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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' REPLY MEMORANDUM IN FURTHER SUPPORT OF THEIR MOTION FOR A PRELIMINARY INJUNCTION

SKADDEN, ARPS, SLATE,
MEAGHER & FLOM

One Rodney Square
P.O. Box 636
Wilmington, Delaware 19899

DATED: October 24, 1988

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PRELIMINARY STATEMENT

Interco's Vice Chairman acknowledged that the decision to sell shares should properly remain with the shareholder:

> Q. Do you believe that the decision --
>
> * * *
>
> Q. -- whether or not a shareholder should or should not sell their shares is one, is a judgment each shareholder should be permitted to make for his or herself?
>
> A. Obviously. He owns the shares . . . .

(Aylward Dep. 196-97). This application can be viewed as City Capital's effort to give effect to Mr. Aylward's wishes.

SUPPLEMENTAL STATEMENT OF FACTS

Plaintiffs Raise Their Offer to $74 Per Share

On October 17, 1988, plaintiffs advised Interco that they had increased the price to be paid pursuant to the Offer to $74 per share and that they had extended the expiration of the Offer until October 31, 1988.* Plaintiffs again urged the Interco board to abandon the Restructuring and to redeem the Rights, adding:

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* Supplemental Affidavit of Paul L. Regan, dated October 23, 1988 ("Regan Supp. Aff."), Exhibit 48.

> Although we believe that our $74 cash offer is a fair price, represents maximum value for your stockholders and is superior to your recapitalization, we remain willing to consider increasing the price to be paid pursuant to our offer further if, after review of non-public information, we believe the inherent values in Interco would warrant such an increase.

The October 19 Board Meeting

The Interco board met at 8:15 p.m. on October 19, 1988. (Saligman Dep. 208-212). Three outside board members -- Zane Barnes, Thomas O'Leary and Marilyn Lewis -- were present only by telephone. (Saligman Dep. 209). Mr. Saligman testified that he did not know whether those three board members received the written materials provided at the meeting to other board members. (Saligman Dep. 223-24).

The October 19 board meeting, like the previous board meetings, was once again literally scripted: Harvey Saligman had a copy of an agenda -- not provided to the other board members -- from which he conducted the meeting. (Saligman Dep. 268-69; Regan Supp. Aff. Ex. 51).*

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* Once again, the board members were not provided with any written materials in advance of the October 19 meeting (Saligman Dep. 222-25) -- despite the fact that Saligman had advised the board at its previous meeting that "we would be calling an additional meeting sometime soon in order to discuss the possibility of declaring additional dividends under our previously announced recapitalization program" (Saligman Dep. 212-13). The material with which the board was provided included a limited presentation by Wasserstein Perella (Regan Supp. Aff. Ex. 52); a one-page

(Footnote continued)

Characteristically, the board gave only minimal consideration to City Capital's $74 Offer. The financial adequacy of the $74 Offer was considered solely in comparison to the Restructuring; according to Saligman, "[i]t was the unanimous feeling of the board that the company's recapitalization program designed to deliver at least $76 to the shareholders was a superior alternative." (Saligman Dep. 229).

The written materials presented by Wasserstein Perella with respect to the $74 Offer consisted of one page of text, over half of which concerned "litigation status" (Regan Supp. Aff. Ex. 52 at 4) and are totally devoid of any financial analysis of the $74 offer. Nothing else was discussed with respect to the financial adequacy or inadequacy of the $74 Offer. (Saligman Dep. 231-34). Nothing was said concerning the "fairness" of the $74 offer. (Saligman Dep. at 267).

(Footnote * continued from previous page) agenda prepared by Wachtell Lipton in consultation with Interco's secretary (Regan Supp. Aff. Ex. 50) (in contrast with the lengthy scripted agenda prepared for Saligman's use (Regan Supp. Aff. Ex. 51); copies of City Capital's October 14 and October 17 letters, given to the board for the first time at October 19 meeting (Saligman Dep. 251-53); and proposed resolutions prepared by Wachtell Lipton (Saligman Dep. 255), drafts of which had been reviewed by Saligman earlier that day but which had not been presented to the board as a whole until the evening of the 19th (Saligman Dep. 256).

Once again, the board also failed to consider contacting City Capital to discuss its Offer. (Saligman Dep. 234). Once again, there was no consideration whether the board should act to redeem the Rights in connection with the City Capital Offer. (Saligman Dep. 250, 253-54).

The board declared a second special dividend in connection with the Restructuring at the meeting, consisting of $24 per share in cash and $6.80 per share of subordinated discount debentures. (Saligman Dep. 214; Regan Supp. Aff. Ex. 50 at 21). The board's consideration of the second stage dividend was no better. Again, the materials provided by Wasserstein Perella were skimpy at best and totally devoid of financial analysis. (See Regan Supp. Aff. Ex. 52 at 6-12).

Despite the board's cursory treatment of the Restructuring and the City Capital Offer, it did take the time, as it had on September 19, to insure that the value of the employee stock options owned by at least six of the management directors*

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* According to Interco's 1988 proxy (Regan Aff. Ex. 11 at 5), the following Interco directors are deemed the beneficial owner of the following respective amounts of stock:

Director	Number of option shares of Interco stock
R.L. Aylward	10,000
H.M. Krogh	1,000
M.H. Lieberman	3,850
R.B. Loynd	750

(Footnote continued)

would not be adversely affected should the Restructuring not achieve a value of $76 per share. The board resolution is found at Regan Supp. Aff. Ex. 50 at 22.* Mr. Saligman explained the purpose and operation of the resolution:

> A. Whatever value the option holder loses in the equity because of dividends being paid, the intent is that that value would be replaced by allowing him to buy additional shares to cover the difference.
>
> * * *
>
> Q. What is your understanding with respect to the point in time at which a judgment will be made with respect to the amount of value that an option holder has lost as a result of the declaration or payment of a dividend?
>
> A. My understanding is that it would be depend upon when he exercises the option, at what point.

(Saligman Dep. 264). To illustrate, assume a holder has one option to buy an Interco share at $60 and Interco is trading at $70 when the dividend is declared. The value of the option is $10. The consequence of making the adjustment at the time the option holder exercises the option is to make the option holder indifferent to the trading price of the stub. So if the "stub"

(Footnote * continued from previous page)

C.J. Rothschild, Jr.	10,600
H. Saligman	42,500

* In connection with the initial dividend under the recapitalization, a similar resolution was approved by the Interco board. (Regan Supp. Aff. Ex. 43 at I03933-34).

is trading at $10 when the holder exercises (as the Recap assumes), he can be made whole by allowing him to buy two shares for $10. However if the "stub" is trading at $4 (and the Wasserstein Perella prediction is not borne out) he would be made whole by allowing him to buy five shares for $10. No shareholder, other than the insider option holders, has this guarantee against a miscalculation of the stub value.

The Third Circuit Decision

On October 20, 1988, the Third Circuit Court of Appeals issued an order vacating its earlier-entered injunction pending appeal and affirmed Judge Farnan's decision denying Interco's motion for a preliminary injunction against the Offer. The court noted that

> [d]espite Interco's access to the documents, employees, and agents of both [City Capital] and Drexel, it has been unable to point to any material misrepresentation or material omission in [City Capital's SEC] filings.

City Capital Associates Limited Partnership v. Interco Incorporated, 3d Cir., No. 88-3645, slip op. at 8-9 (Oct. 20, 1988) (Regan Supp. Aff. Ex. 54 at 8-9).

