. Rio Grande Industries, Inc., Del. Ch. 519 A.2d 116 (1986).

In asserting that this standard was not met by the Offer to Purchase, plaintiffs focus not upon a single fact that was

not disclosed. Rather, they compare what was sent to potential lenders by Bankers Trust Company, the lead bank in a $2.55 billion borrowing needed to fund the purchase, with what was said to the shareholders. This comparison demonstrates, they contend, the inadequacy of information in the Offer to Purchase regarding the Company, its condition, and prospects. Plaintiffs select particular statements appearing in the lengthy (perhaps 50 pages) memorandum sent by Bankers Trust, such as the fact that Fort Howard held the largest share of the U.S. commercial tissue market; that its proprietary process permits it to use waste paper in the manufacture of tissue products which is a substantial competitive advantage; that there are costs of entry into the industry; that earnings have tended to perform well during recessions; that the amount of waste paper is increasing; and that "based on projected additions to industry-wide capacity . . . and an expected increase in demand, tissue pricing could be favorably impacted with the result being enhanced margins."

The lengthy document that plaintiffs use to build this argument was, it appears, prepared by Bankers Trust based upon information from Morgan Stanley and from public sources. It was sent to entities (I assume principally depository institutions of large financial capability — $50 million being the

minimum participation in this credit facility) and, one can safely assume, of great financial sophistication.

The offering document contains virtually no description of the business of the Company, its competitive strengths and weaknesses, or prospects for the future of the various markets within which the Company operates. It does contain a description of the capital structure of the firm (page 3). It includes selected consolidated financial data for three years (page 44) and contains the projected financial information that were supplied by the Company to Morgan Stanley (page 45). It sets forth certain assumptions that formed the basis for the projections (page 46).

I am not persuaded on the current record that plaintiffs have established a probability of success with respect to their claim that the omission from the Offer to Purchase of a description of the Company's comparative strengths and weaknesses vis-a-vis other producers of tissue products constitutes a material omission as that term is defined in our law. That is, I am not yet persuaded that the inclusion or exclusion of this information would have a "substantial likelihood" of having "actual significance" in the deliberations of shareholders. The real significance, for example, of the proprietary deinking process that gives Fort Howard a lower cost of production of tissues is how that fact affects the

Company's ability to generate cash flow, profits and dividends. The specific financial or accounting impact of the process at intermediate steps in financial reporting is fairly unimportant to one asked to value the stock of the Company at least if (1) there is no undisclosed further improvement in the process (or foreseen obsolescence) that can be expected to impact earnings in the future, or (2) no new management (who might arguably wring greater earnings out of known technology).

Suppose, for example, that one is furnished with the most reliable projections of income for a company for a five year period, with historical financial performance measures and with stock price history, and suppose that no material change in the utility of current technology is foreseen (either in improvement or in payment through obsolescence), it is submitted that a rational decisionmaker, asked if he is interested in selling the stock at a given price, will have no particular interest in asking whether the firm is a low cost producer of its products or a high cost producer. It simply should make no difference which it is — high cost or low — because the past stock price was determined with that cost performance (whatever it is) as an input, and the projections of future earnings which have been provided (of course, a most important factor), incorporated, or was premised upon, that

cost structure (whatever it is). So long as no material change in cost structure is foreseen, the firm's particular cost structure is immaterial to a selling shareholder's deliberations.

It may be different, however, if one is going to buy not just shares, but control of the company. For then one may be interested in possibly exercising that control to replace management, with the hope that new organizational arrangements may squeeze additional profit out of existing technology or processes. But for a shareholder faced with the question whether to sell into a tender offer, who has been supplied with the best available financial projections for the firm, it would be to guide important practical affairs by sheer fiction to hold that the omission to give information concerning the company's relative cost structure constituted an omission that had a substantial likelihood of having actual importance.

