IN THE

SUPREME COURT OF THE STATE OF DELAWARE

JOHN A. MORAN and THE DYSON-KISSNER-MORAN CORPORATION, Plaintiffs Below-Appellants, and GRETL GOLTER, Plaintiff Intervenor Below-Appellant, vs. HOUSEHOLD INTERNATIONAL, INC., a Delaware corporation, DONALD C. CLARK, THOMAS D. FLYNN, MARY JOHNSTON EVANS, 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. 37,1985 Appeal from Judgment of the Court of Chancery in and for New Castle County in C.A. No. 7730

BRIEF OF THE UNITED FOOD AND COMMERCIAL WORKERS INTERNATIONAL UNION, AMICUS CURIAE, IN SUPPORT OF DEFENDANTS-APPELLEES

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RELATING TO THE INTEREST OF AMICUS CURIAE

The United Food and Commercial Workers International Union (the "UFCW") is a labor organization which, either directly or through its constituent members, is the collective bargaining representative for over 1,000,000 workers in the United States and Canada. Several local unions of the UFCW represent 12,000 employees of Vons Grocery Co., a subsidiary of Household Merchandising, Inc. The Appellants' proposal to dismantle Household International - initially for their own profit and only belatedly for the alleged benefit of other shareholders - could have far-reaching consequences not only for the unionized workers, but for all of the company's 80,000 employees. The UFCW has a substantial interest in protecting its members from the harm which occurs in the absence of a fair and orderly process for effecting a change in corporate control. It believes that the Rights Plan adopted by Household's Board, coupled with the duties imposed on directors by Delaware law, is a fair and effective method for enabling the Board to perform its obligation to this corporation and the people whose interests are directly at stake.

NATURE OF THE PROCEEDINGS AND SUMMARY OF ARGUMENT

The Rights Plan is a legitimate exercise of the power vested in the Board of Directors by Delaware law. Significantly, that power is not unfettered and may not be used for the sole or primary purpose of entrenching existing management. However, when confronted with a harmful offer or some other threat to the corporation's best interests, the directors have a duty to defend the corporation even though one of the consequences may be the preservation of their own jobs. This principle has been well established by the many cases approving defensive measures which, unlike the Rights Plan, cause fundamental and costly changes in the corporation's business or capital structure. Indeed, the Rights Plan is eminently more

reasonable than sapping the coffers and borrowing power of a healthy company in order to pay "greenmail" or make a purely defensive acquisition.

Although the Rights Plan has been criticized because of its potential for abuse by an unscrupulous board, this risk is inherent in any power vested in directors or other fiduciaries who are responsible for the property of others. Having failed to demonstrate to the Chancellor that Household's Board abused its power, the Appellants would have this Court strip the company of an effective defense against corporate raiders. The principal argument offered to justify this incongruous result rests on the misguided notion that the shareholders' right to sell the company precludes any participation in that process by the Board of Directors. This never has been the law of the State of Delaware. Moreover, although the Chancellor upheld the adoption of the Rights Plan under the business judgment rule, Household's shareholders could reverse their directors' decision at any properly convened meeting. Thus, the Plan does not, as has been argued, fundamentally alter the shareholders' right ultimately to sell their stock to whomever they choose. Indeed, Household's shareholders retain substantially greater power under the Rights Plan than those whose directors were compelled to resort to defensive strategies involving fundamental changes in their companies and did so without a shareholder vote.

The UFCW believes that Household's employees as well as its shareholders are better served when the directors can defend the corporation without resort to risky acquisitions, divestitures, or other such measures. It also believes that the corporation's shareholders and employees deserve to be protected against takeover specialists who resort to stripping the target's assets in order to retire the enormous borrowings commonly incurred to finance their deals. In the long run such transactions benefit no one but the raiders and the teams of professionals who must be hired because of the havoc created by such tactics. The Rights Plan is a sensible alternative

to many of the other defensive measures which have already received court approval. Accordingly, the Chancellor's decision should be affirmed.