Too Little, Too Late: Interco's Belated Attempts to "Fix" The Record and Misrepresent the Facts

Defendants rely extensively, if not exclusively, on generalizations in lawyer-crafted affidavits* and suddenly appearing** board meeting minutes in attempting to "fix" the record and to satisfy their burden of showing good faith and reasonable investigation. As shown below, those lawyer-crafted documents are in jarring conflict with the spontaneous sworn deposition testimony of defendants and others. No credibility should be given to these lawyer-crafted documents to the extent they conflict with sworn deposition testimony.***

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* To the extent that Saligman's or Mohr's affidavit purports to attest to the board's collective state of mind, it should be disregarded as incompetent hearsay. See Chancery Court Rule 56(e) ("affidavits shall be made on personal knowledge and shall set forth such facts as would be admissible in evidence, and shall show affirmatively that the affiant is competent to testify to the matters stated therein") (emphasis added); Bank of Delaware v. Claymont Fire Co. No. 1, Del. Supr., 528 A.2d 1196, 1198 (1987) (affidavits containing hearsay statements of persons having no personal knowledge of the purported facts fail to comply with the requirements of Chancery Court Rule 56(e)).

** The September 19 board minutes were "produced" on October 19. No draft minutes or contemporaneous notes of board proceedings were produced, despite repeated requests. No explanation for their absence has been given. Moreover, defendant directors were cautioned not to take notes at Board meetings (Regan Aff. Ex. 27 at I03858; Saligman Aff. Ex. I at I03928).

*** See Nutt v. A.C. & S. Co., Inc., Del. Super., 517 A.2d 690, 693 (1986)(affidavit did not provide "credible evidence" on liability issue in summary judgment motion when contradict-

(Footnote continued)

For example, defendants assert, in defense of their claim that the board has satisfied their burden of showing good faith and reasonable investigation of plaintiffs' offers, that they considered those offers on four occasions and that "[t]he board's minutes and the deposition testimony clearly reflect that the directors questioned Wasserstein Perella vigorously and that the board's decisions to reject the various offers were taken only after full and frank discussion." (Defendants' Memorandum ("Def. Mem.") at 24). In fact, the record citations offered by defendants in support of this proposition show nothing of the kind.*

(Footnote *** continued from previous page)
ed by witness's unambiguous deposition testimony); Packer v. Yampol, Del. Ch., C.A. No. 8432, Jacobs, V.C., (April 18, 1986), slip. op. at 43 (conclusory affidavits of corporate defendant's interested directors and officers disputing alleged entrenchment motive for issuance of "supervoting" preferred stock conflicted with undisputed evidence in the record).

* For example, defendants cite the Cornelius deposition at 33-36, 113-14 in support of this proposition. Those transcript pages show that the board did not consider the $72 offer at the September 19 board meeting and that the board members simply received the Wasserstein Perella "book" (Regan Aff. Ex. 37) at that meeting -- nothing more.

Defendants also cite the Lasater deposition at 97-98, 143-44. Those pages set out Mr. Lasater's answers that at the August 8 board meeting there were a mere 15 minutes of questions to Bruce Wasserstein following his presentation, followed by a legal presentation by Wachtell Lipton, and that at the August 22 meeting there were again a mere 15 minutes of questions to Mr. Wasserstein. In addition, defendants cite the minutes of the August 8, August 22 and
(Footnote continued)

-- The August 8 Interco Board Meeting

Defendants make no attempt to justify their actions at the August 8 board meeting, stating that City Capital's $70 merger proposal was rejected only "[a]fter full discussion." (Def. Mem. at 10, emphasis added; see also Def. Mem. at 24).

In contrast to Interco's generalities, the unrebutted deposition testimony confirms that the board gave only a superficial and cursory look at the $70 proposal and blindly accepted the recommendation of management and its advisors to reject that proposal. (Plaintiffs' Opening Memorandum ("Pl. Mem.") at 11-17). For example, the board did not know the basis for management's conclusion that the $70 price was inadequate. (Lasater Dep. 121-27). There was no discussion of the assumptions underlying Wasserstein Perella's valuation analysis. (Lasater Dep. 108-109). Moreover, the Interco board determined that the $70 merger proposal was inadequate based upon what Wasserstein Perella has now conceded were "very rough" estimates of taxes (Mohr

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(Footnote * continued from previous page) September 19 board meetings. (Saligman Aff. Exs. F, G and I). However, as shown below, and as shown in plaintiffs' opening memorandum at 11-20 and 24-40, there was no "vigorous questioning" or "full and frank discussion" at those meetings. To the extent the lawyer-crafted minutes are to the contrary, they should not be credited.

Aff. ¶ 7) and views which were "preliminary only." (Id. at ¶ 9).*

-- The August 22
Interco Board Meeting

Defendants also make no attempt to defend or explain the board's failure adequately to examine or consider the Offer at the August 22 board meeting, stating only that the board rejected the Offer after being advised that the Offer was "financially inadequate" and "violated federal law."** (See Def. Mem. at 11-12; see also id. at 23-24). Once again, the flawed processes of the August 22 board meeting identified in plaintiffs' opening brief and fully supported by the sworn deposition testimony remain unrebutted. (See Pl. Mem. at 18-20). For example, no attempt is made to explain the board's failure to question why Wasserstein Perella had changed their valuation figures from a post-tax (on August 8) to a pre-tax basis (on

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* Wasserstein Perella's efforts to walk away from these numbers as anything more than mere rough estimates was not understood by, nor conveyed to, the Interco board. If, in fact, Wasserstein Perella's numbers were "very rough" as of August 8, there was nothing preventing the board from adjourning and re-convening when Wasserstein Perella's numbers were not "preliminary" or "very rough." Instead, that possibility was never discussed. (Lasater Dep. 93-94).

** As the Third Circuit pointedly noted in its October 20 decision, no such violation has yet been found. (See Regan Supp. Aff. Ex. 54 at 8-9).

August 22) or their failure to discuss what those valuation figures would look like on an after-tax basis.* While Mr. Mohr asserts that Wasserstein Perella "specifically called the Board's attention to the fact that our August 22 valuation analysis was entirely pre-tax" (Mohr Aff. ¶ 15), he does not dispute that the after-tax ranges were never discussed with the board -- even the after-tax basis of the August 8 presentation. This failure is glaring since the reference range valuation method was the sole method reflected in Wasserstein Perella's written presentations to the board at all three board meetings on August 8, August 22 and September 19 (see Regan Aff. Ex. 23 at I02757; Regan Aff. Ex. 28 at I02792; Regan Aff. Ex. 37 at I03746). Indeed, at the September 19 board meeting it was the only written valuation methodology presented.

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* Interco flails mightily to minimize the importance of the after-tax numbers reflected in the Gunther Affidavit submitted by plaintiffs. Significantly, however, Interco does not dispute the accuracy of the numbers themselves. Given the disparity in the reference ranges repeatedly presented to the Interco board by Wasserstein Perella when considered on a pre- and post-tax basis, there is simply no justification for the board not to have been presented with and considered this information. The importance of the pre- and post-tax distinction was even pointed out to the board by Wasserstein Perella. One of the caveats specifically identified to the board was that the valuations were "pre-tax." (See Regan Aff. Ex. 28 at I02770). Interco's retort that "the after-tax analysis suggested by the plaintiffs would be extremely difficult, if not impossible, to do in practice" (Def. Mem. at 33, n.*) is no answer. Having calculated the ranges on a pre-tax basis, Wasserstein Perella no doubt could and should have computed these figures on an after-tax basis, just as Mr. Gunther was able to do.

