11/2
71

CONFIDENTIAL
FILED UNDER
SEAL

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

IN AND FOR NEW CASTLE COUNTY

CITY CAPITAL ASSOCIATES LIMITED PARTNERSHIP, et al.,	:	
Plaintiffs,	:	C.A. No. 10105
v.	:	
INTERCO INCORPORATED, a Delaware Corporation, et al.,	:	
Defendants.	:	

PLAINTIFFS' MEMORANDUM IN OPPOSITION TO DEFENDANTS' MOTION FOR A STAY PENDING APPEAL AND FOR CERTIFICATION OF AN INTERLOCUTORY APPEAL

SKADDEN, ARPS, SLATE,
MEAGHER & FLOM
One Rodney Square
P.O. Box 636
Wilmington, Delaware 19899

DATED: November 2, 1988

TABLE OF CONTENTS

TABLE OF CASES AND AUTHORITIES

NATURE AND STAGE OF PROCEEDINGS

On November 1, 1988, this Court entered its memorandum opinion (the "Opinion"), inter alia, granting plaintiffs' motion for a preliminary injunction requiring the Interco board of directors to redeem Interco's shareholder rights plan. In a telephone conference yesterday, counsel for Interco indicated it would present to the court this afternoon an application for (i) certification of an interlocutory appeal pursuant to Supreme Court Rule 42 from the Opinion and (ii) a stay of the order to be entered as contemplated by that opinion (the "Order") pursuant to Supreme Court Rule 32(a) pending defendants' appeal to the Delaware Supreme Court. This is plaintiffs' memorandum in opposition to that application.

SUMMARY OF ARGUMENT AND STATEMENT OF FACTS

In its Opinion, this Court stressed that "the loss of an opportunity for [shareholders] to effectively choose is, for them, irreparable." Opinion at 32. As of 12:01 a.m. today, the owners of more than 91% of Interco's outstanding shares (including shares owned by City Capital) have made their choice and have tendered their shares to plaintiffs. (See Regan November 2 Aff., Ex. 1). The only impediment to plaintiffs' ability to give effect to that choice and purchase shares in the Offer is Interco's Amended Rights Plan -- an impediment

obviated by this Court's decision yesterday. Plaintiffs' Offer will currently expire at 12:01 a.m. November 3, unless otherwise extended.

The grant of a stay pending appeal and certification of an appeal--relief which would, in essence, enjoin the Tender Offer--is not warranted here. Defendants have made no complaint or motion in this Court seeking relief against the Tender Offer. Moreover, as shown below:

-- A stay pending appeal should not be granted The Opinion was correct on the facts and on the law. Moreover, plaintiffs and Interco's other shareholders will be seriously harmed by a stay; a stay would frustrate the clearly expressed choice of an overwhelming majority to have their shares purchased now by City Capital and could sound the death knell of plaintiffs' Offer. Interco will not be harmed, and will be able to press its appeal, should a stay not issue.

-- An appeal should not be certified because the criteria for certification as set forth in Supreme Court Rule 42 have not been satisfied. The opinion does not determine a substantial issue or establish a legal right in the sense required by Supreme Court Rule 42; rather, it involves the application of largely undisputed facts to the standard articulated in Unocal.

ARGUMENT

I

INTERCO'S REQUEST FOR A STAY PENDING APPEAL SHOULD BE DENIED

To paraphrase this Court's decision in State ex rel. Levinson v. Remco Ins. Co., Del. Ch., C.A. No. 8220 Allen, C. (Mar. 18, 1986), denying an application for a stay pending appeal:

> An application of this kind inevitably requires the Court to balance the risks of irreparable injury to the legal interests adversely affected by [the injunction] . . . against the threat to [City Capital and other Interco shareholders] that may be involved by delaying [the effectiveness of this Court's Order and, hence, the ability of City Capital to purchase shares in its tender offer].

In exercising its discretion in considering such an application, this Court "must be sensitive to the particularities of the various interests impacted by the judgment." Id. at 3. Exercise of this discretion compels denial of Interco's application.

