SUPREME COURT OF THE
STATE OF DELAWARE

No. 37, 1985

JOHN A. MORAN, *et al.*,

Plaintiffs-Appellants,

v.

HOUSEHOLD INTERNATIONAL, INC., *et al.*,

Defendants-Appellees.

On Appeal from the Court of Chancery of the
State of Delaware in and for New Castle County

BRIEF OF THE SECURITIES AND EXCHANGE COMMISSION, AMICUS CURIAE

JOSEPH J. FARNAN, JR.
United States Attorney
BY: SUE L. ROBINSON
Assistant United States Attorney

DANIEL L. GOELZER
General Counsel

JACOB H. STILLMAN
Associate General Counsel

ERIC SUMMERGRAD
Special Counsel

GERARD S. CITERA
Attorney

Securities and Exchange Commission
Washington, D.C. 20549

Of Counsel
PAUL GONSON
Solicitor

March 19, 1985

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Page

CASES:

STATUTES:

Securities Act of 1933, 15 U.S.C. 77a et seq.:

COMMISSION RELEASES:

Page

LEGISLATIVE MATERIALS:

MISCELLANEOUS:

SUPREME COURT OF THE
STATE OF DELAWARE

No. 37, 1985

JOHN A. MORAN, et al.,

Plaintiffs-Appellants,

v.

HOUSEHOLD INTERNATIONAL, INC., et al.,

Defendants-Appellees.

On Appeal from the Court of Chancery of the
State of Delaware in and for New Castle County

BRIEF OF THE SECURITIES AND EXCHANGE COMMISSION, AMICUS CURIAE

INTEREST OF THE SECURITIES AND EXCHANGE COMMISSION AND PRELIMINARY STATEMENT

The Securities and Exchange Commission, the agency principally responsible for the administration and enforcement of the federal securities laws, including federal law regulating tender offers, submits this brief as amicus curiae. Although the Commission does not argue that this case directly involves application of the federal securities laws, the case does involve securities activities regulated by those laws. As a result of its experience in drafting, administering, and enforcing those laws, the Commission has formulated views that are relevant, and which the Court may find helpful, in the resolution of this important case.

The issue before this Court is the validity of action taken by the board of directors of defendant Household International, Inc. in adopting what may be the most potent defense yet devised to tender offers, a "poison pill" plan that will, in our view, virtually eliminate hostile tender offers for Household, or for any other company that adopts it. The plan will also deter proxy contests by persons seeking to oust Household's management. The effect of the plan thus will be to entrench management, and usurp to Household's board the shareholders' right to determine who will manage the company. The Chancery Court below held that adoption of this plan by Household, solely by vote of its board of directors and without shareholder approval, was in the shareholders' interests, and thus was a reasonable exercise of the Household board's business judgment.

The Commission's interest in this case arises out of its legislative, administrative and litigation activities with respect to tender offers over the past twenty years. The Commission played a central role in the drafting and adoption of the Williams Act, the principal federal statute regulating tender offers, and administers that statute. The Commission has promulgated rules governing the conduct of tender offers under the Williams Act, has litigated numerous aspects of federal tender offer regulation, and has advised Congress on the need for additional federal law in this area. In addition, the Commission has conducted studies on the effects of tender offers and defenses to such offers.

The Commission's consistent view, and the view of Congress in adopting the Williams Act and of the courts in applying it, has been that it is in the interest of shareholders to be able to consider tender offers on their merits. Congress structured the Williams Act so as to maintain a balance between bidders and management, allow both sides to present their case to the shareholders, and leave it to the shareholders to decide whether to accept or reject the offer. The Commission has, through years of administration and enforcement under the Williams Act and extensive study of tender offers, adhered to this principle.

Based on our experience in this area, it is our view that the Household plan would deprive shareholders of an opportunity to consider virtually all hostile tender offers, would also have a significant deterrent effect on proxy contests against management, would thereby entrench management against efforts to oust it, and thus is not in the shareholders' interests.

We do not, in fact, read the Chancery Court's decision as holding that a plan with this broad effect in blocking virtually all hostile tender offers, and in deterring proxy contests, is in the shareholders' interests or is justified. Rather, the defendants argued below that the Household plan is justified because its only effect is to prevent shareholder consideration of certain types of tender offers they contended are "coercive." The Chancery Court held that the plan was justified because its effect is limited to such offers. Had the Chancery Court not reached this mistaken conclusion, it might well have held that the plan is not in the shareholders' interests. We do not believe that the plan has the limited effect ascribed to it by the Chancery Court, or that it is in the shareholders' interests, and we urge that the decision of the court below be reversed. 1/

1/ In addition to the business judgment rule issue, this case also raises a number of other issues. The Commission expresses no views on those issues.

STATEMENT OF THE CASE

This is an appeal by the plaintiffs from a judgment of the Court of Chancery of the State of Delaware in and for New Castle County denying, after trial, plaintiffs' challenge to the validity of a preferred stock rights dividend plan (the "Rights Plan") adopted by the board of directors of Household International, Inc. ("Household") without shareholder consideration. In sustaining the Rights Plan, the Chancery Court held, inter alia, that adoption of the plan was reasonable under the Delaware business judgment rule.

A. Facts 2/

Household is a diversified holding company incorporated in Delaware. Its principal subsidiaries are engaged in financial services, transportation and merchandising, and include a finance company, a car rental company, and a grocery chain (Op. 2). 3/ Household has acquired this conglomerate status as "the result of a series of acquisitions in recent years" (id.).

In February 1984, Household's management became concerned about the company's vulnerability as a takeover target and began considering various charter amendments which would render a takeover more difficult (Op. 3). It asked a leading proxy consultant to determine the likelihood of shareholder approval of one possible charter amendment, a so-called fair price amendment

---

2/ The Commission expresses no view as to the underlying facts concerning the events leading to the issuance of the rights, or the structure of the Rights Plan, and relies, to that extent, on the facts as found by the Chancery Court.