-- <u>The Continued Refusals To Negotiate</u>

Defendants also make no attempt to defend their requirement that plaintiffs abandon their Offer before being provided with the confidential information about Interco that the company had provided to other potential acquirors. (<u>See</u> Def. Mem. at 12-13). Defendants claim that "[c]ontrary to plaintiffs' assertion (POB 21-22) [Interco's] proposed confidentiality agreement would not require <u>management's</u> approval to defuse the standstill. See Rales Aff. Ex. I, at 3" (Def. Mem. at 13n.) is wrong. The referenced exhibit specifically states, just as plaintiffs said, that, as a condition to receiving confidential material, the recipient:

> will not . . . directly or indirectly, for a period of three years from the date hereof: (a) make any public announcement with respect to, or submit any proposal for, a transaction between the Company or any of its securities holders and yourself (and/or any of your affiliates) . . . <u>unless such proposal is directed and disclosed solely to the management</u> of the Company or its designated representatives, <u>and the Company shall have requested in writing in advance the submission of such proposal</u>. . . .

Rales Aff. Ex. I; emphasis added.

Moreover, while Saligman asserts that there have been "substantial discussions" between Interco and plaintiffs (Saligman Aff. ¶ 38), there is no dispute that there have never been <u>any</u> discussions with City Capital aimed at determining the highest value which plaintiffs would be willing to pay to all Interco shareholders.

-- The September 19 Board Meeting and the Adoption of the Restructuring Plan

While Saligman states conclusorily that "[a]s the Court can see from the minutes of those meetings -- which, in our practice, enumerate the subjects on which directors ask questions, although not recording the full discussion of such questions -- the directors took an active role in the meetings" (Saligman Aff. ¶35), once again sweeping conclusory generalizations are no substitute for the specific unrebutted facts upon which plaintiffs rely.*

Defendants' distortions of the record with respect to their formal adoption of the Restructuring Plan and rejection of plaintiffs' $72 Offer on September 19 begin with the genesis of the Restructuring --

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* The record is undisputed that the minutes were scripted from the lawyer crafted agendas of these meetings (Pl. Mem. 18-19). When the September 19 minutes were produced on October 19, plaintiffs requested production of the notes from which the minutes had been prepared; however, counsel for Interco refused to act on that request.

What Defendants Say

"In recent years, Interco has pursued an asset redeployment program and a policy of divesting underperforming businesses. Saligman Aff. ¶ 14; Cornelius Tr. 38; Lasater Tr. 34. . . . [T]he Restructuring challenged by plaintiffs is the culmination of this strategy." (Def. Mem. at 6; see Def. Mem. at 16-17). Saligman states that "the Board had been involved at every step of the way in our repositioning strategy and the restructuring which we then presented to the board was fully consistent with it." (Saligman Aff. ¶ 44, n.*)

The Facts

The announcement of the proposed Restructuring was made in direct response to plaintiffs' purchases of Interco stock. (Aylward Dep. 184). The defendants' citations to the Saligman affidavit and the Cornelius and Lasater depositions do not show otherwise. Moreover, prior to August 1988 the subject of a possible restructuring at Interco had never been discussed at a meeting of Interco's board of directors or any committee thereof. (Lasater Dep. 24-25). When the July 15 press release announcing the "major restructuring" was issued, the only assets under consideration to be sold were the Apparel Manufacturing Group and some small retail operations. (Pl. Mem. at 9-10). Indeed, in Interco's 1987 Annual Report, Interco concedes that "during the past year, we completed the divestiture phase of our repositioning effort." (See Regan Supp. Aff. Ex. 59 at 2).

-- and extend to the lawyer-crafted documents submitted by defendants, including the minutes of the September 19 board meeting, the affidavits of Mohr and Saligman, and defendants' Memorandum of Law:

What Defendants Say	The Facts
The Interco board inquired and/or commented "with respect to the advantages and disadvantages of the restructuring plan and of other strategic alternatives" and "with respect to the cost and fee differences among various alternatives." (Saligman Aff. Ex. I at I03929; Mohr Aff. ¶ 21, 22).	The only alternative to the Restructuring of which the board was apprised was a leveraged buyout. (Cornelius Dep. 46-48, 127; Pl. Mem. at 27-28). That alternative was given only cursory consideration (Id.) The board did not know what values could be achieved through that leveraged buyout alternative. (Ayl-ward Dep. 50).
The Interco board inquired and/or commented "with respect to the fairness of the restructuring plan to all shareholders." (Saligman Aff. Ex. I at I03930).	Interco's investment banker, who was at the September 19 board meeting, testified that no-one at Interco ever asked Wasserstein Perella "whether or not it believed the values in the recapitalization to be fair from a financial point of view to Interco shareholders." (Mohr Dep. 78; Pl. Mem. at 30). Even in his affidavit, Saligman concedes that he does not "remember [Wasserstein Perella] using the word 'fair' to describe the transaction, nor had I asked the firm to give a 'fairness' opinion." (Saligman Aff. ¶ 56). The best Saligman can come up with is that he understood Wasserstein Perella to mean that the restructuring was "a highly desirable transaction (Saligman Aff. ¶ 56);" "a sound financial alternative" (Id. at 57); or that shareholders "would

What Defendants Say	The Facts
	come out well ahead of the game." (Id. at 36).
The Interco board inquired and/or commented "with respect to the timing of delivery of shareholder value under the restructuring plan" and "whether, and if so how, shareholders will know that on a fully distributed basis the restructuring plan will deliver shareholder value of at least $76 per share." (Saligman Aff. Ex. I at I03929; Mohr Aff. ¶¶ 21, 22).	The testimony is that at the September 19 board meeting no-one expressed a view "with respect to how long it will take until this process [of distribution to shareholders] is concluded" and that the distributions to shareholders "would be done on an orderly basis, hopefully an expeditious time schedule..." but that "no months were involved." Moreover, the board did not understand the term "on a fully distributed basis." (Aylward Dep. 31-37, 160; Cornelius Dep. 51; Pl. Mem. at 30-36).
"It was also explained to the board that Wasserstein Perella's valuation of the Restructuring assumed full distribution of the securities to be issued in the Restructuring. Wasserstein Perella estimated that, before securities can be deemed fully distributed, a month or more must generally elapse while the arbitrageurs dispose of the securities and they are acquired by institutional holders. I understood Wasserstein Perella to be telling us that, accordingly, one could not expect the market to immediately reflect the value which Wasserstein Perella put on the Restructuring securities." (Saligman Aff. ¶ 54).	There is no dispute that, based upon sworn deposition testimony, this understanding was not shared by the entire board (see Pl. Mem. 30-37). The directors either did not at all understand the concept or did not understand the amount of time contemplated by the term fully distributed in the same way.

What Defendants Say	The Facts
The Interco board inquired and/or commented "whether, and if so to what extent, consideration had been given in the development of the restructuring plan to the possibility that core companies may not achieve projected financial results and/or the viability of the business of the core companies in the future, particularly in the event of economic downturn." (Saligman Aff. Ex. I at I03929).	The testimony shows that the board's understanding and consideration of the viability and earning power of the "core" business after the Restructuring was next to nil. (Cornelius Dep. 76-78; Aylward Dep. 86-88; Saligman Dep. 64-65; Pl. Mem. at 37).
The Interco board inquired and/or commented "with respect to the cost savings program of the company." (Saligman Aff. Ex. I at I03930).	There was no discussion by the board with respect to the specifics of the cost savings measures and nothing written was presented to the board with respect to cost savings. (Cornelius Dep. 155; Aylward Dep. 154; Pl. Mem. at 38).
The Interco board inquired and/or commented "with respect to the asset sales program of the company." (Saligman Aff. Ex. I at I03930).	No one asked Wasserstein Perella or management "whether or not any indications of interest had been received with respect to any of the assets which are contemplated to be sold" under the Restructuring. (Aylward Dep. 39). Nothing was said as to the differences in value that could be achieved from a sale of assets on a shorter time frame than that contemplated by the Restructuring. (Aylward Dep. 38).

What Defendants Say

"On September 19, Interco's board rejected plaintiffs' September 10 proposal based, inter alia, on the advice of Wasserstein Perella that the price was financially inadequate." (Def. Mem. at 13).