Plaintiffs And Interco's Other Shareholders Will Be Irreparably Harmed If A Stay Pending Appeal Issues

As of last night, November 1, the holders of over 91% of Interco's shares outstanding (including those shares owned by City Capital) have voted in favor of City Capital's Tender

Offer by tendering their shares into that offer. A stay pending appeal will harm this overwhelming majority of Interco's shareholders in denying to them the ability effectively to choose between the tender offer and the management recapitalization--the very choice which this Court's November 1 decision preserves.

Moreover, the delay that will be caused by a stay presents real and present risks that the tender offer transaction might be lost. The uncertainty and unpredictability of today's political and economic environment presents the real threat of developments which could cause the Offer to be withdrawn. The October 19, 1987 fall of the stock market is only the most visible example of the uncertain nature of the stock market. (See, e.g., Barron's, October 17, 1988 at 1). For example, the Federal Reserve's recent statements about the use of debt in takeovers had a serious effect on stock prices. (See The Wall Street Journal, p. C1, Col. 3, October 28, 1988). Indeed, even unfounded rumors in this election year can profoundly affect the market (See The Wall Street Journal, p. C1, Col. 4, October 20, 1988), to say nothing about the potential effect on the market of the the decision next Tuesday as to who will be elected the next President of the United States. Any significant adverse change in the market price of Interco's shares or in the United States securities or financial markets

in general, specifically allow plaintiffs' withdraw its Offer. Regan Aff. Ex. 7 at 34-35. Thus, as this court stated in Hecco Ventures v. Sea-Land Corporation, Del. Ch., C.A. No. 8486, Jacobs, V.C. slip op. at 14 (May 19, 1986), "to impose such a restraint [delaying a tender offer] might cause irreparable harm, by creating a risk that the . . . offer, due to market changes occasioned by court-ordered delay, might not go forward." See also Freedman v. Restaurant Assocs., Del. Ch., [1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,502, at 97,221-22 (Oct. 16, 1987) (Injunction against leveraged buy-out denied in light of uncertainty of risks in the future and the fact that "[t]o grant the remedy now would surely deprive tendering shareholders of a currently available option to sell their stock at a price more than 50% higher than the price of [the subject company] Restaurant's stock prior to the announcement of the proposed management buy-out.")

Indeed, the very issuance of the stay sought here by defendants may be the death knell of plaintiffs' Offer. Plaintiffs' Offer is specifically conditioned on there being no court action which "results in a delay in the ability of the Purchaser to accept for payment or pay for some or all of the shares or to consummate the Merger." (Regan Aff. Ex. 7 at 35). See Rosman v. Shoe-Town, Del. Ch., C.A. No. 9483, Hartnett, V.C. (Jan. 18, 1988) (declining to enjoin offer where "there is

at least the possibility that if an injunction is entered, [the offeror] will back away from the transaction or will lower the tender offer price.")

In addition, the business conditions of Interco and its various divisions may deteriorate in the near term, eliminating the possibility that the Offer will be successfully consummated. As Mr. Saligman stated in his deposition: "[i]n the first six months [of the] current fiscal year, Ethan Allen is running below the forecast used [by Wasserstein Perella] in determining the values [it presented to the board]", i.e., Ethan Allen has experienced a "downturn in earnings." (Saligman Dep. 239-40). In addition, Interco's most recent 10-Q, for the quarter ended August 31, 1988, shows that costs and expenses have increased as compared to the same quarter in fiscal 1987, while net earnings and gross margins have declined. See Regan November Aff. in Opposition to Certification Ex. B at 3, 9. With respect to the furniture group in particular--of which Ethan Allen is a part--net sales for the second quarter and for the six months ended August 31, 1988 have declined from the year ago period. (Id. at 9). These adverse changes in the business and financial condition of the Offer could also result in triggering a condition causing the termination of the Offer. (See Regan Aff. Ex. 7 at 35).

Defendants Will Not
Be Harmed Should A
Stay Not Issue

Interco will not be harmed should a stay not issue. Interco's shareholders will then be given the choice to tender into that Offer or to accept the Restructuring. Interco's shareholders will not be harmed, hindered or precluded from any alternative in any way by the denial of the present motion.