3/ References to the Slip Opinion of the Chancery Court are Op. —; references to testimony in the record are cited by witness name, transcript volume number, and page number, as in, for example, Clark VI 75; references to plaintiffs' exhibits are PX —, and to defendants' exhibits are DX —.

(id.). 4/ When the consultant reported that such an amendment would "barely" obtain shareholder approval, management dropped any immediate plans to seek shareholder approval of defensive charter amendments (id.).

Management's concern over a takeover subsequently increased when one of its directors, plaintiff John Moran, had his company, plaintiff Dyson-Kissner-Moran Corporation ("DKM"), perform financial studies that showed that Household's stock was "significantly undervalued in relation to" what could be obtained if the conglomerate were broken up and some of its constituent companies sold off (Op. 3). Moran spoke with Household's chairman, defendant Donald Clark, and its chief financial officer about the possibility of a friendly buy-out by Moran and his company (id. 3-4). This proposal, however, "never got beyond the discussion stage" (id. 4), and "there is no indication that Moran ever intended a hostile takeover of Household" (id. 5).

This management concern over a tender offer was also apparently intensified by a letter Clark received on May 14, 1984, from a representative of the Murchison Group, a Dallas-based investment group, requesting a meeting to discuss a matter of "mutual interest" (Op. 4). Clark refused to meet, and the matter apparently was not pursued further (id.).

Household's management sought advice on defenses against tender offers from a law firm and an investment banking firm. Those two firms prepared a possible defensive strategy to be presented to the Household board on August

---

4/ A fair price amendment is, generally, a charter amendment that requires a tender offeror, in any subsequent acquisition of shares (such as in a merger), to pay for those shares at least as much as the highest price paid in the tender offer. See R. Winter, M. Stumpf & G. Hawkins, Shark Repellants and Golden Parachutes 44-45 (1983).

14, 1984. Among the proposed defensive tactics was the Rights Plan. On August 7, a three-page summary of the plan was sent to Household's directors (Op. 5-6).

At the board meeting on August 14, following a presentation of the plan and a brief discussion of its merits, a majority of the board approved the plan (Op. 6,9). Plaintiff Moran, who during the discussion voiced vigorous opposition to the plan, voted against it, as did one other director (id. 9-10).

The Rights Plan is one variation of a new takeover defense referred to colloquially as "poison pills." In essence, a "poison pill" is a stock, a warrant, or a right that is issued to a target company's shareholders. The "poison pill" generally only becomes activated in the event of a tender offer, the acquisition of a specified block of stock by an investor or group of investors, or the formation of a group of investors holding a specified block of stock (such as a group formed to fight a proxy contest). Once activated, the poison pill, for reasons that vary according to the precise plan, makes the target company a far less attractive takeover candidate.

The Household Rights Plan is an unusually potent poison pill scheme. The plan involves the issuance of stock rights -- on their face rights to purchase \$100 worth of Household preferred stock -- to Household's common stockholders (Op. 7). These rights were, when issued, not separable from the common stock and not exercisable (id. 8).

The Plan provides, however, that the rights will detach from the common stock and become exercisable if anyone (a) makes a tender offer for at least 30% of Household's stock, (b) obtains 20% of Household's stock, (c) acquires the right to purchase or to vote 20% of the stock; or (d) forms a group holding 20% for the purpose of acting together (Op. 8).

Even then, however, the rights would not be exercised, since the $100 exercise price for the preferred stock is conceded to be at present very much an "out of the money" price (Op. 7).

The rights are of consequence in one event. If a merger is effected in which Household is absorbed by an acquiror, such as in a merger following a tender offer, the rights will "flip-over" so that the holders will be able to purchase, for $100 per right, $200 worth of the acquiring company's stock (Op. 8). In effect, the acquiring company will have to pay a net of $100 worth of stock for each right held by Household's shareholders. As the Chancery Court found, "[t]he resultant dilution of the acquiror's capital is immediate and devastating" (id.). This dilution effect, which is not common to all poison pill plans, 5/ means that were all of the rights issued by Household exercised, the acquiror would be forced to pay an extra $6 billion for

---

5/ There are other poison pill plans which provide the target's shareholders with stock which may, in the event of a takeover, be redeemed at a price equal to "the highest price per share paid for the target's shares in the year the acquiring entity gained control." Note, Protecting Shareholders Against Partial and Two-Tiered Takeovers: The "Poison Pill" Preferred, 97 Harv. L. Rev. 1964, 1965 (1984). These plans do not require bidders to pay enormous and prohibitive premiums for a target, as the Rights Plan does; they act like "fair price" amendments (see n.4 supra) by requiring a bidder to pay the same price to all shareholders — thus deterring those bidders who seek to save money by offering a high premium for less than all of the stock. See id. at 1967; Finkelstein, Antitakeover Protection Against Two-Tier and Partial Tender Offers: The Validity of Fair Price, Mandatory Bid, and Flip-Over Provisions Under Delaware Law, 11 Sec. Reg. L.J. 291, 300 (1984).

the company, which at the time the plan was adopted had a market value of approximately $1.8 billion 6/.

This "flip-over" will, however, only occur, as a practical matter, if the acquisition is a hostile one not approved by management. Since the rights may be redeemed by the Household board for the relatively nominal amount of fifty cents each at any time before one of the 20% triggering events noted above occurs, the board can remove the "poisonous" effect of the plan for any take-over of which it approves (Op. 9). Thus, the plan forces any tender offeror contemplating a merger with Household (which, as discussed below, includes virtually all tender offerors) to first seek and obtain board approval. As Clark, Household's chairman, explained in a letter sent to shareholders on the day the plan was adopted: "[t]he rights will not prevent a takeover of Household International, but should deter any attempt to acquire your company in a manner or on terms not approved by the Board" (PX 211, at 2) (emphasis added).