The Facts

The board gave essentially no consideration to the September 10 $72 per share proposal. The testimony is unequivocal: the board perceived the $70 per share Offer as "the only offer we have [that] the Board could consider..." (Cornelius Dep. 35-36; Pl. Mem. at 24-26).

All of the backup materials relating to Wasserstein Perella's inadequacy opinion and to the Restructuring to which Mr. Mohr refers (Mohr Aff. ¶ 18; Ex. E) were not made available to the Interco board (Mohr Dep. 67). All of that material was, however, made available to the committee of managing directors of Wasserstein Perella evaluating the financial adequacy of City Capital's proposal (Mohr Dep. 79-80). Indeed, Mohr conceded that such material was necessary for Wasserstein Perella "to make a fully unformed judgment with respect to the financial adequacy of the CCA $72 proposal." (Id.)

Also, while Mohr states that the $72 proposal was analyzed "in light of a number of different financial measures -- discounted cash flow; comparable companies; premiums paid; comparable acquisitions; and the reference range we had discussed with the

What Defendants Say	The Facts
	board on August 22" (Mohr Aff. ¶ 18), the only methodology presented to the board was the pre-tax reference range. (Regan Aff. Ex. 37 at 103746).

In addition, Saligman seeks to justify his unilateral decision to approve the accrual of interest on the dividend from October 13 in light of the fact that the presentation to the board on September 19 had assumed distribution of the securities, and thus the accrual of interest, as of September 1 (Saligman Aff. ¶ 55). However, there is no evidence that such a pro forma presentation apprised the board that paying interest on the dividends prior to distribution was being contemplated -- which it was not; that any interest would be paid to shareholders on the cash portion of the dividend; or that the board considered the additional costs to Interco from accruing this interest as the source from which it will be paid. Saligman concedes that the idea to accrue interest was made after the September 19 board meeting (Saligman Dep. 144-145).

The Board's Continued Failure to Consider and Evaluate the Rights Plan in Light of the City Capital Offer

Interco does not dispute Saligman's testimony that the board never considered redeeming the Rights in connection with the City Capital Offer. (<u>See</u> Saligman Dep. 91-95, 250). Indeed, Saligman concedes that "the board's actions with respect to the rights plan have been very limited" (Saligman Aff. ¶ 24).

Defendants place great emphasis on the fact that the flip-in feature of the rights plan becomes "inoperative" if "an acquiror owning less than 15% of Interco's shares buys enough Interco shares for cash in a single tender offer to give it 80% of the outstanding shares." (<u>See</u> Saligman Aff. ¶ 22). This, however, ignores the impact of the "flip-over" feature of the rights plan.

The flip-over feature <u>would</u> be applicable to a merger with Interco (Regan Aff. Ex. 15 at I00670 <u>et seq</u>.). Interco well knows that the purpose of City Capital's tender offer is to be in a position to effect such a merger (<u>e.g.</u> Regan Aff. Ex. 7 at 27). Interco also knows that City Capital's financing requires that a merger occur within 180 days of the consummation of the Offer (Regan Aff. Ex. 7 at 18.). If the flip over were applicable, the dilution consequences of the flip-over (permitting each Interco shareholder to obtain shares in the acquiror at a 50% discount) would be in Interco's counsels' words "unacceptable." (Regan Aff. Ex. 15 at I00603; <u>see also</u> Regan Aff. Ex. 17 at I00051). It is precisely because the flip-over is so potent a deterrent to City Capital, that Interco is leaving it in place.

ARGUMENT

I.

THE ENTIRE FAIRNESS STANDARD APPLIES

Defendants' argument against applying the entire fairness test is based overwhelmingly on an inference that they draw from language in Unocal Corp. v. Mesa Petroleum Co., Del. Supr., 493 A.2d 946 (1985) (Def. Mem. at 38-39). There is no discussion one way or the other in Unocal about the entire fairness test;* indeed, the board in Unocal was found to be comprised of a majority of outside directors. 493 A.2d at 950. As noted in our opening brief, Pl. Mem. at 51 n.*, when the Delaware Supreme Court did address entire fairness in Ivanhoe Partners v. Newmont Mining Corp., Del. Supr., 535 A.2d 1334 (1987), and declined to apply that test solely on the facts there presented, the court did not reject its application in the takeover context as a matter of law, as defendants mistakenly try to do here.**

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* There was also no discussion of whether to apply the entire fairness test in Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., Del. Supr., 506 A.2d 173 (1986) (Def. Mem. at 39).

** In In re J.P. Stevens & Co. Shareholders Litigation, Del. Ch., 542 A.2d 770, 780 (1988) (Def. Mem. at 40-41) there was no discussion of the effect where, as here, the measures designed to defeat a change of control also involve self-dealing or other personal

(Footnote continued)

Defendants legal argument on the entire fairness issue is, in reality, an overly simplistic invitation to pigeon-hole cases into categories, with all takeover cases in the Unocal column and self-dealing cases in the Weinberger column. Our point is that where, as here, the board's response to the threat of a change of control has the purpose or effect of providing a direct and unique pecuniary benefit to a majority of the board, the board must demonstrate the entire fairness of that response. This concept is entirely separate from the notion that the interest of directors in their directorships -- management and non-management alike -- alone will trigger a Unocal analysis. Here, a majority of the board will keep their well-paying jobs and obtain a unique guarantee in the Restructuring on the values that it will achieve for them alone. Thus, these unique pecuniary benefits, independent of defendants' obvious interest in continuing as directors, take this case out of Unocal and require an entire fairness analysis.

(Footnote ** continued from previous page)
pecuniary interest on the part of the board. Similarly, the board decision under review in Robert M. Bass Group, Inc. v. Evans, Del. Ch., [Current] Fed. Sec. L. Rep. (CCH) ¶ 93,924 (July 14, 1988) (Def. Mem. at 41 n.*) was made by a board that was comprised of a majority of outside directors who received none of the 39% equity interest in the target which defendants here point to with such emphasis.

At a minimum, the entire fairness test must, as a matter of law, be applied to judge the board's failure to redeem the Rights Plan for City Capital's offer. The record is undisputed that at no time did the Interco board consider whether to redeem the Rights in connection with City Capital. As the Supreme Court stated in Aronson v. Lewis, Del. Supr., 473 A.2d 805, (1984), there is no protection under the business judgment rule where directors respond to corporate developments with complete abdication of duty and unconscious inaction:

> [I]t should be noted that the business judgment rule operates only in the context of director action. Technically speaking, it has no role where directors have either abdicated their functions, or absent a conscious decision, failed to act.

Id. at 813 (emphasis added).* Under such circumstances, intrinsic fairness must apply. See A.C. Acquisitions Corp. v. Anderson, Clayton & Co., Del. Ch., 519 A.2d 103, 115 (1986).

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* See also Lewis v. Hett, Del. Ch., C.A. No. 6752, slip op. at 6, Berger, V.C. (Sept. 4, 1984) (citing Smith v. Pritzker, Del. Ch., C.A. No. 6342, slip op. at 11, Marvel, C. (July 6, 1982) (the "directors must have . . . 'brought [their] judgment to bear with specificity on the challenged transaction . . .'"); Kaplan v. Centex Corp., Del. Ch., 284 A.2d 119, 124 (1971) ("Application of the [business judgment] rule of necessity depends upon a showing that informed directors did, in fact, make a business judgment . . . .").

Defendants' backup argument on entire fairness -- that a majority of the Interco board should not be treated as insiders -- also fails (Def. Mem. at 42-44). It is undisputed that seven of the twelve directors who voted to approve the Restructuring and to reject the City Capital offer on September 19 also were salaried officers of Interco.* Of these seven, six are option holders who would benefit financially from the guarantees described above, in a manner distinct from other shareholders.

