

IN THE SUPREME COURT OF THE STATE OF DELAWARE

JOHN A. MORAN and THE DYSON-
KISSNER-MORAN CORPORATION,

Plaintiff Below,
Appellants,

GRETLL GOLTER, individually and in
a derivative capacity,

Plaintiff Intervenor,
Below, Appellant,

-vs-

HOUSEHOLD INTERNATIONAL, INC.,
a Delaware corporation, DONALD
C. CLARK, THOMAS D. FLYNN, MARY
JOHNSON HEAD, WILLIAM D. HENDRY,
JOSEPH W. JAMES, MITCHELL P.
KARTALIA, GORDON P. OSLER,
ARTHUR E. RASMUSSEN, GEORGE W.
RAUCH, JAMES M. TAIT, MILLER
UPTON, BERNARD F. BRENNAN and
GARY G. DILLON,

Defendants Below,
Appellees.

No. 47, 1985

APPEAL FROM AN ORDER
ENTERED BY THE COURT OF
CHANCERY OF THE STATE OF
DELAWARE IN AND FOR NEW
CASTLE COUNTY ON JANUARY
29, 1985, IN CIVIL ACTION
NO. 7730

REPLY BRIEF OF PLAINTIFF INTERVENOR BELOW,
APPELLANT GRETLL GOLTER

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INTRODUCTION

If failure to respond concedes an argument, defendants¹ lose this case out of hand. They have simply ignored many of intervenor's principal arguments. Those arguments are carefully set forth in intervenor's opening brief and will not be repeated here. Intervenor will limit this brief to commenting on some of the more egregious fallacies and oversights of defendants' answering brief.

ARGUMENT

- I. The Trial Court Correctly Found that the Poison Pill Eliminates the Possibility of an Unfriendly Tender Offer for Household.

Perhaps the most remarkable feature of defendants' brief is its carefree disregard of the fact that this case is now in an appellate posture. Defendants attempt to retry the facts by culling out of the thousands of pages of trial transcript those items of testimony which they feel support their position. They barely acknowledge that the case was decided by a trial judge who made detailed findings of fact in reaching his opinion.

1. Defendants Below-Appellees are referred to as "defendants". Plaintiff Intervenor Below-Appellant is referred to as "intervenor". Intervenor's Opening Brief is referred to as "OB" and Defendants' Answering Brief is referred to as "DAB".

It is easy to understand why defendants have chosen to disregard the trial court's opinion. Vice Chancellor Walsh, although he eventually ruled for defendants, did so on the basis of factfindings that compel the conclusion that the Poison Pill is illegal and beyond the authority of the directors to adopt.

The first, and crucial, factfinding which defendants attempt to reargue before this Court concerns the impact of the Poison Pill on the possibility of an unfriendly offer for Household. Defendants repeatedly suggest that the Poison Pill does not seriously impair the prospects of an unfriendly tender offer. But that assertion is flatly contradicted by the trial court's express factual finding to the contrary. Vice Chancellor Walsh concluded that the Poison Pill "will virtually eliminate hostile two-tier offers for Household". Slip op. at 40-41 (emphasis added).

The trial court's express and unambiguous finding is conclusive in this Court unless clearly erroneous. Science Accessories v. Summagraphics, Del. Supr., 425 A.2d 957, 966 (1980); Marta v. Nepa, Del. Supr., 385 A.2d 727, 729 (1978); Levitt v. Bonvier, Del. Supr., 287 A.2d 671 (1972).² The trial court's finding was not clearly erroneous, and indeed was supported by the clear weight of the evidence. Plaintiff and

2. Defendants' assertion that their evidence "outweighed" plaintiffs' evidence, DAB 4, is both false and irrelevant. It is false because the clear weight of the evidence supported the conclusion that the Poison Pill precludes unfriendly takeovers. It is irrelevant because the issue, for purposes of this appeal, is not whether defendants' evidence outweighed plaintiffs' evidence, but whether the trial court's findings were clearly erroneous.

intervenor introduced a wealth of testimony that the Poison Pill precludes unfriendly takeovers of Household. Two of the nation's leading finance economists so testified, as did the head of one of the country's largest investment banks. Jensen IV, 133; Bradley V, 98-106; Greenberg IV, 71-75.³

II. The Trial Court Correctly Found that the Poison Pill Represents a "Fundamental Transfer of Power" from Shareholders to Directors.