ARGUMENT

I.

THE RIGHTS PLAN IS A LAWFUL AND REASONABLE EXERCISE OF THE DIRECTORS' BUSINESS JUDGMENT

The Board of Directors of a Delaware corporation has a duty to manage and protect corporate assets. Nowhere is this responsibility greater than when the corporation is presented with a tender offer or other plan which could radically change its business and finances, thus altering long-standing relationships with shareholders, employees and entire communities. The problems associated with the recent wave of corporate takeovers and reorganizations are well documented not only in the popular press, but have become sufficiently acute to warrant Congressional attention. For example, the report of the House Committee on Energy and Commerce on H.R. 5693, September 7, 1984, states:

> A change in control of a company can result in plant closings, employee layoffs, a change in the location of corporate headquarters, and other significant matters, which impact on the employees and communities involved. At the Subcommittee's hearings, Representative Oxley noted the disruptive effects of the proposed acquisition by Mobil Oil Company of Marathon Oil on the economy of the town of Findley, Ohio. The Mobil/Marathon takeover battle is but one of a number that have threatened to or actually have had an adverse impact on employees and communities in which major corporate operations were located.

H. R. Rep. No. 1028, 98th Cong., 2d Sess., at 22.

In addition to their responsibilities to shareholders, the directors have the right to consider the interests of other parties who are immediately affected by a proposed takeover or reorganization. As stated by Harold M. Williams, former

Chairman of the Securities and Exchange Commission, in a speech before the Seventh Annual Securities Regulation Institute on January 17, 1980:

> In addition to analyzing the offer's terms, the board, as I already noted, has an institutional responsibility to consider such concerns as: the potential adverse impact on employees, suppliers, and communities . . . .

[1979-1980 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶82,445, at 82,875. While such major public policy questions might not ultimately be resolved in this forum, the conduct of Household's directors must be evaluated in the context of these and the other very real problems which such transactions create.

During the last decade, the United States has witnessed what appears to be an ever increasing number of takeovers which purport to cash out the shareholders at a premium, but are actually financed by so-called "junk bonds" carrying high interest rates. See, e.g., Junk Bonds and Other Securities Swill, The Wall Street Journal, April 18, 1985 (Midwest Edition), at 28, col. 3 (Exhibit A). These borrowings are collateralized by the target's own assets, which have to be stripped or dismantled to repay the debt regardless of whether those assets would otherwise have been sold in a rational market. The alleged economic efficiencies of such transactions are questionable and surely are achieved only at great cost. Public shareholders, who were induced to exchange their stock for junk bonds, might well regret their decision if the bidder's reorganization plan is flawed. The careers of nonunionized employees can be abruptly terminated because they now find themselves redundant. Even the protections afforded unionized workers under the National Labor Relations Act can be rendered meaningless when their division is sold in order to repay the raider's debt or to raise cash needed to defend the target from abuse.

However, the impact of such transactions does not end with stockholders and employees. The creation of huge indebtedness to finance corporate takeovers has

serious implications for the banking system as well as the companies whose futures have been mortgaged to finance the takeover. John Shad, the Chairman of the Securities and Exchange Commission, was recently quoted in the Congressional Record as saying:

> Corporate takeovers and buyouts are financed through large loans. The net effect is that debt is being used to retire equity, which is known as leveraging up a company's capitalization. The greater the leverage, the greater the risks to the company, its shareholders, creditors, officers, employees, suppliers, customers and others. . . . The more leveraged takeovers and buyouts today, the more bankruptcies tomorrow. During the past few years, the multi-billion dollar premiums shareholders have received in leveraged takeovers and buyouts have been a multiple of their losses from acquisition related bankruptcies. The premiums come first, the consequences later. The leveraging-up of American enterprise will magnify the adverse consequences of the next recession or significant rise in interest rates.