Moreover, the full board's October 19 decision purporting "to reaffirm the Restructuring" -- after plaintiffs' opening brief pointed out that the twelve-member vote to approve the Restructuring in the first instance was dominated by a majority of at least seven interested directors -- is equally unavailing. An evenly split board of inside and outside directors will, for sound policy considerations, be regarded overall as an interested board. See Kaufman v. Beal, Del. Ch., C.A. No. 6485, Hartnett, V.C., slip op. at 20 (Feb. 25, 1983)

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* Defendants' suggestion that four of these seven management directors should be treated as outsiders because they are merely in charge of Interco's operating companies -- as opposed to the holding company -- is simply ludicrous. Not surprisingly, no authority is offered in support of this extraordinary proposition.

(pre-suit demand excused in stockholder derivative suit, in part because 10 directors of the 20 member board were interested; "the defendants . . . can show, at best, that only ten of the twenty appear to be disinterested. That is not enough.").* Moreover, purportedly outside directors can be found to be interested or lacking in independence where, as here, there are a myriad of business and personal relationships with their management colleagues on the board.**

Defendants' October 19 efforts to "cure" their earlier interested vote must be rejected for the additional reason that the vote of the full board was tainted by the inevitable need to "reaffirm" and thus to try and fix the mess into which the defendants had gotten. In Smith v. Van Gorkom, Del. Supr., 488 A.2d 858, 873-74 (1985), for example, the Delaware Supreme Court made clear that it rejected "post hoc" attempts to cure earlier breaches of the duty of care. A similar theme finds

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* See also Untermeyer v. Fidelity Daily Income Trust, 1st Cir., 580 F.2d 22, 24 (1978); Shamrock Assoc. v. Horizon Corp., S.D.N.Y., 632 F. Supp. 566, 570 (1986)

** See Bershad v. Curtiss-Wright Corp., Del. Supr., 535 A.2d 840, 843 n.4 (1987); Revlon, Del. Supr., 506 A.2d at 176 n.3; Lewis v. Fuqua, Del. Ch., 502 A.2d 962 (1985).

expression in EAC Industries v. Frantz Manufacturing Co., Del. Ch., C.A. No. 8003, Walsh, V.C., slip op. at 20-21 (June 28, 1985), aff'd, Frantz Manufacturing Co. v. EAC Industries, Del. Supr., 501 A.2d 401 (1985), and is particularly apt here:

> The hastily-called directors meeting of April 24, conducted from a script prepared by counsel, had an aura of inevitability which was clearly at variance with the requirement that the board members be adequately informed and act after sufficient deliberation. Smith v. Van Gorkom, Del. Supr., 488 A.2d 858 (1985). The improvised fairness opinion of the Bacon, Stifel; the absence of discussion; and the limited knowledge of the ESOP events by directors other than Musgrove and Collins strongly suggest that the attempted ratification of the ESOP funding and stock purchase was mere window dressing.

In sum, in whatever way their action is viewed, the Interco directors are an interested board with respect to their decisions to approve the Restructuring and to thwart plaintiffs' Offer by refusing to redeem the Rights Plan, and their conduct should be measured under the entire fairness test.

II.

DEFENDANTS HAVE TRIGGERED AN AUCTION UNDER REVLON BY BREAKING UP THE COMPANY

Notwithstanding Interco's repeated assertions, the fair auction duties required by Revlon do not arise only where the "sale" of an entire target corporation is contemplated by its board. Def. Mem. at 44-47. Indeed, as we pointed out in our opening brief at 58-60, the Delaware Supreme Court stated in Revlon that a board of directors must conduct a fair auction in order to maximize valve to shareholders when it becomes "apparent . . . that the break-up of the company" is inevitable. Revlon, 506 A.2d at 182 (emphasis added); see also Black & Decker Corp. v. American Standard, Inc., D. Del. 682 F. Supp. 772, 781-83 (1988) (noting that a recapitalization plan that does not result in "the complete sale of all shares of the company" may result in triggering auction duties under Revlon.)

Interco does not and cannot argue that the proposed sale of assets which accounted for about 50% of its sales during its most recent fiscal year does not constitute a "break up" of that company. (Compare Pl. Mem. at 28-29, 58-59 with Def. Mem. at 18-21, 46-47). Moreover, in order to pay for the special dividends that

Interco allegedly intends to distribute pursuant to the Restructuring, it has made arrangements to borrow well over $2 billion from a consortium of banks. (Regan Aff. Ex. 41). Approximately one-half of that amount will be repaid through the sale of major assets which will generate $1.15 billion, after taxes. Id. The dividends it is declaring, on Interco's own assumptions, constitute 87% of Interco's value.* Finally, as security for its more than $2 billion in loans, Interco will pledge virtually 100% of the assets it does not sell.**

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* If the recap is worth $76 per share and the "Stub" equity worth $10, Interco is disposing of 66/76ths of itself.

** The banks' September 19, 1988 Commitment Letter is very specific in this regard. According to the Term Sheet attached to the Commitment Letter, the following "Security" will be provided by Interco:

> Perfected, first priority (and sole) security interest in: (1) all stock of existing and future direct and indirect subsidiaries of INTERCO and (2) any other tangible or intangible assets of INTERCO and its direct and indirect subsidiaries specified by any [of the lending banks], including, but not limited to, real estate, accounts receivable, inventory, equipment general intangibles, chattel paper, instruments, documents, trademarks and all proceeds thereof. The security is for the sole benefit of the Lenders under the Facilities. At the reasonable request of the Co-Agents made prior to the Funding

(Footnote continued)

A. <u>Section 203 Incorporates A Legislative Determination That The Revlon Standard Should Apply To A Board's Actions In Choosing Between A Restructuring And A Tender Offer</u>

Section 203, 8 <u>Del. C.</u> §203 (1988), incorporates the legislature's determination that a board should allow a "level playing field" when confronted with a choice between a tender offer and a restructuring such as that proposed by Interco.

Pursuant to Section 203(b)(6), the three-year moratorium against a merger or consolidation with a target company will not apply to a competing offer where the target's board has approved one of a number of transactions specifically enumerated in the Act -- including the "sale . . . mortgage, pledge, transfer or other disposition" of assets of the company that have a value of 50% or more of the value of the company's assets or outstanding stock." The Restructuring squarely falls under Section 203(b)(6). Indeed, the proposed sale of assets

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(Footnote ** continued from previous page)
Date, <u>INTERCO will place in a subsidiary and operating assets which are not already owned by a subsidiary</u>.

(Exhibit 20 to Interco's Schedule 14D-9, Amendment No. 6; Regan Aff. Ex. 39) (emphasis added).

alone may involve more than 50% of Interco's value.* Even aside from the sale of assets, in order to obtain the over $2 billion in loans that it will need to carry out the Restructuring, Interco will pledge, as security for those loans, almost 100% of the assets it does not sell. Because of the sheer magnitude of these pledges, it is unnecessary to engage in an extensive valuation of Interco, since the aggregate value of virtually <u>all</u> of its assets necessarily exceeds 50% of the value of that company.

According to the legislative history of Section 203, subsection (b)(6) is described as follows:

> This section assures that directors will not be able to take advantage of the three year statutory period to enter into a transaction with themselves or with a third party to the exclusion of others <u>and thereby avoid a fair auction for a sale of the company</u>.

M. Goldman & E. McNally, <u>The Proposed Delaware Takeover Statute: A Report to the Delaware General Assembly</u> at 6-7 (1988) (emphasis added).** Inasmuch as the Restructuring fits precisely within the terms of Section 203(b)(6),

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* The exception stated in Section 203(b)(6) applies even though the transfers and dispositions are made in a series of transactions and may be made from the assets of direct or indirect subsidiaries.

** Interco also has cited this Report as authority for substantive propositions of Delaware law. <u>See</u> Def. Mem. at 54.

it should also be found to constitute the type of control transaction that triggers the fair auction duties of Revlon, duties that Interco does not even claim to have discharged.