B. Proceedings in the Court of Chancery

Plaintiffs Moran and DKM filed a complaint in the Court of Chancery on August 17, 1984, seeking to invalidate the Rights Plan and to permanently enjoin Household from pursuing it in the future. 7/ Plaintiffs argued, among other things, that issuance of the stock rights was beyond the power of the

---

6/ Household had approximately 60,000,000 shares of common stock outstanding, which were trading at a price of around $30 per share. Household issued 60,000,000 rights, one per share of common, each costing an acquiror a net of $100 in payment to the right holder following a "flip-over."

7/ Plaintiff Gretl Golter, holder of 500 shares of Household, was subsequently permitted to intervene as a plaintiff (Op. 1).

board of directors, as it was designed to entrench the board and management against changes of control. They also argued that the plan improperly altered fundamental shareholder rights by depriving shareholders of the ability to receive and consider hostile tender offers and by severely limiting the ability of shareholders to engage in proxy contests. The effect on proxy contests, the plaintiffs charged, would result from the fact that the rights would become exerciseable and non-redeemable in the event a group controlling 20% of Household's stock were formed, or in the event any person acquired the "right to vote" 20% or more of the stock. By deterring formation of groups controlling 20% or more of the stock, they argued, the likelihood of insurgent success in proxy contests would be greatly diminished. Furthermore, by making the rights non-redeemable when anyone acquires the right to vote 20% or more of the stock, they argued, proxy contests would be eliminated, since any successful proxy contest would involve acquisition of the right to vote, through proxies, more than 20% of the stock.

Defendants, for their part, claimed that the issuance of the stock rights was protected by the Delaware business judgment rule as a reasoned and deliberate approach to deter harm to the corporation and its shareholders from abuses which they claimed are common in corporate takeover battles.

On January 29, 1985, after a nine-day trial, the Court of Chancery entered judgment for the defendants, upholding the validity of the Rights Plan on the ground that the Board acted within its authority in adopting the plan (Op. 40-41). The court held that under the Delaware business judgment rule, because the Rights Plan would "result[] in a fundamental transfer of power" (id. 36) from the shareholders to the directors with respect to who will be the "prime negotiator" of certain tender offers, the burden was on Household and its directors to go forward with evidence to establish the reasonableness of the plan (although they would not bear the burden of persuasion on this issue). The court found that the defendants met this burden. It said that the board had adopted the plan in order to deter two-tier tender offers, in which the offeror proposes to buy part of the target company's stock for cash, and then follows the offer with a merger to acquire the remaining shares. Although the court found that because of the "devastating" dilution effect of the "flip-over" provisions of the rights in the second-step merger, the Rights Plan will "virtually eliminate hostile two-tier offers for Household," it held that this was reasonable since "the coercive nature of such tender offers * * * is well documented" (id. 43). The Court also held that any deterrence of proxy contests resulting from the effect of formation of a 20% group would be limited and "highly conjectural", since persons with less than a 20% interest in a company can be successful in waging proxy contests. This limited deterrent effect, the court held, had a rational purpose in preventing persons from making hostile two-tier tender offers (by deterring them from waging a proxy contest to redeem the rights), and thus was valid (id. 49).

ARGUMENT

THE RIGHTS PLAN, BY PREVENTING SHAREHOLDER CONSIDERATION OF VIRTUALLY ALL HOSTILE TENDER OFFERS, AND BY DETERRING PROXY CONTESTS AGAINST MANAGEMENT, DOES NOT SERVE THE SHAREHOLDERS' INTERESTS.

The Chancery Court held that in order to have the Rights Plan sustained, the Household board would have to show some evidence that "its approval of the plan was not motivated primarily by a desire to retain control but by a reasonable belief that the plan was necessary to protect the corporation from a perceived threat to corporate policy and effectiveness" (Op. 36-37). The court concluded that the plan serves a reasonable corporate purpose because it protects shareholders from "coercive" hostile two-tier tender offers, which it found contrary to the best interests of the shareholders (id. 39, 43). 8/ The plan was never submitted to the shareholders for their consideration of this proposition. 9/ The court found that while the Plan would restrict a shareholder's ability to receive tender offers, that effect would be limited since the Plan's "impact is upon * * * only such a prospective purchaser who wishes

---

8/ The Chancery Court used the pejorative term "coercive" because of its view that two-tier offers put extreme pressure on shareholders to tender, since shareholders realize that if they do not tender, they will almost certainly (although not necessarily) be offered less in a second-stage merger. The same holds true for partial offers, where the offeror tenders for part of the company's shares, and the non-tendering shareholders will be left in a minority position, perhaps with a thin or nonexistent trading market.

However, to a degree, all tender offers are "coercive" to the extent that they afford shareholders the opportunity to accept or reject substantial premiums within a specified time period. Thus, pressure always exists on the shareholder to take the premium. Indeed pressure to tender is the hallmark of a tender offer. The term "tender offer" is not defined in the Williams Act or in Commission rules. Rather its definition has been left to case by case development, and the chief criterion is pressure on shareholders. See, e.g., Panter v. Marshall Field & Co., 646 F.2d 271, 285 (7th Cir.), cert. denied, 454 U.S. 1092 (1982); Crane Co. v. Harsco Corp., 511 F. Supp. 294, 302 (D. Del. 1981).

9/ As noted, the board had determined, after seeking expert advice, that a fair price amendment, which is a far less potent takeover defense, but which would block two-tier offers, would "barely" obtain shareholder approval. Numerous shareholders or their investment advisers have strongly objected to the Rights Plan (see PX 251, 252, 253, 254, 257, 260, 312).

to pursue a hostile two-tier offer" (id. 44). 10/ The court also said that the plan would only have an "incidental consequence of limiting the proxy activity of those opposed to the Board's present policies" (id. 49).