131 Cong. Rec. S3244 (daily ed. Mar. 20, 1985) (statement of Sen. Proxmire).

The risks and abuses of corporate takeovers and reorganizations are nowhere more apparent than in the two-tier tender offer where the raider acquires control of a company at a cash price in excess of the current market and eventually merges out the minority stockholders by exchanging their shares for the debt-laden securities of the bidder or one of its subsidiaries. Except in unusual circumstances, the bidder owes no fiduciary obligations to the target and may not initially be required to disclose how it intends to acquire the remaining shares unless it has actually formulated a rather concrete or specific plan to do so. Such risks are not confined solely to two-tier tender offers, but may appear in any offer where the shareholders receive something other than all cash. Shareholders confronted by such tactics are often confused, disorganized, pressured or lured by the prospect of an immediate gain to tender their shares. Thus, unless the Board acts, the company will be sold without

regard to the best interests of its owners and others with a substantial stake in its future.

Not only are the directors of a target corporation in the best position to evaluate a takeover bid and negotiate on behalf of shareholders, they have a duty to determine whether a potential offer is in the best interests of the corporation and to oppose it if not. Panter v. Marshall Field & Co., 646 F.2d 271 (7th Cir.), cert. denied, 454 U.S. 1092 (1981); Northwest Indus., Inc. v. B.F. Goodrich Co., 301 F.Supp. 706, 712 (N.D.Ill. 1969). As the Court held in Panter v. Marshall Field & Co., it is the board's duty to "evaluate proposed business combinations on their merits and oppose those detrimental to the well-being of the corporation . . . ." 646 F.2d at 299.

Thus, courts have accorded target boards wide latitude to adopt, in the exercise of business judgment, measures to deter or thwart offers which are not in the best interests of the target and its shareholders. For example, a target may make a counteroffer for the stock of a bidder which has already acquired a majority of the target's shares. Martin Marietta Corp. v. Bendix Corp., 549 F.Supp. 623 (D.Md. 1982). The target may make a competing self-tender for its own shares. Pogo Producing Co. v. Northwest Indus., Inc., No. H-83-2667 (S.D.Tex. May 24, 1983) (Exhibit B). Some boards have sold the "crown jewel" or prize assets of the target in order to make it unattractive to the bidder. See, e.g., Whittaker Corp. v. Edgar, 535 F.Supp. 933, 951 (N.D.Ill. 1982); GM Sub Corp. v. Liggett Group, Inc. Del.Ch., C.A. No. 6155, Brown, V.C. (Apr. 25, 1980) (Exhibit C). Other boards have issued blocks of stock to a prospective "white knight" or entered into a "lock up" agreement with a friendly party. See, e.g., Treadway Cos. v. Care Corp., 638 F.2d 357, 381 (2d Cir. 1980); Buffalo Forge Co. v. Ogden Corp., 555 F.Supp. 892, 903-04 (W.D.N.Y.), aff'd, 717 F.2d 757 (2d Cir.), cert. denied, 104 S.Ct. 550 (1983). Other defensive measures, which have already received court approval, include the making of an exchange offer to facilitate a

merger with a third party, Crouse-Hinds Co. v. InterNorth, Inc., 634 F.2d 690, 701-04 (2d Cir. 1980), making an acquisition for the purpose of creating an antitrust obstacle to the tender offer, Panter v. Marshall Field & Co., supra, and issuing "springing" warrants to a third party in order to dilute a bidder's stockholdings, Gearhart Indus., Inc. v. Smith Int'l., Inc., 741 F.2d 707 (5th Cir. 1984). Finally, even so-called "poison pill" amendments and stock warrants have been approved in appropriate situations. Huffington v. Enstar Corp., Del.Ch. C.A. No. 7543, Longobardi, V.C. (Apr. 25, 1984) (Exhibit D); Horwitz v. Southwest Forrest Indus., Inc., No. CV-R-84-467-ECR (D. Nev. Mar. 20, 1985) (Exhibit E).