B. Ivanhoe Partners is Inapplicable

Interco's reliance on Ivanhoe Partners v. Newmont Mining Corp., Del. Supr., 535 A.2d 1334 (1987) is completely misplaced. (See Def. Mem. at 44-45). The facts of that case are all dispositively different from the facts here.

The Restructuring: In Ivanhoe Partners, Newmont sold only "noncore" assets and declared a dividend valued at less than 1/3 of the tender offer price. See Ivanhoe Partners, 533 A.2d at 597. While the proceeds of the dividend were used to purchase stock, it did not constitute a "sale" of the company because the purchases of stock were made in the open market, not from Newmont. Id. In this case, Interco is transforming itself selling both "core" and "noncore" businesses, including its crown jewel, "necessitat[ing] substantial change in strategy and operating philosophy of the company", and declaring a dividend of cash and securities valued at nearly 90% of the tender offer price. (See Regan Aff. Ex. 37 at I03751; Regan Aff. Ex. 41).

The Resulting Company: After its restructuring, Newmont would be a core gold company with "low debt." 533 A.2d at 597 n.13. After the Restructuring contemplated by Interco, it will be an amalgam of companies with a huge debt load. (See Regan Aff. Ex. 41 at 11).

The Process: In Ivanhoe Partners, the board's actions undertaken "in good faith after reasonable investigation." 535 A.2d at 1337. By contrast, Interco's board has abdicated its responsibility to management and their advisors and adopted Restructuring without proper consideration. (See Pl. Mem. 24-40).

The Board That Adopted The Restructuring: "[A] majority of Newmont's Board during this critical period were outside, independent directors." 533 A.2d at 607. At no meeting of Interco's board was there a majority of outside, independent directors present to consider the Restructuring. (See Pl. Mem. at 46-47)

III.

THE DEFENDANTS ARE NOT ENTITLED TO THE PROTECTION OF THE BUSINESS JUDGMENT RULE UNDER UNOCAL

A. Defendants Perception of a "Threat" is Flawed By A Gross Lack of Care

Under the first prong of the Unocal analysis, a target board must demonstrate that it had reasonable grounds to perceive that a potential change of control posed a threat justifying a defensive response. Pl. Mem. at 49, 64. To satisfy this burden, defendants must show "good faith and reasonable investigation." Unocal, 493 A.2d at 955.

Recognizing their inability to do so, defendants complain that they are not lawyers or investment bankers and seek to hide behind their supposed "reliance" on the opinions of managements' investment and legal advisers, citing 8 Del. C. § 141(e). This tactic fails because § 141(e) permits only "good faith, not blind, reliance," and requires that the directors be informed as to the "essential provisions" of documents underlying the opinions before reliance is allowed. Smith v. Van Gorkom, Del. Supr. 488 A.2d 858, 875 (1985).*

In Hanson Trust Plc v. ML SCM Acquisition, Inc., 2d Cir., 781 F.2d 264, 275 (1986), the Second Circuit held that directors must do more than obtain the reports:

> Nor is SCM's argument that it was entitled to rely on advice of Wachtell Lipton and Goldman Sachs dispositive of Hanson's claim that the SCM directors failed adequately to inform themselves under the duty of care. In general, directors have some oversight obligations to become reasonably familiar with an opinion, report, or other source of advice before becoming entitled to rely on it.

In Hanson, as in this case, the rejection of competing offers in favor of a management proposal was presented to the director "more or less as a fait accompli." 781 F.2d at 277. As in this case, the board ignored the essential prerequisite to reliance imposed by the duty of care:

> the Board certainly should have subjected [management's] proposal to some substantial analysis. Instead, we view the board as only minimally fulfilling, if not abdicating, its role.

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* In any event, the reliance-on-experts defense otherwise available under section 141(e) does not apply where, as here, the directors conduct must be measured under the intrinsic fairness test. Greene v. Dunhill, Del. Ch., 249 A.2d 427 (1969).

> The proper exercise of due care by a director in informing himself of material information and in overseeing the outside advice on which he might appropriately rely is, of necessity, a precondition to performing his ultimate duty of acting in good faith to protect the best interests of the corporation.

_Id_. at 276.

Defendants mislead by stating that defendants' purposeful refusal to inform themselves as to how much plaintiffs might be willing to offer is excused by case law that suggests there is no duty to negotiate with a hostile would-be acquiror. (Def. Mem. at 50-52) This argument misses the mark entirely. Defendants concede that the only purported basis for perceiving a threat was inadequacy of price. (Saligman Dep. 23, 28-30)* Yet, in reaching this "perception" they intentionally failed to

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* Contrary to defendants' misleading suggestion (Def. Mem. at 52-54), we do not assert that as a matter of law, inadequacy of price alone cannot be a threat justifying a reasonably proportionate defensive response. Our point is that defendants were so grossly uninformed with respect to the City Capital Offer and the purported "value" to be achieved by the Restructuring that they are incapable of meeting their burden under the first prong of _Unocal_ that their perception of a threat was reasonable. Our second point is that a finding of threat based on inadequacy is precluded as a factual matter because even a rudimentary inquiry by defendants into the advice of their experts would have permitted no other finding than that the City Capital Offer and plaintiffs' repeated expressions of willingness to increase that offer, posed no threat based on inadequacy.

determine whether plaintiffs would offer a price that defendants' experts would consider adequate. It is thus no answer that financial experts advised them as to adequacy of the price on the table when plaintiffs expressly stated at every turn that price was negotiable.* No expert could advise defendants what price plaintiffs would be willing to offer. Only plaintiffs could inform defendants of this fact and defendants studiously avoided receiving this information. See Robert M. Bass Group Inc. v. Evans, [Current], Del. Ch., Fed. Sec. L. Rep. (CCH) ¶ 93,924 at 90,198 (July 14, 1988), (citing In re Anderson Clayton Shareholders, Del. Ch., 519 A.2d 669, 697 (1986)).

The absence of any meaningful investigation into the adequacy of plaintiffs' offers, which the record in this case amply reflects, precludes a finding that defendants' perception of threat was reasonable, i.e., was in good faith based on reasonable investigation. Defendants thus fail to meet the first prong of the Unocal analysis and on this basis alone should be denied the protection of the business judgment rule.

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* Indeed, defendants have declined to respond to plaintiffs' recently expressed willingness to consider offering more than $74 per share based on a review of non-public information.

B. The Restructuring and the Refusal to Redeem the Rights Are An Unreasonable Response

1. The Combined Effect of Defendants' Two Part Response

The primary and fatal defect in defendants' arguments on the purported reasonableness of their response to the Cardinal Offer is their utter failure to address the combined effect of their two-part response, the Restructuring and the refusal to redeem the Rights. Part and parcel of the Restructuring's unreasonableness is the fact that defendants' continued refusal to redeem the Rights assures (i) that Interco's stockholders will be forced to accept management's slow-pay combination of paper and cash (which only defendants "value" at $76 per share) and (ii) will be deprived permanently of any opportunity to receive plaintiffs' all-cash, all-shares immediately payable offer of $74 per share. In view of defendants' inability credibly to assert that the Restructuring is superior or even comparable to the Cardinal Offer, their combined, all-preclusive response is patently unreasonable.