Finally, I note that the Bankers Trust solicitation memorandum represents an attempt to sell participations to highly sophisticated financial institutions. It is promotional. Much of the information it contains is general economic data from public sources (growth in industry, market shares); relates public Fort Howard data to public macro-economic data (Fort Howard's performance in recessions); or is information specific to Fort Howard but publicly known (that it has a

secret process that enables it to use wastepaper in production of tissue). What the document represents is an attempt to stir up interest in participating in this credit. Ordinarily, where hard financial data or other nonpublic facts are disclosed to lenders, such data or information is likely to be regarded as material with respect to disclosure to shareholders. Burlington Industries, Inc. v. Edelman, 666 F. Supp. 799 (M.D.N.C. 1987). Here, the material nonpublic information that was disclosed to Morgan Stanley and to its prospective lenders — the financial projections and the assumptions underlying them — was disclosed as well to the shareholder. The rest is, in my opinion, analysis or sales promotion, depending upon how much dignity one wishes to give it, based largely, if not entirely, upon public information. See, e.g., Rodriguez Aff., Exh. 1. I cannot conclude now that the absence of this type of information is reasonably likely to be found to have had a substantial likelihood of actual significance in making the decision that is now facing Fort Howard shareholders.

* * *

For the foregoing reasons, the application for a preliminary injunction will be denied. IT IS SO ORDERED.

Exhibit B

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

IN AND FOR NEW CASTLE COUNTY

FREDERICK RAND, MICHAEL CEASAR and ELIZABETH GIROS, individually and on behalf of those similarly situated,	)	
Plaintiffs,	)	
v.	)	Civil Action No. 8632
WESTERN AIRLINES, INC., FRED BENNINGER, ARCHIE R. BOE, JOSE CARRAL, JOSEPH T. CASEY, GERALD GRINSTEIN, WALTER J. HICKEL, BERT T. KOBAYASHI, JR., LAWRENCE H. LEE, CHARLES LEVINSON, SPENCER R. STUART, ROBERT H. VOLK, ROBERT H. H. WILSON and DELTA AIR LINES,	)	
Defendants.	)	

MEMORANDUM OPINION

Date Submitted: February 25, 1988
Date Decided: September 11, 1989

Kevin Gross, Esquire of MORRIS, ROSENTHAL, MONHAIT & GROSS, Wilmington, Delaware; Of Counsel, STULL STULL & BRODY, New York, New York; LAW OFFICES OF JOSEPH H. WEISS, New York, New York and KAUFMAN MALCHMAN KAUFMANN & KIRBY, New York, New York, Attorneys for Plaintiffs

Steven J. Rothschild, Esquire, Kevin F. Brady, Esquire and John G. Day, Esquire of SKADDEN, ARPS, SLATE, MEAGHER & FLOM, Wilmington, Delaware, Attorneys for Defendant Delta Air Lines

Allen M. Terrell, Jr., Esquire of RICHARDS, LAYTON & FINGER, Wilmington, Delaware; Of Counsel, DAVIS POLK & WARDWELL, New York, New York, Attorneys for Defendants Western Air Lines, Inc. and the Individual Defendants

BERGER, Vice Chancellor

This is the decision on a motion to dismiss a purported class action that was precipitated by the merger of Western Airlines, Inc. ("Western") and a wholly-owned subsidiary of Delta Airlines ("Delta"). The amended complaint (hereafter the "complaint"), filed by former stockholders of Western, names as defendants Western, most of its directors and Delta. Defendants argue that the complaint must be dismissed because it raises derivative claims, which plaintiffs no longer have standing to pursue. Alternatively, defendants argue that the former stockholders of Western are limited to an appraisal proceeding.

The relevant facts, as alleged in the complaint, may be summarized as follows. Prior to the merger at issue, Western had approximately 48 million shares of common stock outstanding, and only three of its thirteen directors were employed by the company. During the summer of 1986, representatives of Western and Delta began to negotiate a possible merger of Western into Delta. In connection with those negotiations, Delta requested, and was granted, an option to purchase up to 32.7 million authorized but unissued Western shares (approximately 30% of the outstanding stock on a fully diluted basis) (the "stock option"). In addition, Western agreed to a provision in the merger agreement that allegedly deprived it of the ability to "shop" the company or even to provide information to an unsolicited third party concerning an

acquisition of the company (the "no-shop" clause). The merger agreement, announced in September, 1986, provided that the stockholders of Western would receive $12.50 per share, consisting of $6.25 in cash and Delta stock of an equal value.