The Chancery Court's decision seriously understates the impact of this plan. In fact, as we discuss below, the Rights Plan will deter not only two-tier offers, but virtually all hostile tender offers. It will also greatly diminish proxy contests by persons opposed to management. It is our view that the Household plan, by preventing shareholders from considering virtually all tender offers, unless the board of directors has first approved any such offer, by deterring proxy contests, and by thereby entrenching Household's management against efforts to oust it, is not in the shareholders' interests. The defen-

---

10/ The defendants offered two other major rationales for the plan, neither of which was cited by the court below as justification for the plan. First, they argued that Household was vulnerable to a takeover by a highly leveraged acquiror, which would then sell off parts of the company at "distress" prices to pay off its debt (Def. Post-Trial Br. at 10-12, 15-16). But while Household was apparently vulnerable to a "bust-up" by an acquiror, that does not necessarily imply the liquidation at distress prices that defendants suggest. It could mean that this conglomerate was inefficient, and that its constituent parts, if sold or spun-off at a fair market price, could be operated more efficiently and profitably (see Jensen V 64-66). Since, as noted above, Household was not facing any actual hostile offer, this general concern that some heavily leveraged buyer might conduct such a distress sale (a concern that is shared by any potential target) could not justify deterring all hostile offers.

Second, defendants argued that the plan would give Household's shareholders an equity interest in any merged entity (Def. Post-Trial Br. at 62). That does not explain, however, why the plan not only gives shareholders the right to buy stock in the merged entity, but gives them the right to make a $100 per right profit while doing so. In fact, this profit would assure that no acquiror would allow the "flip-over" to take place, and would assure that Household's shareholders would not obtain an equity interest in the merged entity.

dants, in fact, did not argue below that such a broad effect on tender offers or proxy contests would be beneficial to the shareholders. Nor did the court so hold. The defendants argued, rather, and the court below found, that the deterrent effect of the plan would be far more limited, and that this limited effect justified the plan as being in the shareholders' interests (see, e.g., Def. Post-Trial Br. at 52-53, 62-63). Had the Chancery Court not misperceived the effect of the Rights Plan on the shareholders' ability to receive hostile tender offers and engage in proxy contests, it might well have concluded that the plan is not in the shareholders' interests, and thus is not justified.

A. It Is In the Shareholders' Interests to Be Able to Consider Hostile Tender Offers.

Our view as to the interests of shareholders, and as to the effect of the Rights Plan on those interests, is based on the Commission's experience in regulating tender offers at the federal level. The Commission has responsibility for administering the Williams Act in connection with tender offers, for enforcing the provisions of the Act, for evaluating various tactics by bidders and management in tender offers, and for formulating regulations and proposing legislation governing the conduct of tender offers. As a result of that experience, the Commission has gained extensive expertise in evaluating what type of tender offer process best serves shareholders' interests, and in determining what type of practices might prove inimical to those shareholder interests. We believe that the Commission's views are relevant to determining the outcome of this case, and that the Court might find it useful to consider these views.

For twenty years, Congress and the Commission have consistently held the view that tender offers can benefit shareholders by offering them an opportunity to sell their shares at a premium, and by acting as a guard against the entrenchment of management, and that it thus is in the shareholders' interests to allow them the opportunity to consider and act on tender offers.

Prior to the adoption of the Williams Act in 1968, federal law had only peripheral application to cash tender offers, and the states, with the exception of Virginia, had not adopted tender offer regulation. 11/ As a result of this regulatory vacuum, a number of abuses by both bidders and management had developed -- abuses which allowed bidders to place "undue pressure on shareholders to act hastily and accept the offer," 12/ and allowed management unfairly to deter shareholders from accepting offers on the basis of insubstantial or irrelevant arguments or by unfair practices that made the offer look unattractive. 13/

In adopting the Williams Act, Congress was concerned that shareholders should have a fair opportunity to consider tender offers on their merits. Congress found that "takeover bids should not be discouraged because they serve a useful purpose in providing a check on entrenched but inefficient management."

11/ In those instances where the tender offer took the form of an exchange of securities, the transaction was subject to the disclosure requirements of the Securities Act of 1933, 15 U.S.C. 77a et seq. See S. Rep. No. 550, 90th Cong., 1st Sess. 2-3 (1967); H.R. Rep. No. 1711, 90th Cong., 2d Sess. 3 (1968). Virginia had passed its tender offer statute only 4 months before enactment of the Williams Act, and after Congress had conducted its hearings on the Act.

12/ Full Disclosure of Corporate Equity Ownership and in Corporate Takeover Bids: Hearings on S. 510 Before the Subcommittee on Securities of the Senate Comm. on Banking and Currency, 90th Cong., 1st Sess, 21, 35 (1967) ("Senate Hearings").

13/ See Senate Hearings at 3, 27, 60, 62, 196, 236; Speech by Commission Chairman Manuel Cohen before Association of the Bar of the City of New York, April 14, 1967, reprinted at Senate Hearings at 202, 204-05.

S. Rep. No. 550, 90th Cong. 1st Sess. 3 (1967) ("Senate Report"); see 113 Cong. Rec. 24664 (1967). Also, Congress did not want to deny shareholders "the opportunities which result from the competitive bidding for a block of stock of a given company" -- the opportunity to sell shares for a premium over the market price. 113 Cong. Rec. 24666 (1967) (remarks of Senator Javits); Edgar v. MITE Corp., 457 U.S. 624, 633 n.9 (1982). 14/

The goal of this federal legislation is to allow shareholders to decide whether or not to accept a tender offer, without undue influence either by bidders or by management. Thus, tender offers are conducted through a national "market approach" in which the goal "is to get information to the investor by allowing both the offeror and incumbent management of a target company to present fully their arguments and then let the investor decide for himself." Great Western United Corp. v. Kidwell, 577 F.2d 1256, 1276 (5th Cir. 1978), rev'd on other grounds sub nom. Leroy v. Great Western United Corp., 443 U.S. 173 (1979) (footnote omitted). Unlike mergers, which are presented to the company's board of directors for approval, "[t]ender offers contemplate transfers of stock by shareholders to a third party and do not themselves implicate the internal affairs of the target company." Edgar v. MITE Corp., 457 U.S. at 645.