Moreover, as a factual matter, Interco's reliance on the supposed financial inadequacy of plaintiffs' offers is misplaced. As the accompanying reply affidavits reflect, the $74 offer is indeed judged as a financially superior offer. No better indicator of the market's perception of values exists than the fact that the trading price of Interco stock continues to hover well below $76 per share.*

In Unocal, the Delaware Supreme Court admonished that a defensive response must be deployed with "balance" and be "reasonable" in relation to the threat posed." 493 A.2d at 955 (emphasis added). Thus, under

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* Defendants argue that plaintiffs cannot fairly rely on the market's swift and enormously negative reaction to their recapitalization as an indication of the recapitalization's value relative to City Capital's immediate all cash $74 offer. (Def. Mem. at 61-63) This argument is meritless. Indeed, the cases cited by defendants do not prohibit the consideration of market changes but instead evidence a disapproval of the use of market price as the sole indicia of a company's value. See e.g., Smith v. Van Gorkom, 488 A.2d at 878 (1985) (market price could not be used as the sole basis for the board's conclusion that the merger price reflected the true value of the Company); Chicago Corp. v. Munds, Del. Ch., 172 A. 452, 455 (1934) ("There are too many accidental circumstances entering into the making of market prices to admit them as sure and exclusive reflectors of fair value.") It ill behooves Interco to urge this Court to disregard market trading prices as indicative of value when it urged Judge Farnan, in opposing City Capital's motion for a preliminary injunction against application of Section 203, that the trading price of Interco Stock, which at the time was higher than $70 per share, reflected the market's perception that the offer was inadequate. See Answering Brief of the Interco Defendants in Opposition to Plaintiffs' Motion for a Preliminary Injunction at 6 (Regan Supp. Aff. Ex. 45)

Unocal and its progeny, a threat perceived based on supposed price inadequacy does not, as defendants try to suggest, mean that anything goes. This is particularly so here, where the purportedly inadequate price offered is (i) within the target banker's pre-tax range of values, (ii) dramatically exceeds the upper range of the target banker's after-tax range of values, (iii) is by its terms subject to another price increase, (iv) is all cash, fully-financed and immediately payable and (v) is so close to ---- indeed, we submit, exceeds the "value" that defendants and their bankers have placed on the Restructuring, that no credible assertion as to the Restructuring's certain superiority can be articulated.*

2. The Defendants' Lack of Care

Defendants' combined response to the City Capital Offer is also defective as the product of defendants' gross breach of their duty of care. The record established that defendants completely failed to penetrate in

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* In Gelco Corp. v. Coniston Partners, D. Minn., 652 F. Supp. 829, 846 (1986), aff'd in part, vacated in part, 8th Cir., 811 F.2d 414 (1987), on which defendants rely elsewhere in their brief, the court observed in language especially appropriate here, "[o]bviously, to the extent the Board rejects a potential acquirer's all-cash offer closer to these ranges, the judgment of the Board becomes suspect". 652 F. Supp. at 846 (emphasis added).

any respect the conclusions proffered by management's hand-picked experts.

Defendants also breached their duty of care by failing to deliberate at all as to the appropriateness of redeeming the Rights with respect to any of the City Capital offers. Defendants' neglect in assessing whether to redeem the Rights is especially troublesome in view of the "plenary negotiating role" which they arrogated unto themselves by adopting the Rights Plan in the first instance. As this Court stated in the Moran decision, which was affirmed by the Delaware Supreme Court, enhanced responsibilities attend the assumption of such power:

> It must be emphasized . . . that the Rights Plan . . . creates the potential for the misuse of directorial authority. Through its power to redeem the rights before a triggering event occurs the [target's board] has assumed a plenary negotiating role. It has also taken upon itself the responsibility for assuring that the rights are not triggered in such a fashion as to inflict harm upon the corporation by rendering it acquisition-proof.

Moran v. Household Int'l., Inc., Del. Ch., 490 A.2d 1059, 1083, aff'd, 500 A.2d 1346 (1985). (emphasis added).*

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* Defendants mistakenly cite the Supreme Court's decision in Household as support for their argument that "no special rules" apply to Rights Plans. This Court's discussion of Household in MacAndrews & Forbes Holdings, Inc. v. Revlon, Inc., Del. Ch., 501

(Footnote continued)

3. The Cases On Which Defendants Rely Are Inapposite

(i) The Restructuring

The cases cited by defendants fail to support their argument that their proposed Restructuring is a reasonable response to the "threat" of City Capital's purportedly inadequate tender offer. None involved facts reflecting the lack of due care and the equivalence of values among competing alternatives present here. Indeed, Interco seeks to distinguish this Court's decision in AC Acquisitions Corp. precisely because it involved board action to preclude shareholders from choosing between two comparable transactions (Def. Mem. at 60). In Ivanhoe v. Newmont Mining Corp., Del. Supr., 535 A.2d 1334, the threat posed by Ivanhoe was far more severe than mere inadequacy of price. The threat consisted of a

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(Footnote * continued from previous page)
A.2d 1239, 1250 (1985), aff'd, Del. Supr., 506 A.2d 173 (1986), squarely rejects defendants' wooden reading of their fiduciary mandate:

> [H]aving adopted the Rights Plan, the Revlon Board reached the plateau of plenary negotiating authority which Household envisioned. The Revlon Board thus assumed a great degree of responsibility by providing a substitute for the marketplace which ordinarily would judge the merits of Pantry Pride's, and any oher potential acquiror's, offer.

coercive, two-tiered partial tender offer for an inadequate price offered by a notorious "greenmailer."

Similarly, defendants' reliance on The Henley Group Inc. v. Sante Fe Southern Pacific Corp., Del. Ch., C.A. No. 9569, Jacobs, V.C. (Mar. 11, 1988) and Edelman v. Phillips Petroleum Co., Del. Ch., C.A. No. 7899, Walsh V.C. (Feb. 12, 1985) (Def. Mem. at 55-56) also misses the mark. In both of these cases, the directors' actions in adopting the recapitalization plans were reviewed under a traditional business judgment rule analysis because the restructurings there at issue were prompted by bona fide business considerations and were instituted in advance of any specific takeover threat. See Henley Group, slip op. at 39; Edelman, slip op. at 9.

(ii) The Poison Pill

A review of the authorities cited by Interco in defense of the continued force of the Rights Plan (Def. Mem. at 67-70) reveals that none of those cases involved a rights plan being used by a board, as it is here, to foreclose shareholder choice and to force upon those shareholders an uncertain and speculative management-led "alternative."* In each of the cases relied upon by Interco, the board's action was upheld precisely because it was undertaken to increase the choices available to shareholders,** rather than preventing those shareholders from making any choice at all by forcing a management-sponsored alternative.***

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* Indeed, such a result would be directly contrary to this Court's decision in AC Acquisitions Corp., wherein a board's attempt "to structure . . . an option [for shareholders] so as to preclude as a practical matter shareholders from accepting" a competing hostile offer was found to be unreasonable under Unocal. 519 A.2d at 113. Moreover, Interco's citation to Buckhorn, Inc. v. Ropak Corp., S.D. Ohio, 656 F. Supp. 209 (1987), is, to say the least, mysterious. In that case, a target's rights plan was permanently enjoined after the court found that it would operate a "a 'showstopper' which ultimately prevents shareholders from obtaining a fair market price for his or her shares." Id. at 203. That same result would obtain here since, without an order from this Court enjoining Interco's rights plan, shareholders will have no choice but to accept the restructuring concocted by Interco's management.

** Similarly, in BNS, Inc. v. Koppers Co., Inc., D. Del., 683 F. Supp. 458 (1988) (Def. Mem. at 68), Judge Schwartz did not enjoin a rights plan because it (i) was being held in place pending the target's board's exploration of a possible recapitalization plan and (ii) did not operate to foreclose shareholder choice, rather it was facilitating such choice. Id. at 475 (citing AC Acquisitions, supra.) The court did note, however, that after the target board took some firm action on such a recapitalization, judicial intervention with respect to the rights plan might be appropriate. Id.