The complaint charges that the Western directors' negotiation and approval of the merger was wrongful in several respects. First, the Western directors allegedly had information that the company was worth $28 per share but failed to disclose that information to the Western stockholders. Complaint, ¶12. Second, the Western directors allegedly failed to exercise due care by agreeing to the stock option and no-shop clause. Id. Third, they allegedly obtained "no substantive value opinions from [Western's] financial advisors that the option price was within the range of fair value, and failed to seek and analyze the documents that underlay any opinions that [they] did obtain." Complaint, ¶23. There is also a suggestion that the Western directors wrongfully agreed to the stock option and no-shop clause in consideration for accelerated rights under Western's stock option agreements, "golden parachute" employment agreements and lucrative employment contracts with Delta. Complaint, ¶¶12, 26. Finally, the Western directors failed to disclose their alleged concern that Carl Icahn might make a hostile bid for the company. Delta allegedly aided and abetted the various breaches of fiduciary duty by the Western directors.

It is also worth noting what the complaint does not allege. There is no claim that Delta owned any Western stock prior to the merger or that it exercised any control over Western's board. There is no allegation that any of the ten Western directors identified as "outside" directors had stock options that were accelerated in the merger, received golden parachute employment contracts or obtained any employment position with Delta following the merger. In short, it appears from the complaint that a majority of the Western directors were disinterested and that the merger was negotiated at arms length[1].

Defendants' primary argument in favor of dismissal is that the complaint states only derivative claims. They point out that similar claims, attacking the improvident grant of stock options, golden parachute employment agreements and other alleged mismanagement have been found to be derivative claims. See, e.g., Penn Mart Realty Co. v. Perelman, Del. Ch., Civil Action No. 8349, Hartnett, V. C. (April 15, 1987) (claims over severance payments are derivative); Elster v.

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[1]I am aware that ¶22 makes reference to the Western directors' alleged concern that Carl Icahn might make a hostile bid for the company. However, the complaint does not allege that any of the Western directors' actions were motivated by that purported concern. The complaint charges only that defendants failed to disclose this information. Accordingly, I am treating the Carl Icahn matter as a disclosure claim.

American Airlines, Del. Ch., 100 A.2d 219, 222 (1953) (claims challenging the grant of stock options are derivative). The fact that similar claims are raised here in the context of a merger does not transform those claims from being derivative to direct.

Defendants' position would be well founded if this Court were able to conclude that the complaint does not directly attack the merger. In Kramer v. Western Pacific Indus., Del. Supr., 546 A.2d 348 (1988), a former stockholder was held to have no standing following a cash-out merger to pursue claims of mismanagement. Plaintiff had argued that the alleged wrongs (excessive stock options, fees and termination bonuses) directly affected the price paid in the merger and that, as a result, the complaint should be read as a direct attack on the fairness of the merger terms. Although the Court found otherwise, it recognized that direct attacks on corporate restructurings may be maintained even after the transaction has been completed:

> As recognized by this Court in [Cede & Co. v. Technicolor, Inc., Del. Supr., 542 A.2d 1182 (1988)], direct attacks against a given corporate transaction (attacks involving fair dealing or fair price) give complaining shareholders standing to pursue individual actions even after they are cashed-out through the effectuation of a merger. Specifically, this Court stated that "[n]o one would assert that a former owner suing for loss of property through deception or fraud has lost standing to right the wrong that arguably caused the

> owner to relinquish ownership or possession of the property." [citation omitted].

Id. at 354. The complaint here, unlike the one in Kramer, does directly attack the Western/Delta merger. Plaintiffs claim that the merger consideration was grossly inadequate (Complaint, ¶¶24, 25); that the allegedly inadequate price resulted from the Western directors' failure to "shop" the company and their grant of the stock option to Delta (See Complaint, ¶¶20, 26, 27); and that defendants solicited approval of the merger without full disclosure of certain facts relating to the value of the company (Complaint, ¶21, 22). These allegations, if they state a claim at all, constitute direct attacks on the validity of the merger and, thus, cannot be dismissed for lack of standing in light of the consummation of the merger.