14/ The premiums that shareholders can realize in a tender offer are established beyond doubt. The Commission's Chief Economist, in a study of tender offers between the years 1981 and 1983, found that the shareholders received premiums over market value of, on average, 31.3% for partial offers, 55.1% for two-tier offers, and 63.4% for any and all offers. 49 Fed. Reg. 26755, 26760 Table 4 (June 29, 1984). The Supreme Court of the United States has also recognized that, where tender offers are blocked, "[s]hareholders are deprived of the opportunity to sell their shares at a premium. The reallocation of economic resources to their highest valued use, a process which can improve efficiency and competition, is hindered. The incentive the tender offer mechanism provides incumbent management to perform well so that stock prices remain high is reduced." Edgar v. MITE Corp., 457 U.S. at 643.

In furtherance of this determination that the shareholders should have the opportunity to consider tender offers, Congress adopted a policy of "even-handedness," and structured the Williams Act so that neither bidders nor management would exercise undue influence over the process. The hearings leading to adoption of the legislation emphasized the need "to get information to the investor * * * and then to let the investor decide for himself." 15/ Then Commission Chairman Manuel Cohen testified before the Senate that the approach of the bill was "to provide the investor, the person who is required to make a decision, an opportunity to examine and assess relevant facts * * *" (Senate Hearings at 15). The House and Senate Reports on the Williams Act underscore Congress' intention that shareholders, informed through full disclosure by both sides in the contest, be the actual decision-makers in the tender offer process: "This bill is designed to make relevant facts known so that shareholders have a fair opportunity to make their decision." (Senate Report at 3; H.R. Rep. No. 1711, 90th Cong., 2d Sess. 4 (1968)). See Edgar v. MITE Corp., 457 U.S. at 633-34; Rondeau v. Mosinee Paper Corporation, 422 U.S. 49, 58 (1975); Piper v. Chris-Craft Industries, Inc., 430 U.S. 1, 26-31 (1977); Buffalo Forge Co. v. Ogden Corp., 717 F.2d 757, 760 (2d Cir.), cert. denied, 104 S. Ct. 550 (1983).

15/ Takeover Bids: Hearings on H.R. 14475 and S. 510 Before the Subcomm. on Commerce and Finance on the House Comm. on Interstate and Foreign Commerce, 90th Cong. 2d Sess. 4, 47-48 (1968); Senate Hearings at 17, 19, 25, 182. See Great Western United Corp. v. Kidwell, 577 F.2d at 1279-80.

After more than fifteen years of administering the Williams Act, the Commission has adhered to the view that shareholders are not served by practices that would preclude shareholder consideration of tender offers. The Commission continues to believe that it is "necessary and appropriate in the public interest and for the protection of investors" to "ensure a balance between the interests of the person making a tender offer and the management of the company whose securities are being sought." Securities Exchange Act Release No. 16384, 44 Fed. Reg. 70326, 70326 (Dec. 6, 1979).

B. The Rights Plan Is Contrary to Shareholder Interests In that It Deprives Shareholders of the Opportunity to Consider Hostile Tender Offers and Limits Their Ability to Wage Proxy Contests Against Management, and Thereby Entrenches Management.

In furtherance of the Congressional and Commission view that it is in the shareholders' interests to be able to consider tender offers, the Commission has appeared as amicus curiae on a number of occasions to challenge action that would deprive shareholders of this choice. Although those cases involved challenges to statutes under the Supremacy Clause, rather than the validity of board of directors action addressed here, the fundamental principle of those cases is instructive in this case. That principle is that policies or practices that give management the ability to remove tender offers from shareholder consideration frustrate the shareholder choice that Congress and the

Commission have viewed as being in the shareholders' interest. See Great Western United Corp. v. Kidwell, 577 F.2d at 1279; Edgar v. MITE Corp., 457 U.S. at 633-39 (opinion of Justices White and Blackmun and Chief Justice Burger). See also National City Lines, Inc. v. LLC Corp., 687 F.2d 1122, 1129-30 (8th Cir. 1982); Kennecott Corp. v. Smith, 637 F.2d 181, 189-90 (3d Cir. 1980).

This case involves, if anything, a practice far more extreme than what was at issue in the above-cited cases. The state statutes at issue in those cases generally only gave management added time, by requiring pre-commencement disclosure by bidders or by allowing management to seek a fairness hearing, in which to attempt to defeat a tender offer. The Rights Plan, in contrast, gives Household's management an absolute veto over any tender offer. This plan simply will not allow a non-management approved tender offer to be made for Household. In addition, the plan will have at least a significant deterrent effect on proxy contests and consent solicitations against management. The ultimate effect of this plan will be to entrench Household's management, or the management of any company that adopts such a plan, against virtually any attempt to oust it. The Household board has, by this plan, usurped the shareholders' right to control who will manage their company.

To begin with, the plan will not, as the Chancery Court concluded, block only two-tier offers. It will block virtually all hostile tender offers. In understanding this effect, it must first be recognized that "[t]here is apparent agreement that the primary goal of a potential acquiror is to achieve 100% ownership" of a target company's stock (Op. 41). Tender offer statistics compiled by the Commission's Chief Economist show that pure partial tender offers, in which the offeror has as its goal less than 100% ownership, are relatively infrequent, and have been declining in frequency in recent years. 16/ One of Household's own experts at trial, Jay Higgins, managing director of the mergers and acquisitions department of Salomon Brothers, testified that he is aware of no case where a successful offeror for a company, like Household, valued at more than $1 billion was willing to settle ultimately for less than 100% of the company (Higgins VII 159-60). But even if an offeror would make such a partial offer for a company of this size, and be willing to hold less than 100% indefinitely, it would not wish to be foreclosed from later acquiring the remainder of the stock. Thus, in any event, an offeror will be strongly deterred by any plan that prevents it from acquiring 100% of the company.

An offeror has two basic ways in which it can acquire 100% of a company. First, it can make a tender offer for part of the company's shares, perhaps 51%, and then obtain the remaining shares by a second stage merger. In a "two-tier" offer the merger will closely follow the offer. But even in a "pure partial" offer, the acquiror may effect a second step merger sometime after the offer. As the Chancery Court recognized, the Rights Plan will "virtually eliminate" such offers (if hostile) by making the second step of the offer, the merger, excessively expensive (Op. 40).