Should a stay not issue, Interco remains free to pursue its appeal. Nothing will change as a result of plaintiffs' purchase of any shares tendered, other than the fact that plaintiffs will be the owner of those shares. However, the composition of a majority of Interco's board will not be altered simply by the purchase of Interco shares by plaintiffs. Interco has a staggered board, under which plaintiffs may not be able to gain a majority of seats for two annual meetings of shareholders. See Regan Aff. Ex. 12 at 25-26. Thus, plaintiffs will not be able to prevent defendants from pressing their appeal to the end.*

---

* The Court's decision to grant a stay in Mills Acquisition Co. v. MacMillan, Inc., Del. Ch., C.A. No. 10168, Jacobs, V.C. (Oct. 17, 1988), upon which Interco so heavily relies supports plaintiffs' position here. In that case, the plaintiffs were seeking, inter alia, to invalidate and enjoin the lock-up option and certain fee and expense provisions of a merger agreement entered into by the subject company, MacMillan, and a competing tender offeror. Slip op. at 3. The plaintiffs in MacMillan also asked the Court "to direct the MacMillan Board to redeem the poison pill rights or otherwise to exempt [the plaintiffs'] offer

(Footnote continued)

Defendants' Are Unlikely to Prevail on
The Merits of Their Appeal

This Court's opinion was correct, is well founded in established Delaware precedent and should be affirmed on appeal. As reflected in the November 1 opinion, this Court applied largely undisputed facts (slip op. at 18-20) to settle principals articulated in Unocal Corp. v. Mesa Petroleum Co., Del. Supr., 493 A.2d 946 (1985). Little chance exists that this Court's determination will be reversed.

II

THIS COURT'S ORDER SHOULD
NOT BE CERTIFIED FOR AN APPEAL

In order to be entitled to the certification of an interlocutory appeal the would-be appellant must show that the

---

(Footnote * continued from previous page)
from the Rights Plan." Id. This claim was granted and MacMillan's rights plan was enjoined on the condition that plaintiffs proceed with their offer. Id. at 51. The Court denied the request for an injunction as to the lock-up option and related fee and expense provisions. Id. The Court subsequently entered an order, inter alia, enjoining both tender offerors from purchasing any shares pursuant to their respective tender offers. Mills Acquisition Co. v. MacMillan, Inc., Del. Ch., C.A. No. 10168, Jacobs, V.C. (Injunction Pending Appeal) (Oct. 18, 1988). The effect of that decision was to insure shareholder choice -- to insure that MacMillan's shareholders would be able to choose between two competing offers. In the present case, the only way to insure that Interco's shareholders will be able to choose between the Offer and the Restructuring is to deny a stay pending appeal.

order: "(1) determines a substantial issue and (2) establishes a legal right and (3) meets one or more of the following criteria:

(i) Any of the criteria applicable to proceedings for certification of questions of law set forth in Rule 41; or

(ii) The interlocutory order has sustained the controverted jurisdiction of the trial court; or

(iii) An order of the trial court has reversed or set aside a prior decision of the court, a jury, or an administrative agency from which an appeal was taken to the trial court which had determined a substantial issue and established a legal right, and review of the interlocutory order may terminate the litigation, substantially reduce further litigation, or otherwise serve considerations of justice; or

(iv) A review of the interlocutory order may terminate the litigation or may otherwise serve considerations of justice.

Supr. Ct. R. 42; Appellate Handbook at 5-6 (emphasis in original).

Plaintiffs have failed to demonstrate that any of the criteria of Supreme Court Rule 42 apply.

The Opinion Does Not Determine A Substantial Issue And Establish A Legal Right

A substantial issue is not presented merely because control of a corporation may be at stake or because the decision involves a large transaction. In Telvest, Inc. v. Olson, Del. Ch., C.A. No. 5798, Brown, V.C. (Mar. 22, 1979), the Court denied certification of an interlocutory appeal from the

Court's order granting a preliminary injunction restraining the defendants from taking action to repel an anticipated takeover bid. The Telvest defendants argued that the preliminary injunction had determined a substantial issue and established a legal right. Nevertheless, this Court denied the application for certification, concluding that no "substantial issue" was determined or legal right established merely because the case involved a control contest. The Supreme Court also refused the application for an interlocutory appeal. Outdoor Sports Indus., Inc. v. Telvest, Inc., Del. Supr., No. 73, 1979, Quillen, J. (May 2, 1979) (Order). Instead, our courts have held that orders granting or denying interim injuctive relief are "interlocutory in the strict sense," because such an order "determines nothing finally against [the litigants]." Consolidated Fisheries Co. v. Consolidated Solubles Co., Del. Supr., 99 A.2d 497, 500 (1953).