Defendants also assert that the Poison Pill does not involve any radical changes to Household's business or financial structure. DAB 4. Once again, this contention overlooks the trial court's express factual findings to the contrary. Vice Chancellor Walsh concluded, after hearing all the evidence in the case, that the Poison Pill involves a "clash of fundamental interests within the corporate structure," slip op. at 30, resulting in a "fundamental transfer of power" from shareholders to directors. Id. at 36 (emphasis added). Defendants do not contend that this finding is plainly erroneous; indeed, it is compelled by the facts of record. The Poison Pill deprives shareholders of the power to decide whether to tender their

3. Defendants' attempt to denigrate the scholarship in this area as mere "speculat[ion]", DAB 4, is not surprising given the virtually unanimous opinion of academic economists that tender offers benefit shareholders. See Plaintiff-Intervenor's Opening Brief at 36-38. Defendants apparently failed to uncover even a single nationally-recognized finance economist willing to testify on behalf of their position. Moreover, contrary to defendants' implication, plaintiffs introduced a wealth of "real-world" testimony as well. Few people have had more practical experience in the world of corporate mergers and acquisitions than Alan Greenberg, the Chief Executive Officer of Bear, Sterns & Co., who testified strongly on plaintiffs' behalf.

shares in a tender offer and vests that power in Household's management. Defendants' attempt to relitigate this factual issue is entitled to no consideration from this Court. Their arguments must fail.

III. Having Correctly Found that the Poison Pill Precludes Unfriendly Tender Offers and Represents a Fundamental Transfer of Power from Shareholders to Directors, the Trial Court Erred as a Matter of Law in Applying the Business Judgment Rule to Sustain the Poison Pill.

Unlike defendants, intervenor accepts these basic findings by the trial court -- that the Poison Pill precludes unfriendly tender offers and that it represents a fundamental transfer of power from shareholders to directors. Where intervenor differs from the trial court is in its legal conclusion that the business judgment rule shields the Poison Pill from legal challenge.⁴

As intervenor demonstrates at length in her opening brief, OB at 10-18, the business judgment rule is inapplicable because the Poison Pill is simply outside the scope of the director's powers. It represents a unilateral alteration by the directors of the rights shareholders acquired when they purchased their shares.⁵

4. This Court, of course, reviews the trial court's legal conclusions -- as opposed to its factual findings -- de novo.

5. Defendants claim to deny each and every one of plaintiff's arguments. DAB 3. However, defendants nowhere expressly respond to the argument that the Poison Pill violates the fundamental compact between shareholders and the corporation, even though it is one of plaintiff's principal contentions. Plaintiff can only speculate that defendants had no good answer.

Even if the business judgment rule applies, the trial court should have used its own business judgment in evaluating the propriety of Poison Pill. As in Zapata v. Maldonado, Del. Supr., 430 A.2d 779 (1981), the directors' personal interest in the matter requires, at a minimum, that the court not defer absolutely to the directors' self-serving rationalizations, but instead apply its independent business judgment to the facts of record.⁶

IV. The Poison Pill is Not Justifiable as a Means of Countering the Alleged "Coercive" Effects of Two-Tier Offers.

The trial court sustained the Poison Pill under the business judgment rule on the sole ground that it is a justifiable means of countering the "coercive" effects of two-tier offers. Slip op. at 43. Defendants attempt to bolster this finding with a plethora of supposed reasons why two-tier offers "coerce" shareholders into tendering. None of these arguments has merit. The trial court's finding is clearly erroneous and should be corrected by this Court.

A. As Demonstrated by the SEC's Decision to File an Amicus Brief on Intervenor's Behalf, the Trial Court's Reliance on the Disavowed Report of the SEC Advisory Committee Was Wholly Misplaced.

6. Plaintiff also made this argument in her opening brief, OB 34-35. Again defendants apparently could think of no good response.

As documented in intervenor's opening brief, the trial court's finding was wholly based on a single reference, without page citation, to an SEC advisory committee report. Yet the Vice Chancellor overlooked the fact that the advisory committee report has been repudiated by the Chief Economist of the SEC and by the SEC itself. See OB 44-48. Far from supporting the Poison Pill, the SEC has vigorously opposed it as contrary to the best interests of shareholders and of the economy as a whole.

As this Court is well aware, the SEC is so strongly opposed to the Poison Pill that it has filed an amicus brief demonstrating how the device harms the interests of shareholders and the economy. In so doing, the SEC departed from its tradition of many years' standing not to file briefs on matters of state law.

The SEC is the agency charged with protecting the interests of investors and the integrity of the nation's securities markets. It has many years of expertise in the area of securities regulation. It has a staff of highly trained economists who have studied corporate control transactions in the greatest depth. Its analysis and recommendations are entitled to substantial deference in this or any court.⁷

7. Defendants make the bizarre assertion that the SEC's decision to file its amicus brief is somehow a reason to sustain the Poison Pill. DAB at 5. Defendants seem to claim that the SEC's brief is not entitled to deference because two commissioners dissented from the decision to file it. Presumably they would also assert that a decision of this Court is not entitled to respect if two of its five Justices dissented.

Defendants' hostility to the SEC is entirely selective. They still rely -- albeit with lessened enthusiasm -- on the disavowed SEC advisory committee report. DAB at 8. Apparently defendants think that an advisory committee is more reliable than (note cont. next pg.)

Additional weight should be given to the decision of the Investment Company Institute to file an amicus brief challenging the Poison Pill. The Investment Company Institute is probably best suited of any organization in the country to speak on behalf of shareholders. It represents over 1,000 mutual funds with total assets of \$345 billion. This organization has no vested interest in the case, no previous connection with Household, and no reason to provide its views as a friend of the Court other than its strong belief that the Poison Pill and similar devices seriously hurt the interests of the nation's shareholders.