16/ In a report entitled "The Economics of Partial and Two-Tier Tender Offers," 49 Fed. Reg. 26755 (June 29, 1984), the Office of the Chief Economist reported that between 1981 and 1983, among 148 tender offers studied, only 25 were partial offers where a followup merger for the remaining shares was not conducted "closely following" the offer. Id. at 26760 Table 1. Furthermore, the percentage of such offers declined steadily throughout those three years. In 1981, they accounted for 15 out of 64 offers studied; in 1982 they accounted for 7 out of 51 offers studied, and in 1983 only 3 out of 33 offers studied. Id.

Alternatively, the offeror can make an "any and all" tender offer, in which the offeror agrees to accept all shares tendered by shareholders. The Rights Plan will deter these types of hostile offers as well. This is because while, in theory, an any and all offer could lead to an offeror being tendered 100% of the stock, it is not disputed that in practice 100% of the shares will not be tendered, and the offeror must still undertake a merger in order to obtain the untendered shares. But the Rights Plan will render any substantial merger financially impossible, and thus will deter any and all offers. 17/

No justification has been advanced for Household adopting a plan that blocks any and all offers. The defendants have not claimed that they needed to protect shareholders from any and all offers, and there are other plans that the Household board could have adopted that would have deterred two-tier

---

17/ In fact, since any and all offers constitute the vast majority of tender offers, the impact of this type of plan, if widely adopted, in deterring any and all offers will be far greater than its effect on the two-tier offers at which the plan is assertedly directed. The Commission's Chief Economist found that of 148 tender offers made between 1981 and 1983 that were studied, 91, or 61.5%, were any and all offers, while 32, or 21.6%, were two-tier offers. 49 Fed. Reg. 26755, 26760 Table 1 (June 29, 1984). The Chief Economist's latest statistics show that the percentage of two-tier offers dropped precipitously in 1984, to 7.5% (6 out of a total of 80 offers).

Beyond deterring tender offers, the plan will also deter persons from making substantial open-market purchases, or other purchases, of Household stock as a first step towards acquiring 100% of the company's stock, since any purchases of 20% or more of Household's common stock will render the rights non-redeemable, and highly potent in any follow-up merger. It is not uncommon for such purchases to precede a tender offer and follow-up merger. See Freund & Easton, The Three-Piece Suitor: An Alternative Approach to Negotiated Corporate Acquisitions, 34 Bus. Law. 1679 (1979).

offers, without deterring any and all offers. 18/ In fact, the defendants did not attempt to argue below that this effect on any and all offers was necessary or justified. They suggested instead that there are ways — albeit untested and highly uncertain ways — to circumvent the plan's extreme reach. However, the evidence shows that defendants' suggestions are unworkable.

First, defendants suggested that an any and all offer could be made conditional on the offeror being tendered at least 95% of the rights, thus limiting the dilution effect of a second step merger to 5% of the rights, or, in this case, "only" $300 million or so. 19/ The flaw in this theory is that it is almost certain not to work. The Chancery Court noted that "[t]he market professionals on both sides agree that a high minimum offer for a company of Household's size has never been attempted and it is questionable that such an approach would succeed" (Op. 40). If anything, that summary understates the testimony.

18/ For example, Household could have adopted a "poison pill" plan that would force bidders to pay the same price for all shares (see n.5 supra). Such a plan would have deterred two-tier offers by precluding an offeror from paying a lesser amount in the second-stage; it would not, however, deter any and all offers, where the bidder is already willing to pay the same amount to all shareholders. In taking note of this less restrictive alternative, we express no view as to whether adoption of such a plan would be a reasonable exercise of the board's judgment.

19/ The board was told, at the time it approved the plan, that an offeror could compensate for the dilution from merging out the remaining 5% of the rights by reducing the amount paid in the tender offer (PX 203 at 9). Even if this would work, however, the effect would be that the offeror would be forced to pay substantially more to the small number of shareholders who did not tender their rights, while paying less than it would otherwise to the 95% of shareholders who did tender their rights. It is difficult to see how a plan that leads to such results can be said to be in the best interests of the shareholders as a whole.

Plaintiffs' principal market expert was Alan C. Greenberg, chief executive officer of Bear Stearns & Co., and a risk arbitrageur, whose profession calls for the objective evaluation of the likelihood that tender offers will or will not succeed (Greenberg IV 64-66). Greenberg testified that a hostile offer conditioned on even 80% to 90% being tendered, let alone 95%, would be "[t]otally hopeless" (id. 73). He explained:

> "[t]he only company I've ever heard of that have gotten 80 or 90 percent is when they have made a tender and they already own 70 or 65 or 75 percent, and you tender for a little bit more for accounting reasons to get above 80. It's totally unrealistic. A certain number of shareholders are out of the country. A certain number of shareholders have lost their certificates. A certain number of shareholders wouldn't tender to anybody for any price" (id. 73-74). 20/

The defendants' market expert, Jay Higgins, also testified that such a high minimum offer, even one for an 80% minimum, is unheard of. He testified that "[c]ertainly anything like that is very unusual. You would be advised not to do it because it would be self-defeating" (Higgins VII 184-85). 21/

20/ The likelihood of reaching 95% may be virtually nil if management and its allies control significant amounts of stock. Household's management owns or has the right to acquire 2.3% of Household's stock (PX 5 at 12). Its employee benefit plans own approximately 4.6% (PX 41 at 3). Significantly, on the same day the Rights Plan was adopted, the board gave employees, who are likely to side with management (see Wilcox IX 93-95), the right to control tendering of those shares (Op. 6-7), rather than vesting control over such tenders in an independent trustee.