The next issue is whether the complaint should be dismissed for failure to state a claim. Defendants seem to assume that, if plaintiffs are not raising derivative claims attacking the golden parachutes and stock option, for example, they must be trying to allege an "entire fairness" claim. See Weinberger v. UOP, Inc., Del. Supr., 457 A.2d 701 (1983). Plaintiffs seem to embrace the idea that theirs is an entire fairness claim, and the parties' respective arguments centered upon whether appraisal is plaintiffs' exclusive remedy. See

Weinberger, supra; Rabkin v. Philip A. Hunt Chemical Corp., Del. Supr., 498 A.2d 1099 (1985).

However, Delta did not control Western and did not stand on both sides of the transaction. Indeed, there is no allegation that Delta owed any fiduciary duties to the stockholders of Western, and only a small minority of the members of Western's board are alleged to have any interest in this transaction. In short, the complaint provides no basis to invoke the entire fairness standard —— the special scrutiny given to transactions effectuated by stockholders or directors who have divided loyalties. See David J. Greene & Co. v. Dunhill Int'l, Inc., Del. Ch., 249 A.2d 427, 430-31 (1968) ("In the absence of divided interests, the judgment of the majority stockholders and/or the board of directors...is presumed made in good faith and inspired by a bona fides of purpose. But when the persons, be they stockholders or directors, who control the making of a transaction and the fixing of its terms, are on both sides, then the presumption and deference to sound business judgment are no longer present. Intrinsic fairness, tested by all relevant standards, is then the criterion.")

Although plaintiffs have not stated an entire fairness claim, the allegations in the complaint must be reviewed to determine whether there are any other claims that are viable. I conclude that the complaint states two claims that cannot be

resolved on a motion to dismiss. The first is a "Revlon" claim. In Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., Del. Supr., 506 A.2d 173, 182 (1986), the Delaware Supreme Court held that, once a board of directors determines that the company is for sale, the directors become "auctioneers charged with getting the best price for the stockholders...." The Revlon holding was explained most recently in Mills Acquisition Co. v. Macmillan, Inc., Del. Supr., 559 A.2d 1261, 1285 (1988):

> At a minimum, Revlon requires that there be the most scrupulous adherence to ordinary principles of fairness in the sense that stockholder interests are enhanced, rather than diminished, in the conduct of an auction for the sale of corporate control. This is so whether the "sale" takes the form of an active auction, a management buyout, or a "restructuring".... The sole responsibility of the directors in such a sale is for the shareholders' benefit. The board may not allow any impermissible influence, inconsistent with the best interests of the shareholders, to alter the strict fulfillment of these duties.

It is not necessarily inconsistent with these responsibilities for directors to grant lock-up options (for stock or assets) or agree to no-shop clauses. However, "[i]f the grant of an auction-ending provision is appropriate, it must confer a substantial benefit upon the stockholders in order to withstand exacting scrutiny by the courts." Id. at 1284. Where there are competing bidders, and the company's directors do

not treat all of the bidders equally, "the board's action must be reasonable in relation to the advantage sought to be achieved, or conversely, to the threat which a particular bid allegedly poses to stockholder interests." Id. at 1288. Only after satisfying this standard will the directors' actions be accorded the protection of the business judgment rule.

There were no competing bidders in this case. However, the principles summarized above apply here with equal force. The complaint alleges that Delta was granted a stock option for 30% of Western's outstanding stock on a fully diluted basis and that no "fairness" opinion was obtained on the price of the stock option. In addition, the merger agreement allegedly contains a no-shop clause and the merger price was slightly less than Western's recent trading price and approximately half of its alleged asset and synergy value. These facts, if true and not explained, could form the basis for a finding that the Western directors failed to act in the best interests of the stockholders in conducting the sale of the company. Accordingly, defendants' motion to dismiss this aspect of plaintiffs' complaint is denied.