B. The Poison Pill Cannot Be Justified as a Means of Countering any "Prisoner's Dilemma".

Defendants argue that two-tier offers harm shareholders because they create a "prisoner's dilemma". According to defendants, all shareholders will rush to tender in fear of being frozen out at a lower price in the second stage of the acquisition. Thus, according to defendants, shareholders will not be able to demand an "adequate" price from the acquiring firm.

This argument ignores elementary differences between the classic prisoner's dilemma and the two-tier offer. The former is called the prisoner's dilemma specifically because the participants

the full Securities and Exchange Commission. And defendants are apparently not deterred by the fact that the advisory committee report was accompanied by strong dissenting opinions from several of the committee's members. Defendants' view appears to be that if a precedent favors them, the majority opinion controls, but if the precedent is against them it is the dissenting opinion that governs.

face a choice of evils. Each prisoner would prefer to remain at large rather than be captured and faced with the choice whether to confess or not. Defendants argue, by analogy, that shareholders would prefer to have no two-tier offer at all rather than be faced with the choice of tendering or being frozen out at a lower price.

This analogy is flawed. Prisoners face a choice between evils, but shareholders in a two-tier offer face a choice between goods. No shareholder is harmed by a two-tier offer and most are benefited. Those who tender earn a substantial premium over market. Those who do not tender usually earn some kind of a premium over the pre-offer market price. And in no circumstances can those who do not tender be frozen out with compensation that is below the fair value of their stock. The corporate law of this State prevents such a result by requiring that the compensation in the freeze-out phase be fair to minority shareholders. Weinberger v. UOP, Del. Supr., 457 A.2d 701, 703 (1983).

Because two-tier offers give shareholders a choice between goods, any rational shareholder would prefer to have the option to tender. But the Poison Pill deprives shareholders of that choice. As the trial court correctly found, the device eliminates any realistic possibility that an unfriendly offer will ever be made for Household. The Poison Pill will hurt shareholders, not help them.⁸

8. With breathtaking inconsistency, defendants overlook the fact that if the prisoner's dilemma is a problem, the Poison Pill is a cure far worse than the disease. The Poison Pill makes it much more desirable for shareholders to hold out and not tender than to tender. If they tender in an unfriendly tender offer, they receive some premium over market; but if they hold out they receive a huge \$100 per share premium from the acquiring (note cont. next pg.)

Moreover, there are other well-known and less destructive means for ensuring that the compensation offered in a two-tier offer is adequate. The most obvious such means is the auction that inevitably develops when a potential acquiror makes an unfriendly tender offer. The target company, in resisting the offer, is likely to seek a "White Knight" to make a competing offer. And other companies often choose to make competing offers even if not solicited by the target's management.⁹ The consequence is that an auction develops in which, if the initial tender offer price is inadequate, other bidders appear to drive the offer price up. Shareholders are much more likely to be served by this marketplace protection than by a device which places the power of life or death over a tender offer in the hands of managers who have a strong vested interest in defeating the offer.

If additional protections are needed, the fairest and simplest solution is a "fair price" provision. A fair price provision simply requires the offeror to pay the same price at the freeze-out stage as in the initial offer. If Household had adopted such a provision it could have completely prevented the alleged danger that shareholders would rush to tender in the front end in order to avoid being squeezed out at the back end at a lower price.

It is not as if defendants were unaware of the availability of

company. Shareholders are far more effectively coerced not to tender under the Poison Pill than they have ever been coerced to tender under a two-tier offer.

9. Indeed, the Poison Pill was a direct response to Clark's fear that Moran's proposal for a leveraged buy-out would spark a bidding war in which some unrelated company would make a higher bid and acquire the company.

a "fair price" provision. Indeed, a fair price provision was actively considered as a means of deterring hostile takeovers. But such a provision would have required a shareholder vote, and management determined not to proceed because it felt the proposal might be defeated. Slip op. at 3. It was only after rejecting the fair price option because of the danger of shareholder disapproval that defendants turned to the extreme and destructive Poison Pill idea, which is specifically structured to avoid the need for shareholder ratification.

Because other less destructive means were readily available to remedy the alleged problems of two-tier offers, the Poison Pill cannot be justified on the ground that it was necessary to counteract any "coercive" effect of such offers.¹⁰

10. Intervenor made this argument in her opening brief, OB 41-43. Defendants failed to offer any explanation why a fair price provision would not have been fully sufficient to counter the supposed "coercion" of two-tier offers.

CONCLUSION

For the reasons stated herein and in intervenor's opening brief, this Court should reverse the judgment of the trial court and declare the Poison Pill to be illegal and of no force and effect.

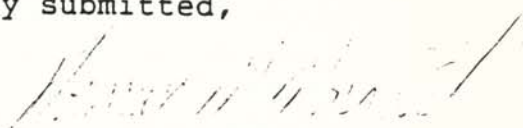
Respectfully submitted,

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