21/ In fact, a high minimum conditioned offer for the rights is even less likely to succeed than in the usual offer for stock. In the usual offer, the largest premium for the shares is offered up front, in the tender offer, with a lesser premium (or none at all) offered in the second-stage merger. Individuals know that if they do not tender, they are likely not to get the best premium. Even though that "front-end loaded" aspect of the usual offer provides an incentive to tender, a 95% condition is still virtually impossible to meet. Here, in contrast, investors know that if

(footnote continued)

The defendants' alternative position, again discussed by Higgins, is that any and all offers can be made either because if a fair offer is made, the board will relent, 22/ or even if the board does not relent of its own will, a high percentage of tenders (even if a 95% condition cannot be met) may persuade the board of directors to redeem the rights and allow the offer to go forward. Higgins was, however, highly equivocal and uncertain about how this might be brought about. He suggested that "something will happen. I don't know exactly what, but something will happen" (id. 189). 23/

21/ (continued)

they do not tender their rights, and the offer succeeds, they are guaranteed a $100 per right profit in the second-stage merger. Thus there is an incentive not to tender, since whatever premium a right holder could get by tendering is sure to be far less than $100. The only reason a shareholder would tender in these circumstances would be a belief that his tendering would make the difference between the offer succeeding (and thus providing some premium) and failing (and providing no premium at all). But it is unlikely that any individual shareholder who holds a small number of shares will believe that his decision to tender will make such a difference (see Jensen IV 179-88).

22/ Household argued below that "the board must be presumed, under the business judgment rule, to have a willingness to consider all takeover proposals and redeem the rights to permit an attractive takeover bid to proceed" (Op. 25). This Court has long adhered to the conclusion that boards of directors, when faced with contests for control, cannot be presumed to act in the shareholders' interests. See Bennett v. Propp, Del. Supr., 187 A.2d 405, 409 (1962) ("when a threat to control is involved," the "directors are of necessity confronted with a conflict of interest, and an objective decision is difficult. * * * Hence, in our opinion, the burden should be on the directors to justify [a defensive response] as one primarily in the corporate interest"); Cheff v. Mathes, Del. Supr., 199 A.2d 548, 554 (1964) (same).

23/ Higgins conceded, however, that if this unknown "something" did not happen, the offeror was taking "[a] tremendous downside risk" (id. 190) that after committing millions of dollars to the offer it would fail. Higgins also suggested that a tender offeror could bid for less than 100% of Household's stock, and simply be satisfied to hold less than 100%

(footnote continued)

One thing that is less likely to happen is a proxy contest, or the seeking of consents, by a shareholder to force redemption of the rights. The Rights Plan effectively prevents formation of a group of shareholders who hold 20% or more of Household's stock for the purpose of waging a proxy contest, or a consent solicitation, since formation of such a 20% group will trigger the rights and render them non-redeemable. The Chancery Court recognized that this would "deter the formation of proxy efforts of a certain magnitude" (Op. 48), but thought it "highly conjectural to assume" that it would prevent any particular proxy contest from being waged (id. at 148-49). But the effect of the limitation in inhibiting proxy contests, or consent solicitations, is beyond conjecture.

As defendants conceded below, the very reason why they chose 20% as the percentage of ownership that would trigger the rights is that "20% is a well recognized threshold for measuring control" of a company (Def. Post-Trial Br. at 57 n.*), and they wanted to prevent formation of "a group of shareholders committed by agreement to concerted action with respect to a block of stock large enough to be deemed effective control of Household" (id. at 58). Defendants cannot reasonably, on the one hand, argue that 20% ownership is a "threshold" of control of the company and concede that the plan was structured

---

23/ (continued)

until the rights expire (id. 152-53, 194-95). He agreed, however, that he has never heard of such an offer being made for a company of Household's size (id. 159-60). Even if an offeror would be satisfied with making a partial offer, however, such a partial offer would be at least as "coercive" as a two-tier offer, see n.8 supra, and would run counter to the stated reason for the plan — to block coercive offers.

to prevent formation of a control group, but at the same time argue that prevention of the formation of a 20% group will not inhibit the ability of insurgents to win proxy contests.

In fact, the only empirical evidence in the record shows that the holding of 20% or more of a company's stock is a significant advantage in a proxy contest, and that limiting insurgents to less than 20% will greatly enhance management's ability to defeat a contest. This evidence (DX 39) was a study of 96 proxy contests between 1981 and 1984 that was prepared by one of defendants' experts. It showed that where insurgents held 20% or more of a company's stock, they were able to win a proxy contest (in whole or in part) 24/ or force a settlement with management 50% more often than where insurgents held less than 20%. 25/ Likewise, where persons waging a proxy contest against management held less than 20% of the company's stock, management won (in whole or in part) 44% of the time; where insurgents held more than 20% of the stock, management only won 19% of the time. While a group of shareholders could still be formed to oppose Household management, the Rights Plan, by holding such a group to below the 20% threshold, greatly diminishes the chance that they will be successful, and more than doubles the chance that Household's management will prevail in any such contest. The effect will be to make it far more likely that Household's shareholders will be unable to band together to oppose management successfully, and that Household's management will remain entrenched.

24/ In some cases, the contests involved more than one issue, and the insurgents won on only some issues.

25/ In the former situation, insurgents won or forced a settlement in 76.2% of the contests, while in the latter situation that rate was only 50.6%.