The complaint also raises disclosure claims that cannot be resolved without a more developed record. It is settled law that the Western directors owe a duty of complete candor to their stockholders and that, to satisfy this obligation, all material facts must be disclosed. See Rosenblatt v. Getty

Oil Co., Del. Supr., 493 A.2d 929, 944 (1985). "An omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote." TSC Indus., Inc. v. Northway, Inc., 426 U. S. 438, 449 (1976). The facts allegedly withheld from Western's stockholders relate to the company's value, independently and to Delta. As compared with the merger price of $12.50, plaintiffs allege that Western's value to Delta was approximately $25 per share and that Western's system replacement cost was $28 per share. Defendants argue that the "synergy values" are merely unreliable estimates and future earnings projections that are speculative and need not be disclosed. However, the cases they rely upon in support of this general proposition were decided after a factual record had been developed. See Weinberger v. Rio Grande Indus., Inc., Del. Ch., 519 A.2d 116 (1986); Repairman's Service Corp. v. National Intergroup, Inc., Del. Ch., Civil Action No. 7811, Walsh, V. C. (March 15, 1985); Lewis and Markewich v. Charan Indus., Inc., Del. Ch., Civil Action No. 7738, Berger, V. C. (September 20, 1984); Biechele v. Cedar Point, Inc., 747 F.2d 209 (6th Cir. 1984). Here, the Court has no information as to how the Western directors arrived at the values allegedly withheld from the stockholders. Without that factual development, it is impossible for this Court to rule on these disclosure claims.

The Carl Icahn non-disclosure, by contrast, can be dismissed. Plaintiffs allege only that the Western directors were "concerned" about a possible takeover attempt by Icahn. Complaint, ¶22. There is no allegation that any of the decisions made by the Western board were motivated by that concern or that any of the merger terms were intended to address the "Icahn threat." Without such a connection, I find that a reasonable stockholder would not find the omitted information important in deciding how to vote on the merger.

There remains Delta's motion to dismiss for failure to state a claim. As noted earlier, Delta is charged with aiding and abetting the Western directors in their alleged breaches of fiduciary duty. Specifically, the complaint charges that Delta was a "direct and integral participant and architect of the transaction in dispute and the beneficiary of the lock-up option and the 'no-shop/no-talk' clause." Complaint, ¶33.

There are three elements to an aiding and abetting claim: "(1) the existence of a fiduciary relationship, (2) a breach of the fiduciary's duty and (3) a knowing participation in that breach by the defendants who are not fiduciaries." Weinberger v. Rio Grande Indus., Inc., Del. Ch., 519 A.2d 116, 131 (1986). Assuming, for purposes of this motion, that the first two elements have been established, the question becomes whether plaintiffs have sufficiently pled a "knowing participation" by Delta. Plaintiffs argue that Delta's knowing

participation may be reasonably inferred from the fact that Delta requested the stock option and no-shop clause.

If any of the actions taken by the Western directors were illegal per se, plaintiffs' argument would be more compelling. Likewise, if there were objective evidence that the transaction benefits the fiduciaries at the stockholders' expense, knowing participation by a third party might be inferable. See Gilbert v. El Paso Co., Del. Ch., 490 A.2d 1050, 1057 (1984). Here, however, there is nothing alleged that would necessarily alert Delta to the Western directors' alleged wrongs. Lock-ups and no-shop clauses are permissible under certain circumstances. Thus, the fact that Delta requested and obtained those concessions does not, without more, give rise to an inference that Delta was aware of any wrongful conduct by Western or its directors. See L A Partners, L.P., et al. v. Allegis Corp., et al., Del. Ch., Civil Action No. 9033, Berger, V.C. (October 22, 1987).

Based upon the foregoing, Delta's motion to dismiss for failure to state a claim is granted and the remaining defendants' motions are granted in part and denied in part in accordance with this decision. **IT IS SO ORDERED.**

CERTIFICATE OF SERVICE

I, Pamela S. Tikellis, do hereby certify that I caused the foregoing Answering Brief Of Shareholder Plaintiffs Below-Appellees to be served upon the following counsel as indicated below on December 4, 1993:

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