In light of these precedents, Household's Rights Plan is both lawful and clearly within the sound business judgment of its directors. The deterrent effect of the Plan on a harmful takeover is no different from the other anti-takeover measures already sanctioned by the courts. However, like those measures, the Rights Plan cannot be used for an improper purpose, such as entrenching existing management, because the directors do not thereby escape their fiduciary duty not to oppose a fair offer for the company. Indeed, two of the five commissioners of the Securities and Exchange Commission, Commissioners Tready and Marinaccio, have expressed the view that Household's Rights Plan does not permit management to entrench themselves.

> The case [i.e., Moran v. Household International, Inc.] does not represent a "bullet proof" defense, Commissioner Charles L. Marinaccio replied. Marinaccio agreed with Treadway that if a possible offeror offered a fair price for the company, the directors could not turn it down and still meet their fiduciary obligations to shareholders. The decision merely gives a little more leverage to directors, he argued.

Commissioners Debate Delaware Poison Pill Case At "SEC Speaks", 17 Sec. Reg. & L. Rep. (BNA) No. 10, at 400.

The Rights Plan is actually more beneficial to shareholders than other defenses because it creates fewer risks than those already sanctioned by the courts. First, the Plan is not a hasty, reactive measure adopted in the heat of battle. Next, it does not require the Board to make a fundamental change in Household's business or capital structure and becomes effective at a fraction of the cost of other defensive measures. Finally, the Board has complete flexibility to negotiate with any bidder and can neutralize the Plan very quickly and without undue expense. Moreover, the modest redemption payment of $.50 per preferred right to Household's own shareholders is more desirable than the payment of millions in "greenmail" to a corporate raider.

Thus, the Rights Plan is an effective, constructive means by which Household's Board can discharge its duties to shareholders. A ruling striking the Plan would constitute nothing less than a repudiation of the entire body of case law establishing the duty and authority of a target board to protect its shareholders from harmful tender offers and other corporate maneuvers. While anti-takeover measures are not without their risks, the courts are quite capable of redressing any abuse and should not leave corporations defenseless against unfair and coercive tactics.

II.

HOUSEHOLD HAD AUTHORITY TO ADOPT THE RIGHTS PLAN

Appellants assert that Household lacked authority under DGCL §157 to adopt the Rights Plan. They contend (1) that the Rights Plan is a "sham" and (2) that it exceeds the authority granted by §157 because the Plan gives Household's shareholders a right to purchase shares of the bidder, rather than Household's own shares. Each of these arguments misses the mark.

First, the preferred rights created by the Plan are in no sense a "sham." They are exactly what they purport to be - rights to acquire certain Household stock or, in the event of a merger, rights to acquire the common shares of the acquiring

company pursuant to an agreement with that company. There is nothing illusory about the rights. They are listed and traded on the New York Stock Exchange.

The cases on which Appellants rely in this regard are wholly irrelevant. For example, in Telvest, Inc. v. Olson, Del. Ch. C. A. No. 5798, Brown, V.C. (Mar. 8, 1979) (Exhibit F), the issuance of certain preferred stock was enjoined under DGCL §157. However, that decision was based on a finding that the "preferred" stock, which was identical to the company's common stock except for a special voting feature, had no independent economic substance and was, therefore, not really preferred stock. In contrast, where preferred stock has economic substance, such as dividend and liquidation rights not enjoyed by the common stock, it cannot be treated as a sham. National Education Corp. v. Bell & Howell Co., Del. Ch. C. A. No. 7278, Brown, C. (Aug. 25, 1983) (Exhibit G). Thus, Appellants' attempted analogy to Telvest clearly fails because the Household preferred rights have an independent economic substance and are in no sense a sham.

Telvest is totally inapposite for yet another reason. There the Court found that the issuance of preferred stock had the effect of altering the existing voting rights of shareholders by improperly weighting the votes of common shareholders who also owned preferred. Here, on the other hand, the Rights Plan has no effect on shareholders' voting rights. Indeed, when compared to other defensive measures, the Plan actually enhances those rights because it can be voted out at any properly convened shareholders meeting.