It is expected that defendants will argue that entry of a mandatory injunction against the poison pill rights plan determines a substantial issue and establishes a legal right within the meaning of Supr. Ct. R. 42. Far from determining a "substantial issue," however, the Court applied familiar legal and equitable principles to undisputed facts in the record in holding that "the board's determination to leave the stock rights in effect is a defensive step that, in the circumstances

of this offer and at this stage of the contest for control of Interco, cannot be justified as reasonable in relationship to a threat to the corporation or its shareholders posed by the offer . . ." Opinion at 4. The Court's decision was based on the Supreme Court's holding in Unocal Corp. v. Mesa Petroleum Co., Del. Supr., 493 A.2d 946 (1985) -- the principal case relied on by defendants in defense of their decision to keep the Rights Plan in place to defeat the Offer.

In addition, the Court's opinion does not create any legal rights. Rather, this Court merely confirmed the shareholders' inherent right to choose to consider plaintiffs' noncoercive offer. As the Court observed:

> Our corporation law exists, not as an isolated body of rules and principles, but rather in a historical setting and as a part of larger body of law premised upon shared values. To acknowledge that directors may employ the recent innovation of "poison pills" to deprive shareholders of the ability effectively to choose to accept a noncoercive offer, after the board has had a reasonable opportunity to explore or create alternatives, or attempt to negotiate on the shareholders behalf, would, it seems to me, be so inconsistent with widely shared notions of appropriate corporate governance as to threaten to diminish the legitimacy and authority of our corporation law.

Opinion at 31.

The grant or denial of injunctive relief, per se, does not establish legal rights.* The Court need go no further to deny the application.

Novel Questions of Law

If the Court were convinced that the Opinion establishes legal rights and determines substantial issues -- which it does not -- there is still no basis upon which to certify an interlocutory appeal. Defendants cannot show that the Court's decision meets any of the criteria required under the Supreme Court's rules.

This case presents no novel questions of law, nor are there conflicting trial court opinions bearing on the issues raised herein. Sup. Ct. R. 41(b). The Court's decision is a straightforward application of the Unocal analysis to a series of largely undisputed facts. Therefore, defendants cannot meet the Rule 41 requirements for accepting certification -- which is the first criteria set forth in Rule 42.** Defendants' application for certification must be denied.

---

* See Plant Indus. v. Katz, Del. Supr., C.A. No. 123, 1981, Quillen, J. (May 1, 1981) (Order) (granting of a preliminary injunction did not finally establish a legal right); Mobile Communications Corp. of Am. v. MCI Communications Corp., Del. Ch., C.A. No. 8108, Berger, V.C. (Sept. 18, 1985) (Order) (denial of a preliminary injunction does not establish legal rights).

** Criteria (ii) through (iv) of Rule 42 are equally unavailing. The Court's opinion has not "sustained the contro-

(Footnote continued)

CONCLUSION

For all of the foregoing reasons, defendants' motion for a stay pending appeal and for certification of this appeal should be denied.

SKADDEN, ARPS, SLATE, MEAGHER & FLOM

By: Paul L. Regan
Rodman Ward, Jr.
Paul L. Regan
One Rodney Square
P.O. Box 636
Wilmington, Delaware 19899
(302) 651-3000

Attorneys for Plaintiffs

OF COUNSEL:

Robert E. Zimet
Jay B. Kasner
Charles F. Walker
Skadden, Arps, Slate,
Meagher & Flom
919 Third Avenue
New York, New York 10022

DATED: November 2, 1988

(Footnote ** continued from previous page)
verted jurisdiction of the trial court," "reversed or set aside a prior decision," or "vacated or opened a judgment." Nor would a "review of the interlocutory order ... terminate the litigation or ... otherwise serve considerations of justice." As noted above, the issues on appeal would not automatically be rendered moot merely by virtue of City Capital's purchase of tendered shares.