While such a deterrent effect itself is of substantial concern, the plan could in fact be read to mean that even if a proxy contest could be successfully waged without formation of a 20% group, <u>any successful</u> solicitation of proxies or consents will render the rights non-redeemable. The rights become non-redeemable whenever any person becomes the "Beneficial Owner" of 20% or more of Household's stock, defined in the plan to include any person who "<u>has * * * the right to vote</u> [the stock] pursuant to any agreement, arrangement or understanding" (PX 204 at 2-3) (emphasis added). But any person who wages a successful proxy contest or consent solicitation could be said to obtain, through an "agreement, arrangement or understanding" with shareholders, the "right to vote" their shares. Any person who, at the time of the shareholders' meeting, holds valid proxies for 20% or more of the company's stock would thus have the "right to vote" 20% or more of the company's shares. 26/ Yet

---

26/ Defendants argued below that the receipt of proxies or consents from 20% of the shareholders would not trigger the rights because "[i]t is hornbook law that receipt of a proxy does not make the recipient the beneficial owner of the shares involved" (Def. Pre-Trial Br. at 50). But the Rights Plan does not require that a person become a beneficial owner in a common law sense; it specifically defines the term "Beneficial Owner" to include anyone who, pursuant to an "agreement, arrangement or understanding" has the "right to vote" stock. A proxy or consent can be construed to be such an agreement, arrangement or understanding. Even if, as defendants argued (<u>id</u>. at 51), there is no unconditional "right to vote" the stock so long as the proxy remains revocable, once the meeting commences the proxy holder's right to vote the shares clearly exists. The cases cited by defendants below (<u>id</u>. at 51 n*) are not to the contrary. Indeed, the first case they cite, <u>Josephson v. Cosmocolor Corp.</u>, Del. Ch., 64 A.2d 35 (1949), said that the plaintiffs in that case "procured proxies from other record stockholders which, with the 6,000 shares [plaintiffs owned] <u>gave them the right to vote</u> more than 80,000 shares." <u>Id</u>. at 36 (emphasis added).

such a result will render the rights non-redeemable. Under such a reading of the plan, proxy contests or consent solicitations to force redemption of the rights will not be made. 27/

Even if proxy contests are only deterred, however, and not eliminated, the decision whether to redeem the rights will rest almost solely in the hands of the board. Household's view is, in essence, that the courts should wait and see how the board reacts to a specific offer before passing judgment on the validity of the Rights Plan. The Chancery Court took the same approach (Op. 56). This view fails to take into account that the plan, and the difficulties it creates, are likely to deter many offers, even friendly offers, from being made in the first place. By vesting such pervasive control in the board, this plan will greatly increase the cost to tender offerors to the point where potential bidders will seek out other, more available, targets. Thus, many companies that otherwise would be bid for will have no offers made, and their shareholders will receive no premium.

The making of a tender offer involves great expense, the foregoing of other investment opportunities, and reputations of offerors and their advisers (Higgins VII 129-31). Thus, the offeror must believe it has a fairly strong chance of success. Yet the Chancery Court noted that the plan's "very complexity is designed to create uncertainty on the part of a potential acquiror"

27/ This would not, however, render it impossible for Household itself to solicit proxies. Under the plan, the rights are only rendered non-redeemable when a person becomes a "Beneficial Owner" of more than 20% of the stock, and either Household or the person makes a public announcement that the person has thereby become an "Acquiring Person," as that term is defined in the plan (PX 204 at 4). In the case of a proxy solicitation by Household, therefore, the rights would only become non-redeemable if Household publicly announced that it had become an "Acquiring Person"; Household could avoid this simply by not making such an announcement.

(Op. 7). As Higgins testified, this plan raises complications that bidders "may not care to attempt to solve or deal with" (Higgins VII 129). They will simply seek out a less problematic target. In fact, a recent study of anti-takeover charter amendments, all far less potent than Household's Rights Plan, concluded that even such weaker defensive devices have a "significant" effect in deterring offers from being made, reducing the incidence of such offers by at least 26%. Investor Responsibility Research Center, Inc., The Impact of Antitakeover Charter Amendments on Contests for Corporate Control 7-8 (1985). 28/ The effect of this plan in deterring offers could be expected to be much more significant.

More importantly, however, even if the plan would not deter all offers from being made, the defendants' wait and see approach does not allow shareholders to consider hostile offers, allow them to wage proxy contests, or return to them the power to oust management. It merely suggests that Household's present board may, in certain circumstances, approve an offer. Thus, Household's chairman testified that if an offeror made a 95% minimum conditioned offer, and 80% of the shareholders tendered, Household would redeem the rights (Clark VI 82-83). Even this concession means that 51%, or perhaps even 75%, of the shareholders could tender their shares to an offeror, and the board might still refuse to allow the offer to go forward. Of course, the

28/ This finding is consistent with empirical evidence that shows that adoption of the Williams Act and state takeover statutes, laws which add to the costs of takeovers, reduced the number of takeover bids that were subsequently made. See Jarrell & Bradley, The Economic Effects of Federal and State Regulations of Cash Tender Offers, XXIII J. L. & Econ. 371, 398-403 (1980).

plan itself offers no guarantee to shareholders whether, and under what conditions, management would let a tender offer go forward. 29/

The interpositioning of management as the sole authority for determining whether a tender offer should go forward is not a substitute for a vigorous "market approach" in which the shareholders decide. As discussed above, the consistent view of Congress and of the Commission has been that the decision whether to accept or reject tender offers should be left, after full disclosure by management and bidders, to the shareholders. The Rights Plan would undercut the process contemplated by the Williams Act by giving the board a "plenary negotiation role" on behalf of the shareholders (Op. 56). Such a scheme, in our view, renders the Rights Plan inherently contrary to the shareholders' interests. It is our view that this plan is not justified and should not be sustained.

29/ We note that at a recent public forum, two of the five members of the Commission expressed the view that Household's plan would not allow a board to reject a fair offer for the company, and thus do not believe it tremendously enhances management's power to block tender offers. See 17 Sec. Reg. & L. Rep. (BNA) 400 (Mar. 8, 1985).

CONCLUSION

For the foregoing reasons, the judgment of the Chancery Court should be reversed.

Respectfully submitted,

JOSEPH J. FARNAN, JR.
United States Attorney
BY: SUE L. ROBINSON
Assistant United States Attorney

DANIEL L. GOELZER
General Counsel

JACOB H. STILLMAN
Associate General Counsel

ERIC SUMMERGRAD
Special Counsel

GERARD S. CITERA
Attorney

Securities and Exchange Commission
Washington, D.C. 20549

Of Counsel
PAUL GONSON
Solicitor

March 19, 1985