Appellants also cite Aldridge v. Franco Wyoming Oil Co., Del. Supr., 14 A.2d 380 (1940), in support of their argument that the Plan is a sham. However, that case simply stands for the proposition that voting rights, within the meaning of former DGCL §13, did not include a right to veto the decisions of other shareholders. Thus, Aldridge has no bearing on the issues in this case.

Appellants assert that the Rights Plan exceeds the authority granted by §157 because that section allows a company to issue rights to acquire "its" own shares and not the shares of another corporation. Obviously, no corporation can issue rights to acquire the stock of a company it does not own or control. Moreover, the Rights Plan purports to do no such thing. Rather, the Plan gives common shareholders, upon the occurrence of certain conditions, rights to purchase Household preferred and requires that Household, in the event of a merger, enter into a supplemental agreement with the acquiring firm to obtain that firm's undertaking to exchange $200 of its common stock for each right. The alternative or "flip-over" feature of the Rights Plan does not run afoul of the term "its" as used in §157 because no one is compelled to issue any stock. It is a simple anti-destruction clause serving to ensure that the preferred rights are not extinguished in the event of a merger. This Court has already upheld the validity of similar anti-destruction clauses. Wood v. Coastal States Gas Corp., Del. Supr., 401 A.2d 932 (1979); B.S.F. Co. v. Philadelphia National Bank, Del. Supr., 204 A.2d 746 (1964).

III.

THE HOUSEHOLD BOARD HAD AUTHORITY TO ADOPT THE RIGHTS PLAN WITHOUT SHAREHOLDER APPROVAL

Appellants assert that the Board had no authority to adopt the Rights Plan without shareholder approval. This argument should be rejected because courts have already upheld the adoption, without shareholder approval, of a variety of defensive measures which have caused far more fundamental corporate changes than the Plan at issue in this case. Recognizing this, Appellants seek to distinguish those situations as involving merely "managerial" actions rather than a change in the "fundamental structure" of the company. This is a distinction without substance because the defenses already sanctioned by the courts are effective only when they change the

fundamental structure of the target and thereby render it an impossible or unattractive takeover candidate.

IV.

ADOPTION OF THE HOUSEHOLD RIGHTS PLAN
FALLS WITHIN THE BUSINESS JUDGMENT RULE

Appellants contend that the adoption of the Rights Plan is not protected by the business judgment rule because the Board acted to preserve its own control and thereby became "interested" in the transaction. Thus, it is alleged that the burden of proving the fairness of the Plan to Household's shareholders shifted to the Board. This argument rests on a fundamental misapprehension of Delaware law.

Under the business judgment rule, directors are entitled to a presumption that their actions were taken in good faith. This presumption is equally as applicable to the adoption of anti-takeover measures as it is to other types of Board action. A plaintiff can overcome the presumption of good faith only by proving that self-perpetuation or some other improper purpose was the sole or primary motive of the challenged action. As the Court stated in Johnson v. Trueblood, 629 F.2d 287, 293-94 (3d Cir. 1980):

> The business judgment rule . . . achieves . . . [its] purpose by postulating that if actions are arguably taken for the benefit of the corporation, then the directors are presumed to have been exercising their sound business judgment rather than responding to any personal motivations . . . .[U]nless the plaintiff can tender evidence from which a factfinder might conclude that the defendants' sole or primary motive was to retain control, the presumption of the rule remains. In short, we believe that under Delaware law, at a minimum the plaintiff must make a showing that the sole or primary motive of the defendant was to retain control.

See also Panter v. Marshall Field & Co., supra; Crouse-Hinds Co. v. InterNorth, Inc., supra; Cheff v. Mathes, Del. Supr., 199 A.2d 548 (1964).