*** Ironically, the courts in some of those cases also noted that the board's actions were justified where
(Footnote continued)

In Mills Acquisition Co. v. MacMillan, Inc., Del. Ch., C.A. No. 10168, Jacobs, V.C. (Oct. 17, 1988) after finding that no "corporate purpose [would be] served by maintaining the rights plan in place, because the auction is over and the two highest bids are now on the table," slip op. at 50, the Court concluded that failure to redeem the rights would "only cause shareholders irreparable harm, since they will be deprived of the opportunity to consider, as an alternative to" a mangement-approved offer, the bid of a competing offeror. Id. (citing Bass Group, supra.) A similar result should apply here.

IV.

DEFENDANTS' BREACHES OF FIDUCIARY DUTY WILL CAUSE IRREPARABLE INJURY TO CITY CAPITAL AND INTERCO'S OTHER SHAREHOLDERS

In an attempt to deny City Capital and Interco's other shareholders any meaningful relief, defendants argue that their failure to redeem the poison pill and

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the market for the target's shares was trading above the tender offer price. Tate & Lyle Plc v. Staley Continental, Inc., Del. Ch., [1987-88] Fed. Sec. L. Rep. (CCH) ¶93,764 at 98,587 (May 9, 1988); see also Nomad Acquisition Corp. v. Damon Corp., Del. Ch., C.A. Nos. 10173, 10189, Hartnett, V.C. (Sept. 20, 1988) (tender offer price was below market price of stock).

their approval of the Restructuring does not constitute irreparable injury. All of defendants' contentions in this regard are without merit and should be rejected.

A. <u>The Poison Pill</u>

Defendants assert that the Interco board's failure to redeem the Rights Plan cannot constitute irreparable harm because City Capital's offer is contingent upon elimination of the Rights Plan as an obstacle to the Offer. (Def. Mem. at 72, 74-75). This fact expressly was recognized by Vice Chancellor Jacobs granting an injunction on a "poison pill removal clause" less than one week ago in <u>Mills Acquisition Co. v. MacMillan, Inc.</u>. The Court found that "keeping the rights in place will only cause the shareholders irreparable harm, since they will be deprived of the opportunity to consider" the alternative offer. Slip. op. at 50. <u>Accord</u> <u>AC Acquisitions</u>, 519 A.2d 103, 116; <u>see</u> <u>also</u> <u>Robert M. Bass Group, Inc. v. Evans</u>, Del. Ch., [Current] Fed. Sec. L. Rep. (CCH) ¶ 93,924 at 90,202 (July 14, 1988) (irreparable harm flows from the fact that "shareholders will lose the opportunity afforded by the $73 cash offer").

These same considerations compel the conclusion here that failure to grant City Capital's motion will cause irreparable harm to all of Interco's shareholders.*

B. The Restructuring

As noted above, the Restructuring will result in a dramatic change in Interco, the wholesale dismemberment of its divisions -- including the sale of its "crown jewel" Ethan Allen -- and the imposition on the company of massive debt, secured by a pledge of all of Interco's remaining assets. When faced with similar "scorched earth" tactics, this Court and others have not hesitated to find that the harm caused by such actions was irreparable.

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* Interco's "fear" that "[i]f the Court forces Interco to redeem the Rights, the stockholders will be left vulnerable to coercive, inadequate offers by plaintiffs or other assets" (Def. Mem. at 79) is makeweight, since an appropriate order could be fashioned declaring the rights inapplicable with respect to plaintiffs $74 offer. Moreover, unlike Newell Co. v. Wm. E. Wright Co., Del. Ch., 500 A.2d 974 (1985) and the other cases cited by Interco at pages 75 of its brief, plaintiffs here challenge the board's decision not to remove an impediment to plaintiffs' offer in favor of protecting an alternate transaction which management seeks to force shareholders to accept. Interestingly, in Newell, this Court noted that the offeror had "not announced any plan for a follow-up merger should its tender offer succeed" (500 A.2d at 984); in contrast, the harm to plaintiffs from the rights plan flows from its stated intention to seek to effect a merger.

For example, in Bass Group, the Court preliminarily enjoined a management-led restructuring, stating: "MacMillan's capital structure will be permanently and irretrievably altered . . . [T]here would be no practical way to 'put Humpty Dumpty back together again' if the restructuring goes forward but is ultimately found to be unlawful." [Current] Fed. Sec. L. Rep. at 90,202. And, in findings equally applicable to the present Restructuring, the Court further noted:

> MacMillan will incur enormous bank debt . . . if the restructuring goes forward. The proceeds of the borrowing will be distributed to shareholders as a dividend and would be irretrievable.[*] Virtually all of the assets of MacMillan will be pledged to secure the Bank debt. There will be no practical way to lift the burden of this debt from the resulting companies if the restructuring is later declared invalid.

Id. See also Tate & Lyle, supra, at ¶98,586 (irreparable harm found through irrevocable funding of "rabbi" trust designed to assure payment of parachutes and other

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* Thus, "[i]t is no answer to argue (as defendants have) that irreparable harm does not exist because the dividend will benefit shareholders. To obtain the benefit of the dividend, [Interco's] public shareholders must give up the opportunity to receive the larger benefit of a control premium, under circumstances that would make the transaction impossible to rectify." Bass Group, [Current] Fed. Sec. L. Rep. at 90,202; see also Revlon, 506 A.2d at 184-85.

change-of-control benefits); Black & Decker Corp. v. American Standard, Inc., D. Del., 682 F. Supp. 772, 787-88 (1988).

C. The Alleged Uncertainty of City Capital's Offer.

Defendants go to great lengths to convince this Court that City Capital's Offer is "highly uncertain." (Def. Mem. at 76). However, those arguments are wrong as a matter of fact and law. In the first place, prior to the filing of defendants' brief, the Court of Appeals for the Third Circuit lifted its temporary injunction pending appeal and affirmed Judge Farnan's denial of Interco's request to enjoin City Capital's Offer. See Supp. Regan Aff. Ex 54. Thus, defendants' arguments regarding this matter are moot. (Def. Mem. at 76-77).

Additionally, the fact that City Capital's Offer is also contingent on receiving a tender of 75% of Interco's outstanding shares cannot provide the basis for denying it the relief it seeks here. In RP Acquisition Corp. v. Staley Continental, Inc., D. Del., 686 F. Supp. 476 (1988), Judge Roth rejected defendant's argument that no irreparable injury was threatened because "various other conditions . . . placed upon the closing of [the] tender offer" had not yet been fulfilled. Id. at 478.* The district court stated, however, that it would reach the merits of the plaintiff's claim "[d]ue to the proximity of the takedown date and our inability at this time to determine whether the [other] conditions will prevent the threat of irreparable harm even if we do not issue a preliminary injunction." Id. That same result should obtain here.**

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* See also Revlon, 506 A.2d at 185 ("Given the complexity of the proposed transaction . . . the obstacles to [plaintiff] obtaining a meaningful legal remedy are immense. We are satisfied that the plaintiff has shown a need for an injunction plan to be protect it from irreparable harm").

** Interco's tag-along argument that plaintiffs have an adequate remedy at law because they intend to liquidate "a substantial part of the company" (Def. Mem. at 77) is misplaced. Unlike Gelco Corp. v. Coniston Partners, D. Minn., 652 F. Supp. 829 (1986), aff'd. in part, vacated in part, 8th Cir., 811 F.2d 414 (1987), where the bidders intended to liquidate the entire company, plaintiffs seek to acquire and operate major portions of Interco's businesses. (See, e.g., Rales Aff. ¶ 4)

CONCLUSION

For all of the foregoing reasons, and the reasons stated in plaintiffs' opening brief, the motion for a preliminary injunction should be granted.

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CERTIFICATE OF SERVICE

I, Paul L. Regan, certify that on October 24, 1988, I caused true and correct copies of Plaintiffs' Reply Memorandum In Support of Their Motion for a Preliminary Injunction and supporting affidavits to be served by hand on:

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