In this case, Appellants have produced no evidence to show that self-perpetuation was the sole or primary motive for the adoption of the Rights Plan. Instead, they seek to avoid or obscure the "sole or primary motive" standard by citing cases which do not, in fact, support their position. Two of those cases, Norlin Corp. v. Rooney, Pace, Inc., 744 F.2d 255 (2d Cir. 1984) and Treadway Cos., Inc. v. Care Corp., 638 F.2d 357 (2d Cir. 1980), do not even deal with Delaware law. Appellants' Delaware authorities in no way depart from the "sole or primary motive" standard. In both Bennett v. Propp, Del. Supr., 187 A.2d 405 (1962) and Petty v. Penntech Papers, Inc., Del. Ch., 347 A.2d 140 (1975), the Court found that retention of control had, in fact, been the primary motive for the challenged action.

Similarly inapposite is Good v. Texaco, Inc., Del. Ch. C.A. No. 7501, Brown, C. (May 14, 1984) (Exhibit H). There the Board transferred voting control over a substantial block of shares from a dissident group to itself. Nothing in the facts of Good suggests any conceivable purpose for this action other than to eliminate a threat to the Board's continued tenure. There was no claim or suggestion that this transfer of voting control was done for some other purpose arguably beneficial to the corporation. Thus, it was quite clear that self-perpetuation was the sole or primary motive for the transfer. Here, by contrast, plaintiffs have failed to produce any evidence to suggest that self-perpetuation was the sole or primary motive of the Rights Plan. To the contrary, the evidence clearly shows that the Rights Plan was enacted to enable the Board to protect the shareholders against harmful tender offers.

Even if the Board bears the burden of proving fairness or, as Vice Chancellor Walsh found, the burden of going forward with some evidence of fairness, the Rights Plan remains valid. The evidence amply demonstrates that the Rights Plan is fair to Household's shareholders. Any argument to the contrary necessarily rests on the flawed assumption that the Board will act irresponsibly by failing to redeem the

rights even when presented with a fair tender offer. There is no evidence to support any such assumption, which would also be contrary to the law. See Huffington v. Enstar Corp., supra, at 8.

Finally, it must be remembered that the Rights Plan was adopted after due consideration by a Board which is controlled by outside directors. Under these circumstances, the protections afforded by the business judgment rule are heightened. As stated in Enterra Corp. v. SGS Associates, [Current Binder] Fed. Sec. L. Rep. (CCH) ¶ 91,919 at 90,540-41 (E.D.Wis. Dec. 12, 1984):

> It has been held that the presumption of good faith and sound judgment afforded by the business judgment rule is heightened where the majority of the board consists of independent, outside directors and where the directors have obtained and considered expert legal and business advice. Panter v. Marshall Field & Co., 646 F.2d 271, 277, 294 (7th Cir.), cert. denied, 454 U.S. 1092 (1981).

V.

THE RIGHTS PLAN DOES NOT INTERFERE WITH THE PROXY RIGHTS OF HOUSEHOLD'S SHAREHOLDERS

The Rights Plan does not prohibit a proxy contest or otherwise dilute the voting rights of any shareholder. It simply provides that the preferred rights become effective when the holdings, in terms of ownership or voting control, of a single shareholder or group reach the level of 20% of the outstanding stock. Plaintiffs presented no evidence that this aspect of the Plan will deter a proxy contest or that the holders of approximately $400,000,000 worth of common stock (which is less than 20% of the outstanding shares) would be unable to wage an effective proxy fight Instead, they simply ask the Court to engage in sheer speculation in this regard.

What the Rights Plan will do, on the other hand, is deter any effort to obtain control of Household by "creeping" purchases of sufficient shares without a tender offer. This feature of the Rights Plan is essential. Such creeping purchases

present a very real danger of unfairness to shareholders because a raider can achieve control of a company without paying a fair premium and then squeeze out the minority by forcing them to accept high-risk, debt-laden securities. Without such provisions, the Plan could be circumvented by using the creeping purchase approach.

CONCLUSION

For all of the reasons stated above, the UFCW respectfully urges this Court to affirm the decision below.

Respectfully submitted,

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